YumChina

Yum China Holdings, Inc.
百勝中國控股有限公司

NYSE: YUMC HKEX: 9987


# 2021
# ANNUAL REPORT

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# FORWARD-LOOKING STATEMENTS

This annual report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We intend all forward-looking statements to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. These statements often include words such as "may," "will," "estimate," "intend," "seek," "expect," "project," "anticipate," "believe," "plan," "could," "target," "predict," "likely," "should," "forecast," "outlook," "model," "continue," "ongoing" or other similar terminology. Forward-looking statements are based on our current expectations, estimates, assumptions or projections concerning future results or events, including, without limitation, statements regarding our strategies to expand our restaurant network and restaurant portfolio, our strategies to improve store performance and develop new sources of revenue, plans to invest in technology and high-quality assets, plans to enhance digital and delivery capabilities, franchise development, logistics and supply chain management, anticipated effects of population and macroeconomic trends and the expected impact of the COVID-19 pandemic. Forward-looking statements are neither predictions nor guarantees of future events, circumstances or performance and are inherently subject to known and unknown risks, uncertainties and assumptions that could cause our actual results and events to differ materially from those indicated by those forward-looking statements. We cannot assure you that any of our expectations, estimates, assumptions or projections will be achieved. Factors that could cause actual results and events to differ materially from our expectations, estimates, assumptions or projections include (i) the risks and uncertainties described in the Risk Factors included in this annual report and (ii) the factors described in Management's Discussion and Analysis of Financial Condition and Results of Operations included in this annual report. You should not place undue reliance on forward-looking statements, which speak only as of the date hereof. We disclaim any obligation to publicly update any forward-looking statement to reflect subsequent events or circumstances, except as required by law.

# LANGUAGE

If there is any inconsistency between the English annual report and its Chinese translation, the English version shall prevail, provided that if there is any inconsistency between the Chinese names of the entities or enterprises established in the PRC (as defined below) mentioned in this annual report and their English translations, the Chinese names shall prevail.

# PART I

## Business

References to “Yum China” mean Yum China Holdings, Inc. and references to the “Company,” “we,” “us,” and “our” mean Yum China and its subsidiaries.

“U.S. dollars”, “$” or “US$” refers to the legal currency of the United States, and “RMB” or “Renminbi” refers to the legal currency of the People’s Republic of China (the “PRC” or “China”).

The KFC, Pizza Hut, Little Sheep, Huang Ji Huang, Lavazza, COFFii & JOY, Taco Bell and East Dawning brands are collectively referred to as the “brands” or “concepts”. Throughout this annual report, the terms “brands” and “concepts” are used interchangeably and “restaurants,” “stores” and “units” are used interchangeably.

### General

Yum China is the largest restaurant company in China in terms of 2021 system sales. We had $9.9 billion of revenues in 2021 and over 11,700 restaurants as of December 31, 2021. Our growing restaurant network consists of our flagship KFC and Pizza Hut brands, as well as emerging brands such as Little Sheep, Huang Ji Huang, Lavazza, COFFii & JOY, Taco Bell and East Dawning.

We have the exclusive right to operate and sublicense the KFC, Pizza Hut and, subject to achieving certain agreed-upon milestones, Taco Bell brands in China, excluding Hong Kong, Macau and Taiwan. We own the intellectual property of the Little Sheep, Huang Ji Huang, COFFii & JOY and East Dawning concepts outright. KFC was the first major global restaurant brand to enter China in 1987. With more than 30 years of operations, we have developed extensive operating experience in the China market. We have since grown to become the largest restaurant company in China in terms of 2021 system sales, with 11,788 restaurants covering over 1,600 cities primarily in China as of December 31, 2021. We believe that there are significant opportunities to expand within China, and we intend to focus our efforts on increasing our geographic footprint in both existing and new cities.

As of December 31, 2021, we owned and operated approximately 85% of our restaurants. Franchisees contribute to our revenue through the payment of upfront franchise fees and on-going royalties based on a percentage of sales, and payments for other transactions with us, such as purchases of food and paper products, advertising services and other services.

### Restaurant Concepts

#### *KFC*

KFC is the leading and the largest quick-service restaurant (“QSR”) brand in China in terms of 2021 system sales. Founded in Corbin, Kentucky by Colonel Harland D. Sanders in 1939, KFC opened its first restaurant in Beijing, China in 1987. As of December 31, 2021, there were over 8,100 KFC restaurants in over 1,600 cities across China. In addition to Original Recipe® chicken and other chicken products, KFC in China has an extensive menu featuring beef burgers, pork, seafood, rice dishes, congees, fresh vegetables, desserts, coffee, tea and many other products. KFC also seeks to increase revenue from different channels, including dine-in, delivery, takeaway and ready meals. KFC primarily competes with western QSR brands in China, such as McDonald’s, Dicos and Burger King, among which we believe KFC had an approximate two-to-one lead over its nearest competitor in terms of store count as of the end of 2021.

### *Pizza Hut*

Pizza Hut is the leading and the largest casual dining restaurant ("CDR") brand in China in terms of 2021 system sales and number of restaurants as of December 31, 2021, offering multiple dayparts, including breakfast, lunch, afternoon tea and dinner. Since opening its first China restaurant unit in Beijing in 1990, Pizza Hut has grown rapidly and, as of year-end 2021, there were over 2,500 Pizza Hut restaurants in over 600 cities across China. Pizza Hut has an extensive menu offering a broad variety of pizzas, steaks, pasta, rice dishes and other entrees, appetizers, beverages and desserts. Measured by number of restaurants, we believe Pizza Hut has an approximate six-to-one lead over its nearest western CDR competitor in China as of the end of 2021.

### *Other Concepts*

In addition to KFC and Pizza Hut, our restaurant brand portfolio also includes Little Sheep, Huang Ji Huang, Lavazza, COFFii & JOY, Taco Bell and East Dawning.

- *Little Sheep.* Little Sheep, with its roots in Inner Mongolia, China, specializes in "Hot Pot" cooking, which is very popular in China, particularly during the winter months. Little Sheep had over 240 units in both China and international markets as of December 31, 2021. Of these, 220 units were franchise restaurants.

- *Huang Ji Huang.* In April 2020, we completed the acquisition of a controlling interest in Huang Ji Huang. Founded in 2004, Huang Ji Huang had over 650 units in China and internationally as of December 31, 2021. Huang Ji Huang primarily operates a franchise model and is an industry-leading simmer pot brand.

- *Lavazza.* In April 2020, we partnered with Luigi Lavazza S.p.A. ("Lavazza Group"), the world-renowned family-owned Italian coffee company, and established a joint venture ("Lavazza joint venture"), to explore and develop the Lavazza coffee shop concept in China. In September 2021, the Company and Lavazza Group entered into agreements to accelerate the expansion of Lavazza coffee shops, which offer a premium and authentic Italian coffee experience in China. As of December 31, 2021, there were 58 Lavazza units in China.

- *COFFii & JOY.* COFFii & JOY is a coffee concept that we developed in 2018, featuring specialty coffee. As of December 31, 2021, there were 36 COFFii & JOY units in China.

- *Taco Bell.* Taco Bell is the world's leading western QSR brand specializing in Mexican-style food, including tacos, burritos, quesadillas, salads, nachos and similar items. We opened our first Taco Bell restaurant in Shanghai, China, in December 2016. As of December 31, 2021, there were 37 Taco Bell units in China.

- *East Dawning.* East Dawning is a Chinese food QSR brand located predominantly in transportation hubs. The brand was severely impacted by the COVID-19 pandemic. As a result, we have decided to wind down the operations of the brand. As of December 31, 2021, there were five East Dawning units in China and all of them are planned to be permanently closed in 2022.

## Our Strategies

Our primary strategy is to grow sales and profits across our portfolio of brands through organic growth, growth of franchise restaurants and development of new restaurant concepts, along with growing our online business. We are accelerating our store network expansion to reach our next milestone of 20,000 stores. We will drive growth from our core brands, as well as emerging brands such as Lavazza. We will continue to invest in digitalization and supply chain, our key growth enablers.

### *Continue to strategically expand our restaurant network*

We are confident in the long-term market opportunities in China. We believe we have the potential to grow to 20,000 restaurants or more in the future and we are currently tracking over 1,100 cities that do not have a KFC or Pizza Hut restaurant.

- *Further expand geographical coverage.* Restaurant chains have a low penetration rate in China, especially in lower-tier cities. Given the rapidly expanding middle class and dining out population as a result of continued economic growth and urbanization, we believe there are significant opportunities to expand within China, and we intend to focus our efforts on increasing our geographic footprint in both existing and new cities. For additional information on the risks associated with this growth strategy, see the section entitled "Risk Factors," including the risk factor entitled "We may not attain our target development goals; aggressive development could cannibalize existing sales; and new restaurants may not be profitable."

- *Restaurant development pipeline.* We are keen to explore various new restaurant formats to support further store expansion, including different store designs or service models aimed at addressing the needs of different guests and for different occasions. We believe that our first-mover advantage and in-depth local know-how will help us to build robust development pipelines to seize the market opportunities.

- *Franchise opportunity.* While we continue to focus on the operation of our Company-owned restaurant units, we will also continue to seek franchise opportunities for both our core and emerging brands. As of December 31, 2021, approximately 15% of our restaurants were operated by franchisees. We anticipate high franchisee demand for our brands, supported by strong unit economics, operational consistency and multiple store formats to drive restaurant growth. While the franchise market in China is still in an early stage compared to developed markets, we plan to continue to develop our franchisee-owned store portfolio over time, especially in select channels such as gas stations.

- *Grow emerging brands.* Our key growth strategy for emerging brands, such as Little Sheep, Huang Ji Huang, Lavazza, COFFii & JOY and Taco Bell, focuses on exploring suitable business models to achieve sustainable growth. In addition, we plan to continue our efforts in product innovation and operational enhancement for these emerging brands to potentially scale up operations in the future.

### Continue to improve unit-level performance and develop new sources of revenue

- *Food innovation and value proposition.* We will continue to focus on food innovation and strengthen our value proposition. We are keenly aware of the strength of our core menu items. At the same time, we seek to continue to introduce innovative items to meet evolving consumer preferences and local tastes, drive guest engagement and continue to broaden our brand appeal. Each of our restaurant concepts has proprietary menu items, and emphasizes the preparation of food with high quality ingredients. We will continue to develop unique recipes, regionally-inspired menu items and special seasonings to provide appealing, tasty and convenient food choices at competitive prices. In addition, KFC plans to continue providing value with product offerings such as the bucket and increased combo options throughout the day and Pizza Hut plans to continue its multiple value campaigns. KFC and Pizza Hut will continue to promote their respective signature value campaigns "Crazy Thursday" and "Scream Wednesday," which offer selected menu items at attractive prices, and have received positive consumer feedback. We believe our continued food innovation and value proposition are pivotal to enhancing our unit-level performance by driving order frequency and order ticket size.

- *Daypart opportunities.* We believe there are significant daypart opportunities across our brands. For example, KFC has expanded its daypart offerings, including late night street food and afternoon tea, and Pizza Hut continued to drive sales from breakfast and business lunch.

- *Best in-store experience.* We continuously look for ways to improve the guest experience. For example, we plan to continue to invest in refurbishing our restaurants. Our brands also look to improve efficiency to drive sales growth. For instance, we have simplified menus and fine-tuned our in-store self-service order devices. We are also expanding our delivery business through our proprietary smartphone applications and pre-order services. To further enhance the guest experience, we are also evaluating the possibility of adopting other digital initiatives in our restaurants and will continue to invest in this area, as discussed more fully below.

### *Continue to invest in technology, with a focus to capture digital, delivery and off-premise consumption opportunities*

We will continue to invest in technology to further empower and maintain our competitive advantages. We will focus on improving our overall technology infrastructure and digital and delivery capabilities. We believe these efforts will further support our sustainable growth, improve our operational efficiency and ensure quality. Our digital and delivery strategies are set forth below.

- *Digital.* As of December 31, 2021, our loyalty programs had over 330 million members and approximately 110 million members for KFC and Pizza Hut, respectively. The programs have been effective in increasing order frequency and enhancing guest loyalty. Digital orders accounted for approximately 86% of KFC and Pizza Hut Company sales in 2021. Going forward, we will continue to leverage our powerful digital ecosystem to drive sales, improve the guest experience and increase operational efficiency. We plan to increase our investment in end-to-end digitalization, automation and artificial intelligence ("AI"), to more effectively connect online traffic with our offline assets. To improve our operational efficiency, we will focus on connecting our front-end, guest facing systems to back-end systems such as operations and supply chain.

- *Delivery.* China is a world leader in the emerging online to offline, or O2O, market. This is where digital online ordering technologies interact with traditional brick and mortar retail to enhance the customer experience. We see considerable growth potential in the delivery market by aligning our proven restaurant operation capabilities with our delivery network that offers consumers the ability to order restaurant food anywhere. Delivery contributed approximately 32% of Company sales in 2021. Going forward, we will continue to optimize our delivery service by adopting innovative technologies, rolling out new delivery menu items and developing novel delivery service concepts, such as our rainy-day delivery menu.

- *New retail.* As part of our strategy to drive growth from off-premise occasions, our new retail products are designed to capture at-home consumption demand by leveraging our online and offline channels. We launched ready meals such as fried rice, steak and pasta, as well as coffee capsules so customers can enjoy these products any time they want. We intend to continue to capture the opportunity with our capabilities in product innovation, supply chain and online and offline assets.

### *Strategically expand our restaurant portfolio*

We aim to maintain our industry-leading position in the QSR and CDR markets in China with our core brands, and gain a stronger foothold and enhanced know-how in the Chinese cuisine space, which represents a significant share of the restaurant industry in China. In April 2020, we completed the acquisition of a controlling interest in Huang Ji Huang, a leading Chinese CDR franchise business. Following the acquisition of Huang Ji Huang, we established a Chinese dining business unit to manage our Chinese restaurant brands.

We are also building a coffee portfolio to capture today's underserved coffee market in China across different customer segments, including coffee products provided by KFC ("K-Coffee"), which offers convenience and value, balanced by our incubated concept COFFii & JOY, which offers specialty coffee for coffee lovers. In 2021, we sold 170 million cups of coffee at KFC. In April 2020, we also partnered with Lavazza to explore and develop the Lavazza coffee shop concept in China, targeting to open 1,000 Lavazza stores by 2025, to offer premium and authentic Italian coffee in an indulgent atmosphere. As of December 31, 2021, there were 58 Lavazza units in China.

### *Prudently pursue investments in high-quality assets*

Our investment strategy primarily focuses on three areas, restaurant brands with excellent growth potential and synergy, joint ventures and the enablers that empower our brands (e.g. ecosystem, technology). We continue to identify and evaluate investment opportunities in high-quality brands to capture growth opportunities. Also, we look for potential opportunities to invest in digitalization and supply chain, our key growth enablers, to further enhance our competitiveness. We will prudently assess investment targets based on each candidate's strategic value, brand equity, business scale and financial performance, among other factors.

## Operational Management

### *Restaurant Unit Management*

Our restaurant management structure varies among our restaurant brands and restaurant size. Generally, each restaurant that we operate is led by a restaurant general manager, or RGM, together with one or more assistant managers. RGMs are skilled and highly trained, with most having a college-level education. The performance of RGMs is regularly monitored and coached by senior operations leaders. Each restaurant brand issues detailed manuals, which may then be customized to meet local regulations and customs. These manuals set forth standards and requirements for all aspects of restaurant operations. The restaurant management team is responsible for the day-to-day operation of each unit and for ensuring compliance with operating standards. Each RGM is also responsible for handling guest complaints and emergency situations.

### *Franchise Restaurant Management*

As of December 31, 2021, approximately 15% of our restaurants were franchise restaurants. Our franchise program is designed to promote consistency and quality, and we are selective in granting franchises. Franchisees supply capital initially by paying a franchise fee to us and by purchasing or leasing the land use rights, building, equipment, signs, seating, inventories and supplies; and, over the longer term, by reinvesting in the business through expansion. Franchisees contribute to our revenue through the payment of upfront franchise fees and on-going royalties based on a percentage of sales, and payments for other transactions with us, such as purchases of food and paper products, advertising services and other services.

Our franchise agreements set out specific operational standards, which are consistent with standards required for Company-owned restaurants. Like our Company-owned restaurants, our franchise restaurants are also subject to our internal quality audits and reviews. There are no notable operational differences between Company-owned restaurants and franchise restaurants.

We believe that it is important to maintain strong and open relationships with our franchisees and their representatives. To this end, the Company invests a significant amount of time working with the franchisees and their representative organizations on key aspects of the business, including products, equipment, operational improvements and standards and management techniques.

### *Expansion Management*

We believe that there are significant opportunities to expand within China and we intend to focus our efforts on increasing our geographic footprint in both existing and new cities. We expanded our restaurant count from 7,562 at the end of 2016 to 11,788 at the end of 2021, representing a CAGR of approximately 9%. We expect to expand our business through organic growth, growth of franchise units and development of our emerging brands.

Our expansion strategy has been systematically focused on high potential locations across city tiers, including entering new commercial areas within existing cities and new cities. Each potential restaurant site is assessed and evaluated individually based on its site potential, potential financial return and potential impact to nearby stores. We take into account factors such as economic and demographic conditions and prospects, consumption patterns, GDP per capita and population density of the local community, presence of activity centers such as shopping complexes, schools and residential areas that generate guest traffic, and the presence of other restaurants in the vicinity during our site selection process. We also consider the guest traffic and distance from the existing restaurants under the same brand to reduce sales transfer that may occur from existing restaurant units. As we are opening more smaller format stores and actively managing costs, the average capital spending for each new KFC and Pizza Hut restaurant unit in 2021 was approximately RMB1.5 to 2.5 million.

### *Supply Chain Management*

The Company's restaurants, including those operated by franchisees, are large purchasers of a number of food and paper products, equipment and other restaurant supplies. The principal items purchased include protein ingredients (including poultry, pork, beef and seafood), cheese, oil, flour, vegetables and paper and packaging materials. 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 supplies fluctuate. When prices increase, the brands may attempt to pass on such increases to customers, although there is no assurance that this can be done practically. We also control our raw material costs by entering into long-term bulk purchase agreements for our key food ingredients.

The Company partners with over 800 independent suppliers, which are mostly China-based. We implement a strict supplier qualification process that includes supplier compliance checks and on-site audits to ensure the supplier meets our food safety and quality control standards. We have formulated detailed specifications for food ingredients and consumables we procure. We believe supply chain management is crucial to the sustainability of our business and we are dedicated to applying digitalization and automation technologies in our supply chain management system. Our in-house and integrated supply chain management system employs more than 1,400 staff in food safety, quality assurance, procurement management, logistics, engineering and supply chain system.

In addition, we operate a tailor-made, world-class logistics management system, which is capable of accommodating large scale, wide coverage and advanced information dissemination as well as fast store expansions. To further strengthen our supply chain network, the Company acquired land in 2021 to build three new logistics centers. The Company, along with multiple independently owned and operated distributors, utilizes 32 logistics centers to distribute supplies to Company-owned and franchised stores, as well as to third-party customers. In addition, the Company owns seasoning facilities for its Chinese dining business unit, which manufacture and sell seasoning products to Huang Ji Huang and Little Sheep franchisees. The Company's supply chain strategy of working with multiple suppliers, as well as building a vast logistics network, allows for continuous supply of products in the event that supply from an individual supplier or logistics center becomes unfeasible.

To improve the efficiency and effectiveness of our procurement process, the Company has adopted a central procurement model, whereby the Company centrally purchases the vast majority of food and paper products from approved suppliers for most of the restaurants regardless of ownership. The Company believes this central procurement model allows the Company to maintain quality control and achieves better prices and terms through volume purchases.

### *Food Safety and Quality Control*

Food safety is the top priority at the Company. Food safety systems include rigorous standards and training of employees in our restaurants and distribution system, as well as requirements for suppliers. These standards and training topics include, but are not limited to, employee health, product handling, ingredient and product temperature management and prevention of cross contamination. Food safety training is focused on illness prevention, food safety and regulation adherence in day-to-day operations. Our standards also promote compliance with applicable laws and regulations in China when building new or renovating existing restaurants. For further information on food safety issues, see “Risk Factors — Risks Related to Our Business and Industry — Food safety and foodborne illness concerns may have an adverse effect on our reputation and business”.

Our quality assurance department regularly conducts unannounced food safety and operation excellence checks of all restaurants covering food safety, product quality and guest service. We also conduct regular product quality inspections on main menu items, and perform microbiological testing of restaurants’ utensils, small wares, water, ice and food to ensure they meet the required standards.

For our delivery system, we have established our delivery service teams for KFC and Pizza Hut. We require all third-party delivery partners to sign and strictly implement a letter of commitment on the food safety and quality practice of delivery food, which stipulates clear requirements for regulatory compliance, staff management, catering, delivery facilities, equipment and strict management of third-party platforms.

## Innovation and Digitalization

Our vision is to become the world’s most innovative pioneer in the restaurant industry. We are dedicated to adopting innovations in our business model and restaurant operations, which enables us to comprehensively reach our guests and provide superior products and services in a technology-driven and happy way, as vividly demonstrated by our slogan “Tasty food, great fun, pleasant presentation with substance”.

We believe we are a pioneer and first-mover among restaurant brands in China in utilizing and investing in emerging digital technologies to modernize our business operations and accelerate our growth, which is critical to empower and maintain our competitive advantage in China. In recent years, we have stepped up our investment in digitalization, embarking on end-to-end digitalization of our business operations. In 2021, we opened a digital R&D center with three sites in Shanghai, Nanjing and Xi’an, to strengthen our internal digital capabilities and support sustainable business growth by using advanced technology.

### *Dining Experience*

#### Menu Innovations

Offering appealing, tasty and convenient food at great prices is our value proposition. We have a dedicated food innovation team primarily focusing on the development and innovation of new recipes and improvement of existing products. In 2021, we launched over 500 new and improved products across all of our restaurant brands. Leveraging our local know-how and the wealth of consumer taste preference data accumulated, we have become a pioneer in food innovation, pushing the boundaries of QSR and CDR dining in China.

Our menu innovation endeavors are also supported by a world-class 27,000 square-foot innovation center in Shanghai for the development of new recipes, cooking methods and menu concepts. The innovation center is an integrated research and development facility that has been designed to generate new menu ideas and concepts with new ingredients and cooking methods to enable the rapid roll-out of innovative products catering to customers’ local tastes.

#### Ordering

KFC rolled out mobile pre-ordering service on a nationwide basis in December 2016, which allows guests to order online and pick up in store. Pizza Hut launched table-side mobile ordering in 2018, which enables guests to order by scanning a QR code with their mobile phone. Now mobile ordering is a standard feature of our Super Apps including the KFC Super App and the Pizza Hut Super App. Guests can also order through our proprietary mini programs embedded in WeChat. In addition, in certain commercial districts, in-store kiosks provide guests with convenient and fast digital ordering options. We continuously enhance our Super Apps to address the needs of customers and improve their digital experience. For example, in 2021, we launched a personalized menu display in the KFC Super App and introduced an “order together” feature in the Pizza Hut Super App. In 2021, digital orders accounted for approximately 86% of KFC and Pizza Hut Company sales.

## Payment

As early as June 2015, we started to partner with Alipay on digital payment functionalities, making us among the first batch of restaurant chains in China to make mobile payment available to guests. We commenced mobile payment cooperation with WeChat Pay in 2016. Digital payments accounted for an increasing percentage of our Company sales, from 33% in 2016 to 61% in 2017, and further to 81% in 2018, 91% in 2019, 97% in 2020 and 98% in 2021. The increasing percentage indicates growing consumer preference for this feature and reflects our ability to harness the power of technology in our business model. Adoption of digital and mobile payment technologies not only provides a better customer experience by, among other things, reducing guest waiting time and saving guests from having to reach for their wallets or even cellphones, but also reduces staffing needed for cash management and reduces potential risks associated with cash management. In addition to the above business relationships with major third-party mobile payment providers, we developed and launched YUMC Pay in partnership with UnionPay in the first quarter of 2019.

We were the first in the world to commercially implement facial recognition technologies for payment by introducing “Smile to Pay” in Hangzhou’s KFC restaurant in September 2017. “Smile to Pay” enables our guests to make payments for their orders at digital kiosks without having to reach for their wallets. Following positive feedback, we have since implemented “Smile to Pay” in approximately 1,600 KFC restaurants across China as of December 31, 2021.

## Guest loyalty and interaction

China has entered into an age of Super Apps, which integrates multiple functions including messaging, e-commerce and payments in a single application by embedding mini programs or providing in-App links to other applications. In early 2016, the KFC Super App was implemented nationwide. Super Apps play a very important role in our overall digital ecosystem as they enable a digital guest experience by offering convenience, efficiency and interesting functionality before, during and after dining.

Member engagement is fostered through our Super Apps and WeChat mini programs, as these form the primary platform for consumers to sign up for our membership programs. Additionally, we continue to monetize our membership base by introducing privilege membership subscription programs that increase frequency and spend at our brands. These monetization opportunities rely heavily on our ability to engage with our users through our Super Apps. As of December 31, 2021, KFC and Pizza Hut loyalty programs exceeded 360 million members combined. Member sales increased to approximately 60% of system sales in 2021. We believe that creative and engaging interactions with our guests can help us enhance the guest experience and guest loyalty, which will ultimately lead to increased sales.

### *Delivery*

We believe that food delivery is a significant growth driver in China. We were one of the first restaurant businesses in China to offer delivery services. As early as 2010, KFC established its own delivery platform and started to accept delivery orders placed on its mobile applications. Starting from 2015, we were also one of the first to partner with O2O aggregators to further generate delivery traffic. In addition to ordering through aggregators’ platforms, guests may also place delivery orders through the KFC and Pizza Hut Super Apps. The ability to generate orders from our own channels allows us to be well-positioned in commercial collaborations with aggregators, and manage costs and commissions in a more competitive manner. In 2021, approximately one-third of KFC delivery sales, and approximately 20% of Pizza Hut delivery sales, were generated from our own channels.

In the past, we either used our own dedicated riders to deliver orders placed through aggregators' platforms or paid an additional commission for the delivery services provided by aggregators. Starting in 2019, we used our own dedicated riders to deliver orders placed through aggregators' platforms to customers of KFC and Pizza Hut stores, which we believe will give us greater control over delivery quality and improve our ability to make timely deliveries during peak hours. These dedicated riders are either contracted with us or the aggregators' platforms to deliver orders exclusively for KFC or Pizza Hut stores. In 2019, Company sales through delivery accounted for approximately 21% of total Company sales, which further increased to approximately 30% for 2020 and 32% in 2021, partially driven by the increased delivery orders as a result of the COVID-19 pandemic.

### *Restaurant Format Innovation*

To supplement our growth, we are focusing on developing new restaurant formats and upgrading existing restaurants. We have developed multiple restaurant formats to meet different guest needs. For example, our smaller store formats, with reduced store size combined with other cost reduction initiatives, enable us to penetrate further into lower-tier cities and expand more flexibly in higher-tier cities. In addition, we continuously look for ways to improve the guest experience. We have accelerated restaurant upgrades and remodeling to implement the latest technology, equipment and infrastructure and improve the dining experience. Approximately 78% of KFC restaurant units and 89% of Pizza Hut restaurant units as of December 31, 2021 were remodeled or built in the past five years. Our brands also look to improve efficiency to drive sales growth. For example, we have simplified our menu items and fine-tuned our in-store self-service order kiosks.

### *Operational Efficiency*

We have made significant investments to establish an efficient technological infrastructure, which serves as the foundation of our intelligent restaurant network management and facilitates efficient and innovative restaurant operation for all restaurants across our brands. We have adopted AI-enabled technology to analyze and forecast transaction volume so that we can improve labor scheduling and inventory management. For example, the "Super Brain," an end-to-end AI-enabled system, integrates data from store operations and aids the decision making of restaurant general managers. Moreover, managers and staff are also equipped with self-designed "smart watches", and in some pilot stores, "smart glasses", to closely monitor the real-time ordering and serving procedures of the restaurants and make timely staffing adjustments, which substantially improves management efficiency and guest satisfaction. We believe our digitalization along with automation, the Internet of Things and AI work together to enhance food safety, replace manual work and improve overall store efficiency.

## Intellectual Property

Our use of certain material trademarks and service marks is governed by a master license agreement between Yum Restaurants Consulting (Shanghai) Company Limited ("YCCL"), a wholly-owned indirect subsidiary of the Company, and Yum! Brands Inc. ("YUM"), through YRI China Franchising LLC, a subsidiary of YUM, effective from January 1, 2020 and previously through Yum! Restaurants Asia Pte. Ltd., another subsidiary of YUM, from October 31, 2016 to December 31, 2019. Pursuant to the master license agreement, we are the exclusive licensee of the KFC, Pizza Hut and, subject to achieving certain agreed-upon milestones, Taco Bell brands and their related marks and other intellectual property rights for restaurant services in the PRC, excluding Hong Kong, Macau and Taiwan. The term of the license is 50 years with automatic renewals for additional consecutive renewal terms of 50 years each, subject only to us being in "good standing" and unless we give notice of our intent not to renew.

In exchange, we pay a license fee to YUM equal to 3% of net system sales of the licensed brands. We have also agreed generally not to compete with YUM. In addition, we were granted a right of first refusal to develop and franchise in the PRC certain restaurant concepts that YUM may develop or acquire.

We were granted by YUM a royalty-free license to use the name and mark of "YUM" as part of our name, domain name and stock identification symbol pursuant to a name license agreement entered into between YUM and us on October 31, 2016. The name license agreement can be terminated by YUM in the event of, among other things, material breach of the agreement by us. Our use of certain other material intellectual property (including intellectual property in product recipes, restaurant operation and restaurant design) is likewise governed by the master license agreement with YUM.

We own registered trademarks and service marks relating to the Little Sheep, Huang Ji Huang, COFFii & JOY and East Dawning brands and pay no license fee related to these brands. Collectively, these licensed and owned marks have significant value and are important to our business. Our policy is to pursue registration of our important intellectual property rights whenever feasible and to oppose vigorously any infringement of our rights.

## Competition

Data from the National Bureau of Statistics of China indicates that sales in the consumer food service market in China totaled approximately $738 billion in 2021. Industry conditions vary by region, with local Chinese restaurants and western chains present, but we possess the largest market share (as measured by system sales). While branded QSR units per million population in China are well below that of the United States, competition in China is increasing. We compete with respect to food taste, quality, value, service, convenience, restaurant location and concept, including delivery and shared kitchens. The restaurant business is often affected by changes in consumer tastes; national, regional or local economic conditions; demographic trends; traffic patterns; the type, number and location of competing restaurants; and disposable income. We compete not only for consumers but also for management and hourly personnel and suitable restaurant sites. KFC's competitors in China are primarily western QSR brands such as McDonald's, Dicos and Burger King, and to a lesser extent, domestic QSR brands in China. Pizza Hut primarily competes with western CDR brands, including Domino's and Papa John's, as well as other domestic CDR brands in China.

## Seasonality

Due to the nature of our operations, we typically generate higher sales during Chinese festivities, holiday seasons as well as summer months, but relatively lower sales and lower operating profit during the second and fourth quarters.

## Human Capital Management

As of December 31, 2021, the Company had around 450,000 employees, including approximately 147,000 full-time employees and approximately 303,000 part-time restaurant crew members. Our full-time employees primarily included 38,000 restaurant management team members and 102,000 restaurant crew members.

Our board of directors provides oversight on certain human capital matters, including inclusion and diversity, management succession planning, and our employee rewards and benefits program. Under the board's oversight, the Company regularly conducts a people planning review to attract, retain and develop a workforce that aligns with our values and strategies.

### *Culture and People Philosophy*

The Company is committed to the "People First" philosophy by implementing our principle of "Fair, Care, Pride", which includes building employability, creating a diverse and inclusive working environment, providing fair and competitive benefits, empowering employees through digitalization and prioritizing occupational health and safety.

### *Diversity, Inclusion and Equal Opportunities*

The Company is committed to fostering a working environment that is professional, inclusive and non-discriminatory for employees to unleash their potential. In our workplaces, differences are understood, appreciated and encouraged. Each employee, without regard to race, religion, color, age, gender or gender identity, disability, military or veteran status, sexual orientation, citizenship or national origin, is provided with fair opportunity on the Company's diverse platform.

#### Gender Equality

The Company is committed to gender equality by providing fair recruitment, training and promotion opportunities for all employees. By the end of 2021, Yum China employed over 290,000 women, representing 65% of its total workforce. The Company continues to make progress in nurturing talented leaders across all management levels. By the end of 2021, women holding director and above positions represented 53% of our senior management workforce. In January 2022, the Company was named to the Bloomberg Gender Equality Index for the fourth consecutive year, and was one of only three companies from mainland China included in this index.

#### Barrier-free and Inclusive Workplace for People with Disabilities

The Company strives to create a barrier-free and inclusive workplace for people with disabilities. The Company piloted the first "Angel Restaurant" in 2012, using modified equipment and operational processes, and provides trainings to assist "angel employees" — those with special needs — to perform a full range of jobs. By the end of 2021, we had opened 23 Angel Restaurants in 22 cities, providing jobs for over 200 people with special needs.

### *Training and Development*

The Company values the growth of employees and continuously nurtures top talent through a systematic training system. Every employee is required to formulate a specific development goal to improve their competencies in addition to completing the key objectives of the role. We prepare employees not just for fulfilling current job requirements, but also for more challenging expanded job responsibilities in the future. In 2021, the number of total training hours exceeded 12 million.

#### Building Talent Pipeline

The Company is well-known for its career development path — the "Bench Planning" — which enables most operation leaders to grow from within. Two signature programs — the KFC Business School and the Pizza Hut Management Institute — provide systematic training and development opportunities. A new college graduate can advance to RGMs in less than two years by participating in these programs and acquiring the operational, financial and managerial knowledge required for operating a restaurant. In the long run, the programs lay a solid foundation for their future success.

The Company offers a tailored and fast-tracked YUMC Management Trainee Program for fresh graduate trainees in its marketing and supply chain functions. Through job rotations and targeted trainings, they are offered an opportunity to gain a thorough understanding of the business and build a foundation for becoming industry-leading professionals.

#### Digitally-powered Training Platform

Our training programs have tapped into the digitalization trends through the mobile learning platform, with the goal of equipping employees with the knowledge and skills necessary in the digital era and enabling their sustainable career development. The employees can easily access these training programs, even during the pandemic when face-to-face trainings may not be available.

## Continuing Education Program

The Company sponsors a continuing education program to help employees obtain college degrees. By the end of 2021, 3,800 employees were granted subsidies and achieved higher education degrees through our continuing education program. In addition, the Company also provides scholarships for eligible employees to achieve postgraduate degrees.

### *Total Rewards and Employee Benefits*

The Company is committed to equal pay for equal work. Based on annual market research, it provides employees with fair and competitive compensation and benefits, recognizing and rewarding their contributions, performance and efforts.

In line with relevant labor laws and regulations, we provide full-time employees with pension insurance, medical insurance, unemployment insurance, work injury insurance and maternity insurance. Part-time employees are covered by employer liability insurance. Employees also enjoy paid leaves in accordance with labor laws.

The Company has launched equity incentive schemes such as CEO Awards and RGM Restricted Stock Units (RSUs). The scheme is part of Yum China's long-standing commitment to its RGM No. 1 corporate culture. The Company believes that its RGMs serve as the most important leaders and are key contributors to its long-term success. In 2016, Yum China announced a grant of RSUs valued at $2,000 to each qualified RGM. As of the end of 2021, this program has allowed more than 10,700 RGMs to become stockholders of Yum China. In addition, the Company granted RSUs valued at $3,000 to all eligible RGMs starting in February 2021, covering approximately 3,500 RGMs. The turnover rate of RGMs was 10.6% in 2021.

Recognizing the tremendous effort of our employees especially in navigating the COVID-19 pandemic, the Company upgraded the medical insurance coverage of its front-line employees. Medical insurance coverage for each eligible RGM was increased to RMB1 million. Critical illness insurance was extended to service team leaders and coverage was increased for family members of both RGMs and other restaurant management team members. These enhanced benefits are expected to cover around 100,000 front-line employees and their family members.

For office staff, the Company expanded its flexible benefit platform in 2021 to cover more than 6,000 employees, allowing employees, based on their individual needs, to select benefits including family medical insurance, medical examination and recreational activities. Both office staff and RGMs are covered by the Company's housing subsidy scheme.

### *Health and Safety*

The Company strictly complies with laws and regulations on safety and health. For activities imposing higher or distinct risks, the Company implements health and safety measures specifically formulated to protect employees against those risks. Yum China also incorporates compliance management, risk controls, inspections and supervisions in daily operations. The Company regularly inspects and upgrades employees' protective equipment, carries out workplace safety reviews, and trains all employees on the operation procedures and safety precautions.

The Company continues to place top priority on the health and safety of employees amid the fluid COVID-19 conditions. To further protect the health and safety of employees and customers, the Company encourages and rewards employees to get vaccinated against COVID-19.

In addition, Yum China's Employee Assistance Program ("EAP") continues to provide professional counseling and educational sessions to promote employees' physical and mental health. For example, by leveraging the EAP program, the Company was able to offer stress management tips to employees when they underwent quarantine during the pandemic.

### Engagement and Wellbeing

The Top Employers Institute has certified the Company as a Top Employer China for the fourth consecutive year, with Yum China being the only restaurant company named among the top 20 employers.

The Company maintains multiple communication channels with employees, including organizational forums such as RGM Convention and Founders' Day. The Company also ensures effective communication of business strategies and corporate messages through various digital platforms such as corporate WeChat, Apps and intranet portals.

The Company complies with the Universal Declaration of Human Rights and the international conventions signed by the Chinese government to protect legitimate rights and interests of its employees. The Company strictly prohibits the use of child labor and forced labor. The Company deploys a comprehensive system that is built and renewed in accordance with labor laws and regulations, conducts regular internal and external audits from local labor authorities, as well as implements whistleblower policies to detect and deter violations of employees' rights.

## Environmental Matters

We strive to reduce the environmental impact of our business activities and incorporate sustainability into the daily operations of our restaurants, focusing our effort on climate action, managing supply chain environmental impact, using sustainable packaging and waste management.

### Climate Action

Climate action is a focus area for Yum China. We established a management system with specific goals and continuously leverage energy-saving technology to reduce electricity consumption and greenhouse gas ("GHG") emissions. We disclose the impacts of environmental risks and opportunities in our annual sustainability report and CDP questionnaires. In 2021, we announced our commitment to supporting the Paris Agreement by setting science-based emissions reduction targets in line with the Science Based Target initiative ("SBTi") criteria, and striving for net-zero value chain GHG emissions by 2050.

### Supply Chain Environmental Impact

Building a sustainable supply chain is a key component of our sustainability strategy. We have set an ambitious goal to collaborate with our suppliers to achieve a zero-deforestation supply chain. By continuously strengthening the management of traceability in the upstream supply chain, we strive to promote sustainable sourcing of commodities, including our goal of sourcing 100% RSPO-certified palm oil and 100% FSC-certified paper packaging by 2025.

### Sustainable Packaging

We continue to reduce packaging and waste from the source of use through the application of new packaging solutions, new materials, innovative technologies and various other methods. We are committed to ensuring that all customer facing, plastic-based packaging will be recyclable. We are working towards our target of a 30% reduction of non-degradable plastic packaging weight by 2025, as compared to a 2019 baseline.

### Food Loss and Waste

We are working towards a goal of 10% reduction of food waste per restaurant by 2030, as compared to a 2020 baseline, through use of advanced technologies and innovative equipment. To reduce food waste, we continue to promote and extend our food bank project to more restaurants. With our pilot project on converting used cooking oil into biodiesel, we are committed to expanding this project to cover more restaurants.

## Nutrition

We advocate a balanced diet and healthy eating habits through product innovation and other relevant measures. We have increased the offering of grains, fruits and vegetables, beans and nuts in our menus to create balanced food choices. In 2007, we partnered with the China Nutrition Society (CNS) to establish the China Nutrition Society (CNS) — Yum China Dietary Health Foundation. We cooperate with the China Foundation for Poverty Alleviation (CFPA) to encourage donations from the public to improve child nutrition in poor areas.

## Information about our Executive Officers

The executive officers of the Company as of February 22, 2022, and their ages and current positions as of that date, are as follows:

| Name | Age | Title |
|---|---|---|
| Joey Wat | 50 | Chief Executive Officer |
| Andy Yeung | 49 | Chief Financial Officer |
| Johnson Huang | 59 | General Manager, KFC |
| Jeff Kuai | 41 | General Manager, Pizza Hut |
| Leila Zhang | 53 | Chief Technology Officer |
| Joseph Chan | 53 | Chief Legal Officer |
| Aiken Yuen | 62 | Chief People Officer |
| Alice Wang | 52 | Chief Public Affairs Officer |
| Xueling Lu | 48 | Controller and Principal Accounting Officer |

*Joey Wat* has served as our Chief Executive Officer since March 2018 and as a member of our board of directors since July 2017. She served as our President and Chief Operating Officer from February 2017 to February 2018 and the Chief Executive Officer, KFC from October 2016 to February 2017, a position she held at Yum! Restaurants China, from August 2015 to October 2016. Ms. Wat joined Yum! Restaurants China in September 2014 as President of KFC China and was promoted to Chief Executive Officer for KFC China in August 2015. Before joining YUM, Ms. Wat served in both management and strategy positions at A.S. Watson Group ("Watson"), an international health, beauty and lifestyle retailer, in the U.K. from 2004 to 2014. Her last position at Watson was managing director of Watson Health & Beauty U.K., which operates Superdrug and Savers, two retail chains specializing in the sale of pharmacy and health and beauty products, from 2012 to 2014. She made the transition from head of strategy of Watson in Europe to managing director of Savers in 2007. Before joining Watson, Ms. Wat spent seven years in management consulting including with McKinsey & Company's Hong Kong office from 2000 to 2003. Ms. Wat was ranked number 34 on Forbes World's Most Powerful Women list in 2020, named by FORTUNE magazine as one of the Top 25 China Most Powerful Women in Business in 2017, 2018 and 2020, and the Top 50 Most Powerful Women in International Business in 2018, 2019, 2020. She was also named to Business Insider 100 People Transforming Business Asia List in 2020.

*Andy Yeung* has served as our Chief Financial Officer since October 2019. Prior to joining Yum China, Mr. Yeung served as the chief financial officer of Smart Finance International Limited, a financial technology company, from April 2017 to August 2019. Between January 2014 and March 2017, he served as the chief financial officer of Cheetah Mobile Inc., a NYSE-listed mobile internet company (NYSE: CMCM) where he led its successful IPO and built its finance, internal control and investor relations functions. From 2009 to 2013, Mr. Yeung worked at Oppenheimer & Co. Inc. as director, executive director and then managing director, responsible for research coverage of the internet and media sectors in China. From 2004 to 2009, Mr. Yeung was an associate in equity research at Thomas Weisel Partners. He has been a Chartered Financial Analyst charterholder since 2001.

*Johnson Huang* has served as General Manager, KFC since February 2017. He served as our Chief Information and Marketing Support Officer from October 2016 to February 2017, a position he held at Yum! Restaurants China from September 2014 to October 2016. Mr. Huang joined YUM in 2006 to lead the information technology department in China. He served as vice president of information technology from September 2008 to January 2013 and Chief Information Officer from January 2013 to September 2014. Mr. Huang has been the key architect of Yum! Restaurants China's digital strategy and information technology roadmap in China. Prior to joining YUM, Mr. Huang held various information technology and business leadership positions with Capgemini Asia Pacific Pte, Ltd. in Taiwan and the greater China region.

*Jeff Kuai* has served as the General Manager, Pizza Hut since November 2017. Mr. Kuai previously served as the General Manager, Pizza Hut Home Service from October 2016 to October 2017, a position he held at Yum! Restaurants China from January 2015 to October 2016. From March 2012 to August 2013, Mr. Kuai was Director of Delivery Support Center for Yum! Restaurants China, where he was instrumental in building its online ordering and e-commerce capabilities. Prior to that, Mr. Kuai spent nine years in the information technology department of Yum! Restaurants China, enhancing its information technology infrastructure and productivity.

*Leila Zhang* has served as the Chief Technology Officer of Yum China since March 2018. Ms. Zhang served as Vice President, Information Technology from October 2016 to March 2018, a position she held at Yum! Restaurants China from 2014 to October 2016. Ms. Zhang joined YUM in 1996, held various positions in the information technology department, and began leading the department in February 2017. Prior to joining YUM, Ms. Zhang was an engineer with Inventec Electronics (Shanghai) from 1992 to 1996.

*Joseph Chan* has served as our Chief Legal Officer since June 2019. Prior to joining Yum China, Mr. Chan was a partner at Sidley Austin, a U.S. based international law firm, in Shanghai, from November 2010 to May 2019, where he managed and executed large complex multi-jurisdictional legal matters with a focus on mergers and acquisitions and corporate finance transactions across a variety of industries. In addition, Mr. Chan spent over a decade with Pillsbury Winthrop Shaw Pittman, a U.S. based international law firm, in San Francisco and Shanghai, initially as an associate and then a partner. He established the Shanghai office of Pillsbury Winthrop Shaw Pittman in 2006 and served in various leadership positions, including serving as its inaugural managing partner. Mr. Chan is admitted to the bar in California and Pennsylvania in the U.S. and British Columbia in Canada. For many consecutive years he was ranked and recommended by Chambers Asia, IFLR and Legal 500 as a leading lawyer in Asia.

*Aiken Yuen* has served as the Chief People Officer of Yum China since March 2018. Mr. Yuen served as Vice President, Human Resources of Yum China from October 2016 to February 2018, a position he held at Yum! Restaurants China from March 2012 to October 2016. Mr. Yuen joined YUM in 2008 as the Talent Management and Development Director. Prior to joining YUM, Mr. Yuen served in senior HR management positions at American International Group ("AIG") in Hong Kong from 1998 to 2008. His last position at AIG was Vice President, Human Resources of AIA, AIG's life insurance business unit for South East Asia. He was responsible for overall human resources strategy formulation and execution for AIA's Head Office in Hong Kong and its operations in six Asian countries. Before that, he was the Senior Manager of Training and Development with Standard Chartered Bank from 1996 to 1998 and Manager of Management Training with HSBC from 1994 to 1996.

*Alice Wang* has served as the Chief Public Affairs Officer of Yum China since March 2018. Ms. Wang previously served as the Senior Vice President, Public Affairs of Yum China from March 2017 to February 2018 and as Vice President, Public Affairs from October 2016 to March 2017, a position she held at Yum! Restaurants China since she joined YUM in March 2015. Prior to joining YUM, Ms. Wang spent 22 years with Heinz China, a food products company, where she served as Vice President of Corporate Affairs, Greater China from August 2011 to February 2015.

*Xueling Lu* has served as Controller and Principal Accounting Officer of Yum China since January 2018. Ms. Lu previously served as Senior Director, Finance of Yum China, a position she held since she joined the Company in November 2016. Prior to joining the Company, Ms. Lu was the Asia Pacific Controller of Lear Corporation from 2013 to 2016. Before joining Lear Corporation, Ms. Lu spent 10 years in public accounting with Ernst & Young, specializing in audits and initial public offerings of companies listed in the U.S., SEC reporting and Sarbanes-Oxley compliance. Ms. Lu is a certified public accountant in California and a member of the American Institute of Certified Public Accountants.

### *Our History*

Yum China was incorporated in Delaware on April 1, 2016. The Company separated from YUM on October 31, 2016 (the "separation"), becoming an independent, publicly traded company as a result of a pro rata distribution (the "distribution") of all outstanding shares of Yum China common stock to shareholders of YUM. On October 31, 2016, YUM's shareholders of record as of 5:00 p.m. Eastern Time on October 19, 2016 received one share of Yum China common stock for every one share of YUM common stock held as of the record date. Common stock of Yum China began trading "regular way" under the ticker symbol "YUMC" on the New York Stock Exchange on November 1, 2016. On September 10, 2020, the Company completed its secondary listing on the Main Board of the Hong Kong Stock Exchange ("HKEX") under the stock code "9987", in connection with a global offering (the "Global Offering") of shares of its common stock.

## Government Regulation

The Company is subject to various laws affecting its business, including laws and regulations concerning cybersecurity, data privacy and security, labor, health, sanitation, environmental protection and safety. In accordance with the relevant laws and regulations in the PRC, we are required to obtain various approvals, licenses, permits, registrations and filings to operate our restaurant business, including the relevant food business license, environmental protection assessment and inspection registration or approval, and fire safety inspection acceptance approval or other alternatives. The Company has not historically been materially and adversely affected by such requirements or by any difficulty, delay or failure to obtain required approvals, licenses, permits, registrations or filings. The Company is also subject to tariffs and regulations on imported commodities and equipment and laws regulating foreign investment, as well as anti-bribery and corruption laws. Compliance with applicable laws and regulations has not had a material effect on the Company's capital expenditures, earnings and competitive position. However, we cannot predict the effect that the compliance with laws and regulations may have on our capital expenditures, earnings and competitive position in the future. See "Risk Factors" for a discussion of risks relating to federal, state, provincial, local and international governmental regulation of our business.

## Regulations Relating to Dividend Distribution

The Chinese laws, rules and regulations applicable to our China subsidiaries permit payments of dividends only out of their accumulated profits, if any, determined in accordance with applicable accounting standards and regulations. In addition, under Chinese law, an enterprise incorporated in China is required to set aside at least 10% of its after-tax profits each year, after making up previous years' accumulated losses, if any, to fund certain statutory reserve funds, until the aggregate amount of such a fund reaches 50% of its registered capital. As a result, our China subsidiaries are restricted in their ability to transfer a portion of their net assets to us in the form of dividends. At the discretion of their board of directors, as enterprises incorporated in China, our China subsidiaries may allocate a portion of their after-tax profits based on China accounting standards to staff welfare and bonus funds. These reserve funds and staff welfare and bonus funds are not distributable as cash dividends.

## Regulations Relating to Taxation

*Enterprise Income Tax.* Under the China Enterprise Income Tax Law (the "EIT Law") and its implementation rules, a China resident enterprise is subject to Chinese enterprise income tax in respect of its net taxable income derived from sources inside and outside China. The term "resident enterprise" refers to any enterprise established in China and any enterprise established outside China with a "de facto management body" within China.

Our China subsidiaries are regarded as China resident enterprises by virtue of their incorporation in China, and are generally subject to Chinese enterprise income tax on their worldwide income at the current uniform rate of 25%, unless reduced under certain specific qualifying criteria. Our China subsidiaries may deduct reasonable expenses that are actually incurred and are related to the generation of their income, including interest and other borrowing expenses, amortization of land use rights and depreciation of buildings and certain fixed assets, subject to any restrictions that may be imposed under the EIT Law, its implementation regulations and any applicable tax notices and circulars issued by the Chinese government or tax authorities.

Yum China and each subsidiary of Yum China that is organized outside of China intends to conduct its management functions in a manner that does not cause it to be a China resident enterprise, including by carrying on its day-to-day management activities and maintaining its key records, such as resolutions of its board of directors and resolutions of stockholders, outside of China. As such, we do not believe that Yum China or any of its non-Chinese subsidiaries should be considered a China resident enterprise for purposes of the EIT Law, and should not be subject to Chinese enterprise income tax on that basis. See "Risk Factors — Risks Related to Doing Business in China — Under the EIT Law, if we are classified as a China resident enterprise for Chinese enterprise income tax purposes, such classification would likely result in unfavorable tax consequences to us and our non-Chinese stockholders."

*Value-Added Tax/Business Tax and Local Surcharges.* Effective on May 1, 2016, a 6% value-added tax ("VAT") on output replaced the 5% business tax ("BT") that has historically been applied to certain restaurant sales under the China Provisional Regulations on Business Tax. Pursuant to Circular Caishui [2016] No. 36 jointly issued by the Ministry of Finance and the Chinese State Taxation Administration ("STA"), beginning May 1, 2016, any entity engaged in the provision of catering services in China is generally required to pay VAT at the rate of 6% on revenues generated from the provision of such services, less any creditable VAT already paid or borne by such entity upon purchase of materials and services. The latest VAT rates imposed on our purchase of materials and services included 13%, 9% and 6%, which were gradually changed from 17%, 13%, 11% and 6% since 2017. These rate changes impact our input VAT on all materials and certain services, primarily construction, transportation and leasing. However, the impact on our operating results is not expected to be significant. Local surcharges generally ranging from 7% to 13%, varying with the location of the relevant China subsidiary, are imposed on the amount of VAT payable.

*Repatriation of Dividends from Our China Subsidiaries.* Dividends (if any) paid by our China subsidiaries to their direct offshore parent company are subject to Chinese withholding income tax at the rate of 10%, provided that such dividends are not effectively connected with any establishment or place of the offshore parent company in China. The 10% withholding income tax rate may be reduced or exempted pursuant to the provisions of any applicable tax treaties or tax arrangements. Hong Kong has a tax arrangement with mainland China that provides for a 5% withholding tax on dividends upon meeting certain conditions and requirements, including, among others, that the Hong Kong resident enterprise directly owns at least 25% equity interests of the Chinese enterprise and is a "beneficial owner" of the dividends. We believe that our Hong Kong subsidiary, which is the equity holder of our Chinese subsidiaries, met the relevant requirements pursuant to the tax arrangement between mainland China and Hong Kong in 2018 and is expected to meet the requirements in subsequent years, thus, it is more likely than not that our dividends declared or earnings expected to be repatriated since 2018 are subject to the reduced withholding tax of 5%. However, if our Hong Kong subsidiary is not considered to be the "beneficial owner" of the dividends by the Chinese local tax authority, the withholding tax rate on dividends paid to it by our Chinese subsidiaries would be subject to a withholding tax rate of 10% with retrospective effect, which would increase our tax liability and reduce the amount of cash available to the Company. See "Risk Factors — Risks Related to Doing Business in China — We rely to a significant extent on dividends and other distributions on equity paid by our principal operating subsidiaries in China to fund offshore cash requirements."

*Gains on Direct Disposal of Equity Interests in Our China Subsidiaries.* Under the EIT Law and its implementation rules, gains derived by non-resident enterprises from the sale of equity interests in a China resident enterprise are subject to Chinese withholding income tax at the rate of 10%. The 10% withholding income tax rate may be reduced or exempted pursuant to applicable tax treaties or tax arrangements. The gains are computed based on the difference between the sales proceeds and the original investment basis. Stamp duty is also payable upon a direct transfer of equity interest in a China resident enterprise. The stamp duty is calculated at 0.05% on the transfer value, payable by each of the transferor and transferee. We may be subject to these taxes in the event of any future sale by us of a China resident enterprise.

*Gains on Indirect Disposal of Equity Interests in Our China Subsidiaries.* In February 2015, the STA issued the STA's Bulletin on Several Issues of Enterprise Income Tax on Income Arising from Indirect Transfers of Property by Non-resident Enterprises ("Bulletin 7"). Pursuant to Bulletin 7, an "indirect transfer" of Chinese taxable assets, including equity interests in a China resident enterprise ("Chinese interests"), by a non-resident enterprise, may be re-characterized and treated as a direct transfer of Chinese taxable assets, if such arrangement does not have reasonable commercial purpose and the transferor avoids payment of Chinese enterprise income tax. Where a non-resident enterprise conducts an "indirect transfer" of Chinese interests by disposing of equity interests in an offshore holding company, the transferor, transferee and/or the China resident enterprise being indirectly transferred may report such indirect transfer to the relevant Chinese tax authority, which may in turn report upward to the STA. Using general anti-tax avoidance provisions, the STA may treat such indirect transfer as a direct transfer of Chinese interests if the transfer avoids Chinese tax by way of an arrangement without reasonable commercial purpose. As a result, gains derived from such indirect transfer may be subject to Chinese enterprise income tax, and the transferee or other person who is obligated to pay for the transfer would be obligated to withhold the applicable taxes, currently at a rate of up to 10% of the capital gain in the case of an indirect transfer of equity interests in a China resident enterprise. Both the transferor and the party obligated to withhold the applicable taxes may be subject to penalties under Chinese tax laws if the transferor fails to pay the taxes and the party obligated to withhold the applicable taxes fails to withhold the taxes.

The above regulations do not apply if either (i) the selling non-resident enterprise recognizes the relevant gain by purchasing and selling equity of the same listed enterprise in the open market (the "listed enterprise exception"); or (ii) the selling non-resident enterprise would have been exempted from enterprise income tax in China pursuant to applicable tax treaties or tax arrangements, if it had directly held and transferred such Chinese interests that were indirectly transferred. The China indirect transfer rules do not apply to gains recognized by individual stockholders. However, in practice, there have been a few reported cases of individuals being taxed on the indirect transfer of Chinese interests and the law could be changed so as to apply to individual stockholders, possibly with retroactive effect. In addition, the PRC Individual

Income Tax Law and relevant regulations ("IITL"), revised effective January 1, 2019, impose general anti-avoidance tax rules ("GAAR") on transactions conducted by individuals. As a result, if the China tax authority invokes the GAAR and deems that indirect transfers made by individual stockholders lack reasonable commercial purposes, any gains recognized on such transfers might be subject to individual income tax in China at the standard rate of 20%.

It is unclear whether Company stockholders that acquired Yum China stock through the distribution or the Global Offering (discussed under "— Our History") will be treated as acquiring Yum China stock in an open market purchase. If such acquisition of Yum China stock is not treated as acquired in an open market purchase, the listed transaction exception will not be available for transfers of such stock. We expect that transfers in open market transactions of our stock by corporate or other non-individual stockholders that have purchased our stock in open market transactions will not be taxable under the China indirect transfer rules due to the listed enterprise exception. Transfers, whether in the open market or otherwise, of our stock by corporate and other non-individual stockholders that acquired our stock in the distribution or the Global Offering or in non-open market transactions may be taxable under the China indirect transfer rules and our China subsidiaries may have filing obligations in respect of such transfers upon the request of relevant Chinese tax authorities. Transfers of our stock in non-open market transactions by corporate and other non-individual stockholders may be taxable under the China indirect transfer rules, whether or not such stock was acquired in open market transactions, and our China subsidiaries may have filing obligations in respect of such transfers upon the request of relevant China tax authorities. Corporate and other non-individual stockholders may be exempt from taxation under the Chinese indirect transfer rules with respect to transfers of our stock if they are tax resident in a country or region that has a tax treaty or arrangement with China that provides for a capital gains tax exemption and they qualify for that exemption.

*Tax Cuts and Jobs Act (the "Tax Act").* In December 2017, the U.S. enacted the Tax Act, which included a broad range of tax reforms, including, but not limited to, the establishment of a flat corporate income tax rate of 21%, the elimination or reduction of certain business deductions, and the imposition of tax on deemed repatriation of accumulated undistributed foreign earnings. The Tax Act has impacted Yum China in two material aspects: (1) in general, all of the foreign-source dividends received by Yum China from its foreign subsidiaries will be exempted from taxation starting from the tax year beginning after December 31, 2017 and (2) Yum China recorded additional income tax expense in the fourth quarter of 2017, including an estimated one-time transition tax on its deemed repatriation of accumulated undistributed foreign earnings and additional tax related to the revaluation of certain deferred tax assets. The Tax Act also requires a U.S. shareholder to be subject to tax on Global Intangible Low Taxed Income ("GILTI") earned by certain foreign subsidiaries.

The U.S. Treasury Department and the Internal Revenue Services (the "IRS") released the final transition tax regulations in the first quarter of 2019. We completed the evaluation of the impact on our transition tax computation based on the final regulations released in the first quarter of 2019 and recorded additional income tax expense for the transition tax accordingly.

See "Risk Factors" for a discussion of risks relating to federal, state, local and international regulation relating to taxation of our business.

### Available Information

For important news and information regarding Yum China, including our filings with the U.S. Securities and Exchange Commission (the "SEC") and the HKEX, visit Yum China's Investor Relations website at http://ir.yumchina.com. Yum China uses this website as a primary channel for disclosing key information to its investors, some of which may contain material and previously non-public information.

# Risk Factors.

*You should carefully consider each of the following risks, as well as the information included elsewhere in this report, before deciding to invest in our common stock or otherwise in connection with evaluating our business. Based on the information currently known to us, we believe that the following information identifies the most material risk factors affecting us in each of these categories of risk. However, additional risks and uncertainties not presently known to us or that we currently believe to be immaterial may also adversely affect our business, financial condition or results of operations. In addition, past financial performance may not be a reliable indicator of future performance and historical trends should not be used to anticipate results or trends in future periods. If any of the following risks and uncertainties develops into actual events, these events could have a material adverse effect on our business, financial condition or results of operations. In such case, the trading price of our common stock could decline.*

## Summary of Risk Factors

We are exposed to a variety of risks, which have been separated into five general groups:

- Risks related to our business and industry, including (a) food safety and foodborne illness concerns, (b) significant failure to maintain effective quality assurance systems for our restaurants, (c) significant liability claims, food contamination complaints from our customers or reports of incidents of food tampering, (d) health concerns arising from outbreaks of viruses or other illnesses, including the COVID-19 pandemic, (e) the fact that the operation of our restaurants is subject to the terms of the master license agreement with YUM, (f) the fact that substantially all of our revenue is derived from our operations in China, (g) the fact that our success is tied to the success of YUM's brand strength, marketing campaigns and product innovation, (h) shortages or interruptions in the availability and delivery of food products and other supplies, (i) fluctuation of raw materials prices, (j) our inability to attain our target development goals, the potential cannibalization of existing sales by aggressive development and the possibility that new restaurants will not be profitable, (k) risks associated with leasing real estate, (l) inability to obtain desirable restaurant locations on commercially reasonable terms, (m) labor shortages or increases in labor costs, (n) the fact that our success depends substantially on our corporate reputation and on the value and perception of our brands, (o) the occurrence of security breaches and cyber-attacks, (p) failure to protect the integrity and security of our customer or employee personal, financial or other data or our proprietary or confidential information that is stored in our information systems or by third parties on our behalf, (q) failures or interruptions of service or security breaches in our information technology systems, (r) the fact that our business depends on the performance of, and our long-term relationships with, third-party mobile payment processors, internet infrastructure operators, internet service providers and delivery aggregators, (s) failure to provide timely and reliable delivery services by our restaurants, (t) our growth strategy with respect to Lavazza and COFFii & JOY may not be successful, (u) the anticipated benefits of our acquisitions may not be realized in a timely manner or at all, (v) challenges and risks related to our new retail and e-commerce businesses, (w) our inability or failure to recognize, respond to and effectively manage the impact of social media, (x) failure to comply with anti-bribery or anti-corruption laws, (y) U.S. federal income taxes, changes in tax rates, disagreements with tax authorities and imposition of new taxes, (z) changes in consumer discretionary spending and general economic conditions, (aa) the fact that the restaurant industry in which we operate is highly competitive, (bb) loss of or failure to obtain or renew any or all of the approvals, licenses and permits to operate our business, (cc) our inability to adequately protect the intellectual property we own or have the right to use, (dd) our licensor's failure to protect its intellectual property, (ee) seasonality and certain major events in China, (ff) our failure to detect, deter and prevent all instances of fraud or other misconduct committed by our employees, customers or other third parties, (gg) the fact that our success depends on the continuing efforts of our key management and experienced and capable personnel as well as our ability to recruit new talent, (hh) our strategic investments or acquisitions may be unsuccessful; (ii) our investment in technology and innovation may not generate the expected level of returns, (jj) fair value changes for our investment in equity securities and lower yields of our short-term investments may adversely affect our financial condition and results of operations, and (kk) our operating results may be adversely affected by our investment in unconsolidated affiliates;

- Risks related to doing business in China, including (a) changes in Chinese political policies and economic and social policies or conditions, (b) uncertainties with respect to the interpretation and enforcement of Chinese laws, rules and regulations, (c) the audit report included in the annual report on Form 10-K filed with the SEC is prepared by auditors who are not currently inspected by the Public Company Accounting Oversight Board and, as such, our stockholders are deprived of the benefits of such inspection and our common stock is subject to the risk of delisting from the New York Stock Exchange in the future, (d) changes in political, business, economic and trade relations between the United States and China, (e) fluctuation in the value of the Chinese Renminbi, (f) the fact that we face increasing focus on environmental sustainability issues, (g) limitations on our ability to utilize our cash balances effectively due to governmental control of currency conversion and payments of foreign currency and the Chinese Renminbi out of mainland China, (h) changes in the laws and regulations of China or noncompliance with applicable laws and regulations, (i) reliance on dividends and other distributions on equity paid by our principal subsidiaries in China to fund offshore cash requirements, (j) potential unfavorable tax consequences resulting from our classification as a China resident enterprise for Chinese enterprise income tax purposes, (k) uncertainty regarding indirect transfers of equity interests in China resident enterprises and enhanced scrutiny by Chinese tax authorities, (l) difficulties in effecting service of legal process, conducting investigations, collecting evidence, enforcing foreign judgments or bringing original actions in China against us, (m) the Chinese government may determine that the variable interest entity structure of Daojia does not comply with Chinese laws on foreign investment in restricted industries, (n) inability to use properties due to defects caused by non-registration of lease agreements related to certain properties, (o) risk in relation to unexpected land acquisitions, building closures or demolitions, (p) potential fines and other legal or administrative sanctions for failure to comply with Chinese regulations regarding our employee equity incentive plans and various employee benefit plans, (q) proceedings instituted by the SEC against certain China-based accounting firms, including our independent registered public accounting firm, could result in our financial statements being determined to not be in compliance with the requirements of the Exchange Act, (r) restrictions on our ability to make loans or additional capital contributions to our Chinese subsidiaries due to Chinese regulation of loans to, and direct investment in, Chinese entities by offshore holding companies and governmental control of currency conversion, and (s) difficulties in pursuing growth through acquisitions due to regulations regarding acquisitions;

- Risks related to the separation and related transactions, including (a) incurring significant tax liabilities if the distribution does not qualify as a transaction that is generally tax-free for U.S. federal income tax purposes and the Company could be required to indemnify YUM for material taxes and other related amounts pursuant to indemnification obligations under the tax matters agreement, (b) being obligated to indemnify YUM for material taxes and related amounts pursuant to indemnification obligations under the tax matters agreement if YUM is subject to Chinese indirect transfer tax with respect to the distribution, (c) potential indemnification liabilities owing to YUM pursuant to the separation and distribution agreement, (d) the indemnity provided by YUM to us with respect to certain liabilities in connection with the separation may be insufficient to insure us against the full amount of such liabilities, (e) the possibility that a court would require that we assume responsibility for obligations allocated to YUM under the separation and distribution agreement, and (f) potential liabilities due to fraudulent transfer considerations;

- Risks related to our common stock, including (a) the fact that we cannot guarantee the timing or amount of dividends on, or repurchases of, our common stock, (b) the impact on the trading prices of our common stock due to different characteristics of the capital markets in Hong Kong and the U.S., (c) different interests between Primavera and Ant Financial and other holders of our common stock, and (d) the existence of anti-takeover provisions that may discourage or delay acquisition attempts that you might consider favorable; and

- General risk factors.

## Risks Related to Our Business and Industry

### *Food safety and foodborne illness concerns may have an adverse effect on our reputation and business.*

Foodborne illnesses, such as E. coli, hepatitis A and salmonella, have occurred and may re-occur within our system from time to time. In addition, food safety issues such as food tampering, contamination and adulteration occur or may occur within our system from time to time. Any report or publicity linking us, our competitors, our restaurants, including restaurants operated by us or our franchisees, to instances of foodborne illness or food safety issues could adversely affect our restaurants' brands and reputations as well as our revenues and profits and possibly lead to product liability claims, litigation and damages. If a customer of our restaurants becomes ill from foodborne illnesses or as a result of food safety issues, restaurants in our system may be temporarily closed, which would decrease our revenues. In addition, instances or allegations of foodborne illness or food safety issues, real or perceived, involving our or YUM's restaurants, restaurants of competitors, or suppliers or distributors (regardless of whether we use or have used those suppliers or distributors), or otherwise involving the types of food served at our restaurants, could result in negative publicity that could adversely affect our sales. The occurrence of foodborne illnesses or food safety issues could also adversely affect the price and availability of affected ingredients, which could result in disruptions in our supply chain and/or lower margins for us and our franchisees.

In October 2019, China's State Council amended the Regulation for the Implementation of the Food Safety Law (the "Regulation of Food Safety Law"), which became effective on December 1, 2019. The Regulation of Food Safety Law outlines detailed rules for food safety assessment, food safety standards, food production and food business, food inspection and other matters. Pursuant to the Regulation of Food Safety Law, certain violations of the food safety law may result in severe administrative and criminal penalties imposed on the Company, as well as its legal representatives, senior management members and other employees. If penalties are imposed on our senior management members, they may be prevented from performing their duties at the Company, which could in turn negatively affect our business operations. Such penalties could also have a material adverse impact on the Company's reputation.

### *Any significant failure to maintain effective quality assurance systems for our restaurants could have a material adverse effect on our business, reputation, results of operations and financial condition.*

The quality and safety of the food we serve is critical to our success. Maintaining consistent food quality depends significantly on the effectiveness of our and our franchisees' quality assurance systems, which in turn depends on a number of factors, including the design of our quality control systems and employee implementation and compliance with those quality control policies and guidelines. Our quality assurance systems include, but are not limited to, supplier/food processing plant quality assurance, logistics quality assurance, and restaurant quality assurance. There can be no assurance that our and our franchisees' quality assurance systems will prove to be effective. Any significant failure of or deviation from these quality assurance systems could have a material adverse effect on our business, reputation, results of operations and financial condition.

### *Any significant liability claims, food contamination complaints from our customers or reports of incidents of food tampering could adversely affect our business, reputation, results of operations and financial condition.*

Being in the restaurant industry, we face an inherent risk of food contamination and liability claims. Our food quality depends partly on the quality of the food ingredients and raw materials provided by our suppliers, and we may not be able to detect all defects in our supplies. Any food contamination occurring in raw materials at our suppliers' food processing plants or during the transportation from food processing plants to our restaurants that we fail to detect or prevent could adversely affect the quality of the food served in our restaurants. Due to the scale of our and our franchisees' operations, we also face the risk that certain of our and our franchisees' employees may not adhere to our mandated quality procedures and requirements. Any failure to detect defective food supplies, or observe proper hygiene, cleanliness and other quality control requirements or standards in our operations could adversely affect the quality of the food we offer at our restaurants, which could lead to liability claims, complaints and related adverse publicity, reduced customer traffic at our restaurants, the imposition of penalties against us or our franchisees by relevant authorities and compensation awards by courts. Our sales have been significantly impacted by adverse publicity relating to supplier actions over the past decade. For example, our sales and perception of our brands were significantly impacted following adverse publicity relating to the failure of certain upstream poultry suppliers to meet our standards in late 2012 as well as adverse publicity relating to improper food handling practices by another supplier in mid-2014. There can be no assurance that similar incidents will not occur again in the future or that we will not receive any food contamination claims or defective products from our suppliers in the future. Any such incidents could materially harm our business, reputation, results of operations and financial condition.

### *Health concerns arising from outbreaks of viruses or other illnesses may have a material adverse effect on our business. The COVID-19 pandemic has had, and may continue to have, adverse effects on our results of operations, cash flows and financial condition.*

Our business could be materially and adversely affected by the outbreak of a widespread health epidemic, such as COVID-19, avian flu or African swine flu. Outbreaks of contagious illness occur from time to time around the world, including in China where virtually all of our restaurants are located. The occurrence of such an outbreak or other adverse public health developments in China could materially disrupt our business and operations, including if government authorities impose mandatory closures, seek voluntary closures or impose restrictions on operations of restaurants. Furthermore, the risk of contracting viruses or other illnesses that may be transmitted through human contact could cause employees or guests to avoid gathering in public places or interacting with other people, which could materially and adversely affect restaurant guest traffic or the ability to adequately staff restaurants. An outbreak could also cause disruption in our supply chain, increase our raw material costs, increase operational complexity and adversely impact our ability to provide safety measures to protect our employees and customers, which could materially and adversely affect our continuous operations. Our operating costs may also increase as a result of taking precautionary measures to protect the health and wellbeing of our customers and employees during an outbreak. If an outbreak reaches pandemic levels, there may also be long-term effects on the economies of affected countries. Any of the foregoing within China would severely disrupt our operations and could have a material adverse effect on our business, results of operations, cash flows and financial condition.

For example, starting in the first quarter of 2020, the COVID-19 pandemic significantly impacted the Company's operations, resulting in a significant decline in Operating profit mainly driven by same-store sales declines and temporary store closures. At the peak of the COVID-19 outbreak in China in 2020, we closed approximately 35% of our restaurants. For restaurants that remained open, same-store sales declined due to shortened operating hours and reduced traffic, with a significant portion of stores providing only delivery and takeaway services. Our operations and financial results of second half of 2021 were also significantly affected by multiple waves of Delta-variant outbreaks, spreading to nearly all provinces in China. In January 2022, cases of the Omicron variant emerged in China, spreading to major cities including Beijing, Shanghai, Tianjin and Shenzhen. A lockdown in Xi'an, which started in December, lasted nearly the whole month of January. A number of regions were identified as medium to high risk with restrictive measures put in place. At the peak in January, over 500 of our stores were temporarily closed or offered only takeaway and delivery services, compared to nearly 300 stores in the fourth quarter. Many provinces have measures discouraging travel during the Chinese New Year holiday in 2022, which is one of the most important trading periods in the year. Comparing to 2021, same-store sales in the comparable Chinese New Year holiday period in 2022 declined year over year.

We expect that our operations will continue to be impacted by the COVID-19 pandemic, including outbreaks caused by existing or new COVID-19 variants and the actions taken by governmental authorities, such as regional lockdowns, measures restricting travel and large gatherings, and recommendations against dining out. It remains difficult to predict the full impact of the COVID-19 pandemic on the broader economy and how consumer behavior may change, and whether such change is temporary or permanent. Social distancing, telecommunicating and reductions in travel may become the new normal. These conditions could fundamentally impact the way we work and the services we provide, and could have continuing adverse effects on our results of operations, cash flows and financial condition after the pandemic subsides. The extent to which our operations continue to be impacted by the pandemic will depend largely on future developments, which are highly uncertain and cannot be accurately predicted, including resurgences and further spread of existing or new COVID-19 variants, the actions by the government authorities to contain the pandemic or treat its impact, the availability and effectiveness of vaccines, the economic recovery within China and globally, the impact on consumer behavior and other related factors. Our insurance policy does not cover any losses we incur as a result of the pandemic. The COVID-19 pandemic also may have the effect of heightening other risks disclosed in the "Risk Factors" section of this report, such as, but not limited to, those related to supply chain management, labor shortage and cost, cybersecurity threats, as well as consumer perceptions of our brands.

Even if a virus or other illness does not spread significantly, the perceived risk of infection or health risk may affect our business. Our operations could also be disrupted if any of our employees or employees of our business partners were suspected of having a contagious illness or susceptible to becoming infected with a contagious illness, since this could require us or our business partners to screen and/or quarantine some or all of such employees or disinfect our restaurant facilities.

With respect to the avian flu, public concern over an outbreak may cause fear about the consumption of chicken, eggs and other products derived from poultry, which could cause customers to consume less poultry and related products. This would likely result in lower revenues and profits. Avian flu outbreaks could also adversely affect the price and availability of poultry, which could negatively impact our profit margins and revenues.

***The operation of our restaurants is subject to the terms of the master license agreement which, if terminated or limited, would materially adversely affect our business, results of operations and financial condition.***

Under the master license agreement with YUM, we are required to meet a Sales Growth Metric, which requires the average annual Gross Revenue (as defined in the master license agreement) for each of the KFC, Pizza Hut and Taco Bell brands for each rolling five (5) calendar year period throughout the term of the master license agreement ("Measurement Period"), beginning January 1, 2017, to exceed the annual Gross Revenue of the calendar year immediately preceding the corresponding Measurement Period ("Benchmark Year"). To illustrate, the first Measurement Period is January 1, 2017 through December 31, 2021 (corresponding to the first Benchmark Year of January 1, 2016 through December 31, 2016) and the second Measurement Period is January 1, 2018 through December 31, 2022 (corresponding to the second Benchmark Year of January 1, 2017 through December 31, 2017).

The requirement regarding the Sales Growth Metric began at the end of the first Measurement Period on December 31, 2021. Within 60 days after the beginning of each calendar year following December 31, 2021, and during the term of the master license agreement, we are required to provide to YUM a written statement with the calculations of the Sales Growth Metric. If our calculations indicate that any of these restaurant brands failed to meet the Sales Growth Metric (an "SGM Breach"), there is a mechanism under the master license agreement for us to explain and remediate such breach in good faith. YUM has the right to terminate the master license agreement in the event of an SGM Breach. In the event of two consecutive SGM Breaches for KFC, Pizza Hut or Taco Bell, YUM shall be entitled to exercise its right to eliminate or modify the exclusivity of the license granted to us and conduct and further develop the relevant restaurant brand in our licensed territory or license one or more third parties to do so.

The master license agreement may also be terminated upon the occurrence of certain events, such as our insolvency or bankruptcy. We have not experienced any material breach of the master license agreement, and we actively monitor our compliance with the terms of the master license agreement on an on-going basis. Under the master license agreement, we will have the right to cure any breach of the agreement, except for the dissolution, liquidation, insolvency or bankruptcy of the Company or upon the occurrence of an unauthorized transfer or change of control or other breach that YUM determines will not or cannot be cured. Upon the occurrence of a non-curable breach, YUM will have the right to terminate the master license agreement (or our rights to a particular brand) on delivery of written notice. Upon the occurrence of a curable breach, YUM will provide a notice of breach that sets forth a cure period that is reasonably tailored to the applicable breach. If we do not cure the breach, YUM will have the right to terminate the master license agreement (or our rights to a particular brand). The master license agreement also contemplates remedies other than termination that YUM may use as appropriate. These remedies include: actions for injunctive and/or declaratory relief (including specific performance) and/or damages; limitations on our future development rights or suspension of restaurant operations pending a cure; modification or elimination of our territorial exclusivity; and YUM's right to repurchase from us the business operated under an affected brand at fair market value, less YUM's damages. If the master license agreement were terminated, or any of our license rights were limited, our business, results of operations and financial condition would be materially adversely affected.

### *We derive substantially all of our revenue from our operations in China and, as a result, our business is highly exposed to the risks of doing business in China.*

Virtually all of our restaurants are located, and our revenues and profits originate, in China. As a consequence, our financial results are dependent on our results in China, and our business is highly exposed to all of the risks of doing business there. These risks are described further under the section "Risks Related to Doing Business in China."

### *Our success is tied to the success of YUM's brand strength, marketing campaigns and product innovation.*

The KFC, Pizza Hut and Taco Bell trademarks and related intellectual property are owned by YUM and licensed to us in China, excluding Hong Kong, Macau and Taiwan. The value of these marks depends on the enforcement of YUM's trademark and intellectual property rights, as well as the strength of YUM's brands. Due to the nature of licensing and our agreements with YUM, our success is, to a large extent, directly related to the success of the YUM brand strength, including the management, marketing and product innovation success of YUM. Further, if YUM were to reallocate resources away from the KFC, Pizza Hut or Taco Bell brands, these brands and the license rights that have been granted to us could be harmed globally or regionally, which could have a material adverse effect on our results of operations and our competitiveness in China. In addition, strategic decisions made by YUM management related to its brands, marketing and restaurant systems may not be in our best interests and may conflict with our strategic plans.

### *Shortages or interruptions in the availability and delivery of food products and other supplies may increase costs or reduce revenues.*

The products used in the operation of our restaurants are sourced from a wide variety of suppliers inside and outside of China. We are also dependent upon third parties to make frequent deliveries of food products and other supplies that meet our specifications at competitive prices. Shortages or interruptions in the supply of food products and other supplies to our restaurants could adversely affect the availability, quality and cost of items we use and the operations of our restaurants. Such shortages or disruptions could be caused by inclement weather, natural disasters such as floods, drought and hurricanes, increased demand, labor shortages, problems in production or distribution, restrictions on imports or exports, government levies, political instability in the countries in which suppliers and distributors are located, the financial instability of suppliers and distributors, suppliers' or distributors' failure to meet our standards, product quality issues, inflation, other factors relating to the suppliers and distributors and the countries in which they are located, food safety warnings or advisories or the prospect of such pronouncements or other conditions beyond our control. Despite our efforts in developing multiple suppliers for the same items where and when possible, a shortage or interruption in the availability of certain food products or supplies could still increase costs and limit the availability of products critical to restaurant operations, which in turn could lead to restaurant closures and/or a decrease in sales. In addition, failure by a principal supplier or distributor for us and/or our franchisees to meet its service requirements could lead to a disruption of service or supply until a new supplier or distributor is engaged, and any disruption could have an adverse effect on our business.

In addition, we centrally purchase the vast majority of food and paper products, then sell and deliver them to most of our restaurants. We believe this central procurement model allows us to maintain quality control and achieve better prices and terms through volume purchases. However, we may not be able to accurately estimate the demand from franchisees and unconsolidated affiliates, which may result in excessive inventory. We may also not be able to timely collect payments from franchisees and unconsolidated affiliates, which could have a material adverse effect on our business, results of operations and financial condition.

### *The prices of raw materials fluctuate, which may adversely impact our profit margin.*

Our restaurant business depends on reliable sources of large quantities of raw materials such as protein (including poultry, pork, beef and seafood), cheese, oil, flour and vegetables (including potatoes and lettuce). Our raw materials are subject to price volatility caused by any fluctuation in aggregate supply and demand, or other external conditions, such as changes in international trade policies and international barriers to trade, the emergence of a trade war, climate and environmental conditions where weather conditions or natural events or disasters may affect expected harvests of such raw materials, as well as outbreak of viruses and diseases. For example, in 2019, the price of protein, including poultry, increased significantly in China as a result of the African swine flu. We cannot assure you that we will continue to purchase raw materials at reasonable prices, or that our raw materials prices will remain stable in the future. In addition, because we and our franchisees provide competitively priced food, our ability to pass along commodity price increases to our customers is limited. If we are unable to manage the cost of our raw materials or to increase the prices of our products, it may have an adverse impact on our future profit margin.

### *We may not attain our target development goals; aggressive development could cannibalize existing sales; and new restaurants may not be profitable.*

Our growth strategy depends on our ability to build new restaurants in China. We are accelerating our store network expansion to reach our 20,000 store milestone. The successful development of new units depends in large part on our ability to open new restaurants and to operate these restaurants profitably. We cannot guarantee that we, or our franchisees, will be able to achieve our expansion goals or that new restaurants will be operated profitably. Further, there is no assurance that any new restaurant will produce operating results similar to those of our existing restaurants. Other risks which could impact our ability to increase the number of our restaurants include prevailing economic conditions and our or our franchisees' ability to obtain suitable restaurant locations, negotiate acceptable lease or purchase terms for the locations, obtain required permits and approvals in a timely manner, hire and train qualified restaurant crews and meet construction schedules.

In addition, the new restaurants could impact the sales of our existing restaurants nearby. There can be no assurance that sales cannibalization will not occur or become more significant in the future as we increase our presence in existing markets in China.

Our growth strategy includes expanding our ownership and operation of restaurant units through organic growth by developing new restaurants that meet our investment objectives. We may not be able to achieve our growth objectives, and these new restaurants may not be profitable. The opening and success of new restaurants depends on various factors, including:

- our ability to obtain or self-fund adequate development financing;
- competition in current and future markets;
- our degree of penetration in existing markets;
- the identification and availability of suitable and economically viable locations;
- sales and margin levels at existing restaurants;
- the negotiation of acceptable lease or purchase terms for new locations;
- regulatory compliance regarding restaurant opening and operation;
- the ability to meet construction schedules;
- our ability to hire and retain qualified restaurant crews; and
- general economic and business conditions.

### *We are subject to all of the risks associated with leasing real estate, and any adverse developments could harm our business, results of operations and financial condition.*

As a significant number of our restaurants are operating on leased properties, we are exposed to retail rental market conditions. As of year-end 2021, we leased approximately 10,000 properties in China for our Company-owned restaurants. For information regarding our leased properties, please refer to "Properties." Accordingly, we are subject to all of the risks generally associated with leasing real estate, including changes in the investment climate for real estate, demographic trends, trade zone shifts, central business district relocations, and supply or demand for the use of the restaurants, as well as potential liability for environmental contamination.

We generally enter into lease agreements with initial terms of 10 to 20 years. Approximately 8% of our existing lease agreements expire before the end of 2022. Most of our lease agreements contain an early termination clause that permits us to terminate the lease agreement early if the restaurant's unit contribution is negative for a specified period of time. We generally do not have renewal options for our leases and need to negotiate the terms of renewal with the lessor, who may insist on a significant modification to the terms and conditions of the lease agreement.

The rent under the majority of our current restaurant lease agreements is generally payable in one of three ways: (i) fixed rent; (ii) the higher of a fixed base rent or a percentage of the restaurant's annual sales revenue; or (iii) a percentage of the restaurant's annual sales revenue. In addition to increases in rent resulting from fluctuations in annual sales revenue, certain of our lease agreements include provisions specifying fixed increases in rental payments over the respective terms of the lease agreements. While these provisions have been negotiated and are specified in the lease agreement, they will increase our costs of operation and therefore may materially and adversely affect our results of operation and financial condition if we are not able to pass on the increased costs to our customers. Certain of our lease agreements also provide for the payment of a management fee at either a fixed rate or fixed amount per square meter of the relevant leased property.

Where we do not have an option to renew a lease agreement, we must negotiate the terms of renewal with the lessor, who may insist on a significant modification to the terms and conditions of the lease agreement. If a lease agreement is renewed at a rate substantially higher than the existing rate, or if any existing favorable terms granted by the lessor are not extended, we must determine whether it is desirable to renew on such modified terms. If we are unable to renew leases for our restaurant sites on acceptable terms or at all, we will have to close or relocate the relevant restaurants, which would eliminate the sales that those restaurants would have contributed to our revenues during the period of closure, and could subject us to construction, renovation and other costs and risks. In addition, the revenue and any profit generated after relocation may be less than the revenue and profit previously generated before such relocation. As a result, any inability to obtain leases for desirable restaurant locations or renew existing leases on commercially reasonable terms could have a material adverse effect on our business, results of operations and financial condition.

### *We may not be able to obtain desirable restaurant locations on commercially reasonable terms.*

We compete with other retailers and restaurants for suitable locations, and the market for retail premises is very competitive in China. Our competitors may negotiate more favorable lease terms than our lease terms, and some landlords and developers may offer priority or grant exclusivity to some of our competitors for desirable locations for various reasons beyond our control. We cannot provide assurance that we will be able to enter into new lease agreements for prime locations on commercially reasonable terms, if at all. If we cannot obtain desirable restaurant locations on commercially reasonable terms, our business, results of operations and ability to implement our growth strategy may be materially and adversely affected.

### *Labor shortages or increases in labor costs could slow our growth and harm our business and results of operations.*

Restaurant operations are highly service-oriented, and our success depends in part upon our ability to attract, retain and motivate a sufficient number of qualified employees, including restaurant managers, and other crew members. The market for qualified employees in our industry is very competitive. Any future inability to recruit and retain qualified individuals may delay the planned openings of new restaurants and could adversely impact our existing restaurants. Any such delays, material increases in employee turnover rate in existing restaurants or widespread employee dissatisfaction could have a material adverse effect on our business and results of operations. Competition for qualified employees could also compel us to pay higher wages to attract or retain key crew members, which could result in higher labor costs.

The Chinese Labor Contract Law that became effective on January 1, 2008 and amended on December 28, 2012 formalizes workers' rights concerning overtime hours, pensions, layoffs, employment contracts and the role of trade unions, and provides for specific standards and procedures for employees' protection. Moreover, minimum wage requirements in China have increased and could continue to increase our labor costs in the future. The salary level of employees in the restaurant industry in China has been increasing in the past several years. We may not be able to increase our product prices enough to pass these increased labor costs on to our customers, in which case our business and results of operations would be materially and adversely affected.

In addition, our delivery business requires a large number of riders, which are either contracted with us or the aggregators' platforms to deliver orders exclusively for KFC or Pizza Hut stores. A shortage of riders could disrupt our delivery business and result in higher rider costs. Furthermore, an increase in the rates charged by the third-party rider companies could also result in higher delivery costs. Recent guidelines issued by regulatory authorities increased protection on rider safety and welfare, and the cost to comply with such requirements could be passed on to us.

### *Our success depends substantially on our corporate reputation and on the value and perception of our brands.*

One of our primary assets is the exclusive right to use the KFC, Pizza Hut and Taco Bell trademarks in restaurants in China. Our success depends in large part upon our ability and our franchisees' ability to maintain and enhance the value of these brands and our customers' loyalty to these brands in China. Brand value is based in part on consumer perceptions on a variety of subjective qualities. Business incidents, whether isolated or recurring, and whether originating from us, our franchisees, competitors, suppliers and distributors or YUM and its other licensees or franchisees, competitors, suppliers and distributors outside China can significantly reduce brand value and consumer trust, particularly if the incidents receive considerable publicity or result in litigation. For example, our brands could be damaged by claims or perceptions about the quality or safety of our products or the quality of our suppliers and distributors, regardless of whether such claims or perceptions are true. Any such incidents (even if resulting from the actions of a competitor) could cause a decline directly or indirectly in consumer confidence in, or the perception of, our brands and/or our products and reduce consumer demand for our products, which would likely result in lower revenues and profits. Additionally, our corporate reputation could suffer from a real or perceived failure of corporate governance or misconduct by a company officer, employee or representative.

### *The occurrence of security breaches and cyber-attacks could negatively impact our business.*

Technology systems, including our mobile or online platforms, mobile payment and ordering systems, loyalty programs and various other online processes and functions, are critical to our business and operations. For example, as of year-end 2021, KFC had over 330 million loyalty program members and Pizza Hut had approximately 110 million. KFC member sales represented approximately 62% of KFC's system sales and Pizza Hut member sales represented approximately

55% of Pizza Hut's system sales in 2021. Digital orders accounted for 86% of KFC and Pizza Hut Company sales in 2021. As we continue to expand our digital initiatives, the risks relating to security breaches and cyber-attacks against our systems, both internal and those we have outsourced, may increase.

Because of our brand recognition in China, we are consistently subject to attempts to compromise our security and information systems, including denial of service attacks, viruses, malicious software or ransomware, and exploitations of system flaws or weaknesses. Error or malfeasance or other irregularities may also result in the failure of our or our third-party service providers' cybersecurity measures and may give rise to a cyber incident. The techniques used to conduct security breaches and cyber-attacks, as well as the sources and targets of these attacks, change frequently and may not be recognized until launched against us or our third-party service providers. We or our third-party service providers may not have the resources or technical sophistication to anticipate or prevent rapidly evolving types of cyber-attacks. We have in the past and are likely again in the future to be subject to these types of attacks, although to date no attack has resulted in any material damages or remediation costs. The primary risks that could directly result from the occurrence of a cyber incident include operational interruption, misappropriation of company information or private data, deletion or modification of user information, damage to our relationships with customers, franchisees and employees, and damage to our reputation. If we or our third-party service providers are unable to avert security breaches and cyber-attacks, we could incur significantly higher costs, including remediation costs to repair damage caused by the breach (including business incentives to make amends with affected customers and franchisees), costs to deploy additional personnel and network protection technologies, train employees and engage third-party experts and consultants, as well as litigation costs resulting from the incident. These costs, which could be material, could adversely impact our results of operations in the period in which they are incurred and may not meaningfully limit the success of future attempts to breach our information technology systems.

***Unauthorized access to, or improper use, disclosure, theft or destruction of, our customer or employee personal, financial or other data or our proprietary or confidential information that is stored in our information systems or by third parties on our behalf could result in substantial costs, expose us to litigation and damage our reputation.***

We have been using, and plan to continue to use, digital technologies to improve the customer experience and drive sales growth. We, directly or indirectly, receive and maintain certain personal, financial and other information about our customers in various information systems that we maintain and in those maintained by third-party service providers when, for example, receiving orders through mobile or online platforms, accepting digital payments, operating loyalty programs and conducting digital marketing programs. Our information technology systems, such as those we use for administrative functions, including human resources, payroll, accounting and internal and external communications, can contain personal, financial or other information of our over 450,000 employees. We also maintain important proprietary and other confidential information related to our operations and identifiable information about our franchisees. As a result, we face risks inherent in handling and protecting large volumes of information.

If our security and information systems or the security and information systems of third-party service providers are compromised for any reason, including as a result of data corruption or loss, security breach, cyber-attack or other external or internal methods, or if our employees, franchisees or service providers fail to comply with laws, regulations and practice standards, and this information is obtained by unauthorized persons, used or disclosed inappropriately or destroyed, it could subject us to litigation and government enforcement actions, cause us to incur substantial costs, liabilities and penalties and/or result in a loss of customer confidence, any and all of which could adversely affect our business, reputation, ability to attract new customers, results of operations and financial condition.

In addition, the use and handling of this information is regulated by evolving and increasingly demanding laws and regulations. The Chinese government has focused increasingly on regulation in the areas of information security and protection, including by implementing the PRC Cybersecurity Law effective June 1, 2017, which imposes tightened requirements on data privacy and cybersecurity practices. There are uncertainties with respect to the application of the cybersecurity law in certain circumstances. In addition, the PRC Data Security Law, which took effect on September 1, 2021, imposes data security and privacy obligations on entities and individuals carrying out data activities (including activities outside of the PRC), requires a national security review of data activities that may affect national security, and imposes restrictions on data transmissions. Furthermore, the PRC Personal Information Protection Law, which took effect on November 1, 2021, sets out the regulatory framework for handling and protection of personal information and transmission of personal information, and many specific requirements of the law remain to be clarified by the Cyberspace Administration of China and other regulatory authorities. Compliance with these laws, as well as additional regulations and standards regarding data privacy, data collection and information security that PRC regulatory bodies may enact in the future, may result in additional expenses to us as we may be required to upgrade our current information technology systems. Furthermore, as a result of legislative and regulatory rules, we may be required to notify the owners of information of any breach, theft or loss of their information, which could harm our reputation, as well as subject us to litigation or actions by regulatory bodies and adversely affect our financial results.

We expect that cybersecurity, data privacy and security will continue to be a focus of regulators, as well as attract continued or greater public scrutiny and attention going forward, which could increase our compliance costs and subject us to heightened risks and challenges associated with information security and protection. If we are unable to manage these risks, we could become subject to penalties, including fines, suspension of business, shutdown of websites and revocation of required licenses, and our reputation and results of operations could be materially and adversely affected.

### *Our operations are highly dependent upon our information technology systems and any failures or interruptions of service or security breaches in our systems may interrupt our operations and harm our business.*

Our operations are dependent upon the successful and uninterrupted functioning of our computer and information technology systems. We rely heavily on information technology systems across our operations, including those we use for finance and accounting functions, supply chain management, point-of-sale processing, online and mobile platforms, mobile payment processing, loyalty programs and various other processes and functions, and many of these systems are interdependent on one another for their functionality. Additionally, the success of several of our initiatives to drive growth, including our priority to expand digital engagement with our customers, is highly dependent on the reliability, availability, integrity, scalability and capacity of our information technology systems. We also rely on third-party providers and platforms for some of these information technology systems and support.

Our operational safeguards may not be effective in preventing the failure of these systems to operate effectively and be continuously available to run our business. Such failures may be caused by various factors, including fire, natural disaster, power loss, telecommunications failure, problems with transitioning to upgraded or replacement systems, physical break-ins, programming errors, flaws in third-party software or services, disruptions or service failures of technology infrastructure facilities, such as storage servers, provided by third parties, errors or malfeasance by our employees or third-party service providers or breaches in the security of these systems or platforms, including unauthorized entry and computer viruses. We cannot assure you that we will resolve these system failures and restore our systems and operations in an effective and timely manner. Such system failures and any delayed restore process could result in:

- additional computer and information security and systems development costs;
- diversion of technical and other resources;
- loss of customers and sales;
- loss or theft of customer, employee or other data;
- negative publicity;
- harm to our business and reputation;
- negative impact on the availability and the efficiency of our restaurant operations; and
- exposure to litigation claims, government investigations and enforcement actions, fraud losses or other liabilities.

We will continue to upgrade and improve our information technology systems to support our business growth. However, we cannot assure you that we will be successful in executing these system upgrades and improvement strategies and the foregoing risks could intensify while we execute those upgrades and improvements. In particular, our systems may experience interruptions during upgrades, and the new technologies or infrastructures may not be fully integrated with the existing systems on a timely basis, or at all. If we are unsuccessful in upgrading and improving our systems, our ability to increase comparable store sales, improve operations, implement cost controls and grow our business may be constrained.

***Our business depends on the performance of, and our long-term relationships with, third-party mobile payment processors, internet infrastructure operators, internet service providers and delivery aggregators.***

Digital payments, including mobile payments, accounted for approximately 98% of Yum China Company sales in 2021. The ability to accept mobile payments is critical to our business. We accept payments through third-party mobile payment processors, such as WeChat Pay, Alipay and Union Pay. We also developed and launched YUMC Pay in the first quarter of 2019, in partnership with Union Pay, which offers a convenient payment option for users within a single App. If we fail to extend or renew the agreements with these mobile payment processors on acceptable terms, if these mobile payment processors are unwilling or unable to provide us with payment processing service or impose onerous requirements on us in order to access their services, or if they increase the fees they charge us for these services, our business and results of operations could be harmed.

Our business depends on the performance and reliability of the internet infrastructure in China. Almost all access to the internet in China is maintained through state-owned telecommunications operators under administrative control, and we obtain access to end-user networks operated by such telecommunications operators and internet service providers to give customers access to our websites. The satisfactory performance, availability and reliability of our websites, online platforms and Apps depends on telecommunications operators and other third-party providers for communications and storage capacity, including bandwidth and server storage, among other things. If we are unable to enter into and renew agreements with these providers on acceptable terms, if any of our existing agreements with such providers are terminated as a result of our breach or otherwise, or if these providers experience problems with the functionality and effectiveness of their systems or platforms, our ability to provide our services to our customers could be adversely affected. The failure of telecommunications operators to provide us with the requisite bandwidth could also interfere with the speed and availability of our websites and Apps. Frequent interruptions could frustrate customers and discourage them from attempting to place orders, which could cause us to lose customers and harm our operating results.

Furthermore, to the extent we rely on the systems of third parties in areas such as mobile payment processing, online and mobile delivery ordering, telecommunications and wireless networks, any defects, failures and interruptions in their systems could result in similar adverse effects on our business. Sustained or repeated system defects, failures or interruptions could materially impact our operations and results of operations.

Additionally, we have no control over the costs of the services provided by the telecommunications operators. If the prices that we pay for telecommunications and internet services rise significantly, our profit margins could be adversely affected. In addition, if internet access fees or other charges to internet users increase, our user traffic may decrease, which in turn may significantly decrease our revenues.

Our delivery business depends on the performance of, and our long-term relationships with, third-party delivery aggregators. We allow our products to be listed on and ordered through their mobile or online platforms. If we fail to extend or renew the agreements with these aggregators on acceptable terms, or at all, our business and results of operations may be materially and adversely affected. In addition, any increase in the commission rate charged by the aggregators could negatively impact our operating results.

### *Our restaurants offer delivery services. Any failure to provide timely and reliable delivery services by us may materially and adversely affect our business and reputation.*

As of year-end 2021, over 8,900 KFC and Pizza Hut restaurants offer delivery services. Delivery contributed to approximately 32% of KFC and Pizza Hut Company sales for 2021. Customers may order delivery service through KFC and Pizza Hut's websites and Apps. KFC and Pizza Hut have also partnered with third-party delivery aggregators, allowing our products to be listed on and ordered through their mobile or online platforms.

Interruptions or failures in our delivery services could prevent the timely or successful delivery of our products. These interruptions may be due to unforeseen events that are beyond our control or the control of third-party aggregators and outsourced riders, such as inclement weather, natural disasters, transportation disruptions or labor unrest. The occurrence of food safety or product quality issues may also result in interruptions or failures in our delivery service. If our products are not delivered on time and in proper condition, customers may refuse to accept our products and have less confidence in our services, in which case our business and reputation may be adversely affected.

### *Our growth strategy with respect to Lavazza and COFFii & JOY may not be successful.*

We are committed to making coffee a meaningful part of our business. As part of our strategy to tap into the growing China coffee market, we started to develop COFFii & JOY as our standalone specialty coffee concept in 2018. As of year-end 2021, we had 36 COFFii & JOY coffee stores in eight cities in China using different store formats. In April 2020, we established a joint venture with Lavazza Group to explore and develop the Lavazza coffee shop concept in China. In September 2021, the Company and Lavazza Group entered into agreements to accelerate the expansion of Lavazza coffee shops to offer a premium and authentic Italian coffee experience in China. As of December 31, 2021, there were 58 Lavazza stores in China. We are targeting to open 1,000 Lavazza stores by 2025, which may require significant capital and management attention.

The success of Lavazza and COFFii & JOY depends in large part on our ability to secure optimal locations, introduce new and unique store formats, and operate these stores profitably. The effectiveness of our supply chain management to assure reliable coffee supply at competitive prices is one of the key factors to the success of Lavazza and COFFii & JOY.

There is no assurance that our growth strategy with respect to Lavazza and COFFii & JOY will be successful or generate expected returns in the near term or at all. If we fail to execute this growth strategy successfully, our business, results of operations and financial condition may be materially and adversely affected.

### *The anticipated benefits of our acquisitions may not be realized in a timely manner or at all.*

In May 2017, we acquired a controlling interest in Daojia with the expectation that the acquisition will further enhance our digital and delivery capabilities, and accelerate growth by building know-how and expertise in the expanding delivery market. In 2018 and 2019, due to declining sales as a result of intensified competition among delivery aggregators, we recorded impairment charges of $23 million and wrote down the Daojia reporting unit goodwill and intangible assets to zero. In April 2020, we completed the acquisition of a 93.3% interest in Huang Ji Huang, a leading Chinese-style casual dining franchise business, for cash consideration of $185 million. With this acquisition, we aim to gain a stronger foothold and enhanced know-how in the Chinese dining space and create synergies. Achieving those anticipated benefits is subject to a number of uncertainties. The operation of the acquired businesses could also involve further unanticipated costs and divert management's attention away from day-to-day business concerns. We cannot assure you that we will be able to achieve the anticipated benefits of any business acquisitions. Additional information about the Company's goodwill and intangible assets acquired from our acquisitions is included in Note 9 to the Consolidated Financial Statements in Part II. We evaluate indefinite-lived intangible assets and goodwill for impairment on an annual basis or more often if an event occurs or circumstances change that indicates impairment might exist.

### *Our new retail and e-commerce businesses may expose us to new challenges and risks and may adversely affect our business, results of operations and financial condition.*

We operate a mobile e-commerce platform, V-Gold Mall, to sell products, including electronics, home and kitchen accessories and other general merchandise directly to customers. As part of our strategy to drive growth from off-premise occasions, we also launched new retail products, such as fried rice, steak, pasta and other ready meals, as well as coffee capsules, to capture at-home consumption demand. We expect to continue to develop our new retail and e-commerce businesses.

Our new retail and e-commerce businesses expose us to new challenges and risks associated with, for example, anticipating customer demand and preferences, managing inventory and handling more complex supply, product return and delivery service issues. We are relatively new to these businesses and our lack of experience may make it more difficult for us to keep pace with evolving customer demands and preferences. We may misjudge customer demand, resulting in inventory buildup and possible inventory write-downs and write-offs. We may also experience higher return rates on these products, receive more customer complaints about them and face costly product liability claims as a result of selling them, which would harm our brands and reputation as well as our financial performance. In addition, we will have to invest in, maintain and upgrade the necessary network infrastructure, system infrastructure and security to manage and process customer orders, and failures to process orders timely and accurately may also result in complaints and expose us to liability. Furthermore, we rely on third-party delivery companies to deliver the e-commerce products and a portion of the new retail products. Risks related to delivery services are described in further detail above under "— Our restaurants offer delivery services. Any failure to provide timely and reliable delivery services by us may materially and adversely affect our business and reputation." If we do not successfully address new challenges specific to the new retail and e-commerce businesses and compete effectively, our business, results of operations and financial condition may be materially and adversely affected.

### *Our inability or failure to recognize, respond to and effectively manage the impact of social media could materially adversely impact our business and results of operations.*

As a customer-facing industry, the Company is heavily reliant on its brand, the perception of which may be significantly impacted by social media. In recent years, there has been a marked increase in the use of social media platforms, including weblogs (blogs), mini-blogs, WeChat and other chat platforms, social media websites, and other forms of internet-based communications, which allow individual access to a broad audience of consumers and other interested persons. Many social media platforms immediately publish the content their subscribers and participants' post, often without filters or checks on accuracy of the content posted. Information posted on such platforms at any time may be adverse to our interests and/or may be inaccurate. The online dissemination of negative comments about our brands and business, including inaccurate or irresponsible information, could harm our business, reputation, prospects, results of operations and financial condition. The damage may be immediate and intense, without affording us an opportunity for redress or correction, and we may not be able to recover from any negative publicity in a timely manner or at all. If we fail to recognize, respond to and effectively manage the accelerated impact of social media, our reputation, business and results of operation could be materially and adversely affected.

Other risks associated with the use of social media include improper disclosure of proprietary information, exposure of personally identifiable information, fraud, hoaxes or malicious exposure of false information. The inappropriate use of social media by our customers or employees could increase our costs, lead to litigation or result in negative publicity that could damage our reputation and adversely affect our results of operations.

### *Failure to comply with anti-bribery or anti-corruption laws could adversely affect our business and results of operations.*

The U.S. Foreign Corrupt Practices Act and similar Chinese laws and other similar applicable laws prohibiting bribery of government officials and other corrupt practices are the subject of increasing emphasis and enforcement around the world. Although we continue to implement policies and procedures designed to duly comply with these laws, there can be no assurance that our employees, contractors, agents or other third parties will not take actions in violation of our policies or applicable law, particularly as we expand our operations through organic growth and acquisitions. Any such violations or suspected violations could subject us to civil or criminal penalties, including substantial fines and significant investigation costs, and could also materially damage our brands, as well as our reputation and prospects, business and results of operations. Publicity relating to any noncompliance or alleged noncompliance could also harm our reputation and adversely affect our business and results of operations.

### *As a U.S. company with operations concentrated in China, we are subject to both U.S. federal income tax and Chinese enterprise income tax, which could result in relatively higher taxes compared to companies operating primarily in the U.S.*

Yum China is a Delaware corporation that indirectly owns the subsidiaries that conduct our business in China and is subject to both U.S. federal income tax and Chinese enterprise income tax. While U.S. tax law generally exempts all of the foreign-source dividends paid to the U.S. parent company, with operations primarily in China, we continue to be subject to the Chinese enterprise income tax at a rate of 25% and an additional 10% withholding tax on any earnings repatriated outside of China levied by the Chinese tax authorities, subject to any reduction or exemption set forth in relevant tax treaties or tax arrangements. This may put Yum China at a relative disadvantage compared to companies operating primarily in the U.S., which are currently subject to a U.S. corporate income tax rate of 21%.

In addition, U.S. tax law provides anti-deferral, anti-base erosion and other provisions that may subject the U.S. parent company to additional U.S. taxes under certain circumstances. If we are assessed with these taxes, it could cause our effective tax rate to increase and affect the amount of any distributions available to our stockholders.

### *Tax matters, including changes in tax rates, disagreements with tax authorities and imposition of new taxes could impact our results of operations and financial condition.*

We are subject to income taxes as well as non-income based taxes, such as VAT, customs duty, property tax, stamp duty, environmental protection tax, withholding taxes and obligations and local surcharges, in China and income tax and other taxes in the U.S. and other jurisdictions. We are also subject to reviews, examinations and audits by Chinese tax authorities, the IRS and other tax authorities with respect to income and non-income based taxes, including transfer pricing. Our operations in respective jurisdictions generally remain subject to examination for tax years as far back as 2006, some of which years are currently under audit by local tax authorities. If Chinese tax authorities, the IRS or other tax authorities disagree with our tax positions, we could face additional tax liabilities, including interest and penalties. Payment of such additional amounts upon final settlement or adjudication of any disputes could have a material adverse impact on our results of operations and financial condition.

In addition, we are directly and indirectly affected by new tax legislation and regulation and the interpretation of tax laws and regulations worldwide. For example, the U.S. Tax Act implemented broad reforms to the U.S. corporate income tax system and significantly altered how U.S. multinational corporations are taxed on foreign earnings. In addition, the U.S. Presidential Administration has indicated support for proposals to increase the U.S. corporate income tax rate, which were passed by the House of Representatives in the November 2021 Build Back Better Act but stalled in the Senate. Any increases in tax rates or changes in tax laws or the interpretations thereof could have a material adverse impact on our results of operations and financial condition.

Moreover, the tax regime in China is rapidly evolving and there can be significant uncertainty for taxpayers in China as Chinese tax laws may change significantly or be subject to uncertain interpretations. Since 2012, the Chinese government launched a VAT pilot reform to replace BT to make reform to its retail tax structure by ending the co-existence of BT and VAT where BT would be gradually phased out and replaced by VAT. The retail tax structure reform is intended to be a progressive and positive shift to more closely align with a more modern service-based economy. Effective May 1, 2016, the retail tax structure reform has been rolled out to cover all business sectors nationwide where the BT has been completely replaced by VAT. The interpretation and application of the new VAT regime are not settled at some local governmental levels. In addition, the timetable for enacting the prevailing VAT regulations into national VAT law, including ultimate enacted VAT rates, is not clear. Changes in legislation, regulation or interpretation of existing laws and regulations in the U.S., China, and other jurisdictions where we are subject to taxation could increase our taxes and have an adverse effect on our results of operations and financial condition.

### *Our results of operations may be adversely impacted by changes in consumer discretionary spending and general economic conditions.*

Purchases at our restaurants are discretionary for consumers and, therefore, our results of operations are susceptible to economic slowdowns and recessions. Our results of operations are dependent upon discretionary spending by consumers, which may be affected by general economic conditions in China. Some of the factors that impact discretionary consumer spending include unemployment rates, fluctuations in the level of disposable income, the price of gasoline, stock market performance and changes in the level of consumer confidence. These and other macroeconomic factors could have an adverse effect on our sales, profitability or development plans, which could harm our results of operations and financial condition.

### *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. We cannot assure you that we will continue to develop new products and maintain an attractive menu to suit changing customer tastes, nutritional trends, dine-in or at-home consumption patterns and general customer demands in China. Our failure to anticipate, identify, interpret and react to these changes could lead to reduced guest traffic and demand for our restaurants. Even if we do correctly anticipate, identify, interpret and react to these changes, there can be no assurance that our restaurants are able to compete successfully with other restaurant outlets in new and existing markets. As a result, our business could be adversely affected. We also face growing competition as a result of convergence in grocery, convenience, deli and restaurant services, including the offering by the grocery industry of convenient meals, including pizzas and entrees with side dishes. Competition from food delivery aggregators, other food delivery services and shared kitchens in China has also increased in recent years, all of which offer a wide variety of cuisine types across different brands, particularly in urbanized areas. Increased competition could have an adverse effect on our sales, profitability or development plans, which could harm our results of operations and financial condition.

In addition, increased awareness about nutrition and healthy lifestyles may cause consumers to demand more healthy foods. If we are unable to respond to such changes in consumer taste and preferences in a timely manner or at all, or if our competitors are able to address these concerns more effectively, our business, financial condition and results of operations may be materially and adversely affected.

Any inability to successfully compete with the other restaurants, food delivery aggregators, other food delivery services and shared kitchens in our markets may prevent us from increasing or sustaining our revenues and profitability and could have a material adverse effect on our business, results of operations, financial condition and/or cash flows. We may also need to modify or refine elements of our restaurant system in order to compete with popular new restaurant styles or concepts, including delivery aggregators, that develop from time to time. There can be no assurance that we will be successful in implementing any such modifications or that such modifications will not reduce our profitability.

### *We require various approvals, licenses and permits to operate our business and the loss of or failure to obtain or renew any or all of these approvals, licenses and permits could adversely affect our business and results of operations.*

In accordance with the laws and regulations of China, we are required to maintain various approvals, licenses, permits, registrations and filings in order to operate our restaurant business. Each of our restaurants in China is required to obtain (1) the relevant food business license; (2) the environmental protection assessment and inspection registration or approval; and (3) the fire safety inspection acceptance approval or other alternatives. Some of our restaurants which sell alcoholic beverages are required to make further registrations or obtain additional approvals. These licenses and registrations are achieved upon satisfactory compliance with, among other things, the applicable food safety, hygiene, environmental protection, fire safety and alcohol laws and regulations. Most of these licenses are subject to periodic examinations or verifications by relevant authorities and are valid only for a fixed period of time and subject to renewal and accreditation. We did not obtain these licenses or approvals for a limited number of our restaurants in a timely manner in the past and there is no assurance that we or our franchisees will be able to obtain or maintain any of these licenses in the future.

### *We may not be able to adequately protect the intellectual property we own or have the right to use, which could harm the value of our brands and adversely affect our business and operations.*

We believe that our brands are essential to our success and our competitive position. The fact that our trademarks are duly registered may not be adequate to protect these intellectual property rights. In addition, third parties may infringe upon the intellectual property rights we own or have the right to use or misappropriate the proprietary knowledge we use in our business, primarily our proprietary recipes, which could have a material adverse effect on our business, results of operations or financial condition. The laws of China may not offer the same protection for intellectual property rights as the U.S. and other jurisdictions with more robust intellectual property laws.

We are required under the master license agreement with YUM to police, protect and enforce the trademarks and other intellectual property rights used by us, and to protect trade secrets. Such actions to police, protect or enforce could result in substantial costs and diversion of resources, which could negatively affect our sales, profitability and prospects. Furthermore, the application of laws governing intellectual property rights in China is uncertain and evolving, and could involve substantial risks to us. Even if actions to police, protect or enforce are resolved in our favor, we may not be able to successfully enforce the judgment and remedies awarded by the court and such remedies may not be adequate to compensate us for our actual or anticipated losses.

In addition, we may face claims of infringement that could interfere with the use of the proprietary know-how, concepts, recipes or trade secrets we use in our business. Defending against such claims may be costly and, if we are unsuccessful, we may be prohibited from continuing to use such proprietary information in the future or be forced to pay damages, royalties or other fees for using such proprietary information, any of which could negatively affect our sales, profitability and prospects.

### *Our licensor may not be able to adequately protect its intellectual property, which could harm the value of the KFC, Pizza Hut and Taco Bell brands and branded products and adversely affect our business, results of operations and financial condition.*

The success of our business depends in large part on our continued ability to use the trademarks, service marks, recipes and other components of the KFC, Pizza Hut and Taco Bell branded systems that we license from YUM pursuant to the master license agreement we entered into in connection with the separation.

We are not aware of any assertions that the trademarks, menu offerings or other intellectual property rights we license from YUM infringe upon the proprietary rights of third parties, but third parties may claim infringement by us or YUM in the future. Any such claim, whether or not it has merit, could be time consuming, result in costly litigation, cause delays in introducing new menu items in the future or require us to enter into additional royalty or licensing agreements with third parties. As a result, any such claims could have a material adverse effect on our business, results of operations and financial condition.

### *Our results of operations may fluctuate due to seasonality and certain major events in China.*

Our sales are subject to seasonality. For example, we typically generate higher sales during Chinese festivities, holiday seasons as well as summer months, but relatively lower sales and lower operating profit during the second and fourth quarters. As a result of these fluctuations, softer sales during a period in which we have historically experienced higher sales (such as the disruption in operations from the COVID-19 outbreak) would have a disproportionately negative effect on our full-year results, and comparisons of sales and results of operations within a financial year may not be able to be relied on as indicators of our future performance. Any seasonal fluctuations reported in the future may differ from the expectations of our investors.

### *We may be unable to detect, deter and prevent all instances of fraud or other misconduct committed by our employees, customers or other third parties.*

As we operate in the restaurant industry, we usually receive and handle relatively large amounts of cash in our daily operations. Instances of fraud, theft or other misconduct with respect to cash can be difficult to detect, deter and prevent, and could subject us to financial losses and harm our reputation.

We may be unable to prevent, detect or deter all such instances of misconduct. Any such misconduct committed against our interests, which may include past acts that have gone undetected or future acts, may have a material adverse effect on our business and results of operations.

### *Our success depends on the continuing efforts of our key management and experienced and capable personnel as well as our ability to recruit new talent.*

Our future success is significantly dependent upon the continued service of our key management as well as experienced and capable personnel generally. If we lose the services of any member of key management, we may not be able to locate suitable or qualified replacements, and may incur additional expenses to recruit and train new staff, which could severely disrupt our business and growth. If any of our key management joins a competitor or forms a competing business, we may lose customers, know-how and key professionals and staff members. Our rapid growth also requires us to hire, train, and retain a wide range of talent who can adapt to a dynamic, competitive and challenging business environment and are capable of helping us conduct effective marketing and management. We will need to continue to attract, train and retain talent at all levels as we expand our business and operations. We may need to offer attractive compensation and other benefits packages, including share-based compensation, to attract and retain them. We also need to provide our employees with sufficient training to help them to realize their career development and grow with us. Any failure to attract, train, retain or motivate key management and experienced and capable personnel could severely disrupt our business and growth.

### *From time to time we may evaluate and potentially consummate strategic investments or acquisitions, which may be unsuccessful and adversely affect our operation and financial results.*

To complement our business and strengthen our market-leading position, we may form strategic alliances or make strategic investments and acquisitions from time to time. Some of the risks and uncertainties that could cause actual results to differ materially include, but are not limited to, the fact that the integration of the target company may require significant time, attention and resources, potentially diverting management's attention from the conduct of our business, and the expected synergies from the acquisition may not be realized. We may experience difficulties in integrating our operations with new investments or acquired businesses, implementing our strategies or achieving expected levels of net revenues, profitability, productivity or other benefits. Therefore, we cannot assure you that our investments or acquisitions will benefit our business strategy, generate sufficient net revenues to offset the associated investment or acquisition costs, or otherwise result in the intended benefits.

### *Our investment in technology and innovation may not generate the expected level of returns.*

We have invested and intend to continue to invest significantly in technology systems and innovation to enhance digitalization and the guest experience and improve the efficiency of our operations. We cannot assure you that our investments in technology and innovation will generate sufficient returns or have the expected effects on our business operations, if at all. If our technology and innovation investments do not meet expectations for the above or other reasons, our prospects and share price may be materially and adversely affected.

### *Fair value changes for our investment in equity securities and lower yields of our short-term investments may adversely affect our financial condition and results of operations.*

We may invest in equity securities and short-term investments, such as time deposits, from time to time. In September 2018, we invested in the equity securities of Meituan Dianping, the fair value of which is determined based on the closing market price for the shares at the end of each reporting period, with subsequent fair value changes recorded in our consolidated statements of income. We recorded a related loss of $38 million and a related gain of $104 million for 2021 and 2020, respectively. Our short-term investments as of December 31, 2021 and December 31, 2020 amounted to $2,860 million and $3,105 million, respectively. We cannot guarantee that our investment in equity securities will not experience fair value losses, which may adversely affect our period-to-period earnings, financial condition and results of operations. In addition, our short-term investments may earn yields lower than anticipated, and any failure to realize the benefits we expected from these investments may adversely affect our financial results.

### *Our operating results may be adversely affected by our investment in unconsolidated affiliates.*

We apply the equity method to account for the investments in unconsolidated affiliates over which we have significant influence but do not control. Our share of the earnings or losses and share of changes in other comprehensive income or losses of these unconsolidated affiliates are included in net income in our consolidated statements of income and other comprehensive income or losses, respectively. Even if there is no cash flow from unconsolidated affiliates until dividends are received, the performance of unconsolidated affiliates may affect our results of operations through our equity method accounting. In addition, we evaluate our investments in unconsolidated affiliates for impairment whenever events or circumstances indicate that a decrease in the fair value of an investment has occurred which is other than temporary. In addition, when we acquire additional equity interest in the unconsolidated affiliates to obtain control, it may result in gain or loss from re-measurement of our previously held equity interest and thus have a significant impact on our operating results. As a result of the acquisition of Hangzhou KFC, a former unconsolidated affiliate, in the fourth quarter of 2021, we recognized a gain of $618 million from the re-measurement of our previously held 47% equity interest at fair value.

## Risks Related to Doing Business in China

### *Changes in Chinese political policies and economic and social policies or conditions may materially and adversely affect our business, results of operations and financial condition and may result in our inability to sustain our growth and expansion strategies.*

Substantially all of our assets and business operations are located in China. Accordingly, our business, results of operations, financial condition and prospects may be influenced to a significant degree by political, economic and social conditions in China generally, by continued economic growth in China as a whole, and by geopolitical stability in the region. For example, our results of operations in the third quarter of 2016 were adversely impacted by an international court ruling in July 2016 regarding claims to sovereignty over the South China Sea, which triggered a series of regional protests and boycotts in China, intensified by social media, against a few international companies with well-known western brands.

The Chinese economy, markets and levels of consumer spending are influenced by many factors beyond our control, including current and future economic conditions, political uncertainty, unemployment rates, inflation, fluctuations in the level of disposable income, taxation, foreign exchange control, and changes in interest and currency exchange rates. The Chinese economy differs from the economies of most developed countries in many respects, including the level of government involvement, level of development, growth rate, foreign exchange control and fiscal measures and allocation of resources. Although the Chinese government has implemented measures since the late 1970s emphasizing the utilization of market forces for economic reform, the restructuring of state assets and state-owned enterprises, and the establishment of improved corporate governance in business enterprises, a significant portion of productive assets in China is still owned or controlled by the Chinese government. The Chinese government also exercises significant control or influence over Chinese economic growth through allocating resources, controlling payment of foreign currency-denominated obligations, setting monetary and fiscal policies, regulating financial services and institutions and providing preferential treatment to particular industries or companies.

While the Chinese economy has experienced significant growth in recent decades, growth has been uneven, both geographically and among various sectors of the economy. The Chinese government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall Chinese economy but may also have a negative effect on us. Our results of operations and financial condition could be materially and adversely affected by government control over capital investments or changes in tax regulations that are applicable to us. In addition, the Chinese government has implemented certain measures, including interest rate increases, to control the pace of economic growth. These measures may cause decreased economic activity in China. Since 2012, Chinese economic growth has slowed and any prolonged slowdown in the Chinese economy may reduce the demand for our products and adversely affect our business, results of operations and financial condition. Restaurant dining, and specifically casual dining, is discretionary for customers and tends to be higher during periods in which favorable economic conditions prevail. Customers' tendency to become more cost-conscious as a result of an economic slowdown or decreases in disposable income may reduce our customer traffic or average revenue per customer, which may adversely affect our revenues.

### *Uncertainties with respect to the interpretation and enforcement of Chinese laws, rules and regulations could have a material adverse effect on us.*

Substantially all of our operations are conducted in China, and are governed by Chinese laws, rules and regulations. Our subsidiaries are subject to laws, rules and regulations applicable to foreign investment in China. The Chinese legal system is a civil law system based on written statutes. Unlike common law systems, it is a system in which legal cases may be cited for reference but have limited value as precedents. In the late 1970s, the Chinese government began to promulgate a comprehensive system of laws and regulations governing economic matters in general. The overall effect of legislation over the past four decades has significantly increased the protections afforded to various forms of foreign or private-sector investment in China. However, since these laws and regulations are relatively new and the Chinese legal system continues to rapidly evolve, the interpretations of many laws, regulations and rules are not always uniform and enforcement of these laws, regulations and rules involve uncertainties.

From time to time, we may have to resort to administrative and court proceedings to interpret and/or enforce our legal rights. However, since Chinese administrative and court authorities have significant discretion in interpreting and implementing statutory and contractual terms, it may be more difficult to evaluate the outcome of administrative and court proceedings, and the level of legal protection we enjoy, than in more developed legal systems. Any administrative and court proceedings in China may be protracted, resulting in substantial costs and diversion of resources and management attention. Furthermore, the Chinese legal system is based in part on government policies and internal rules (some of which are not published in a timely manner or at all) that may have retroactive effect.

As a result, we may not be aware of our violation of these policies and rules until sometime after the violation. Such uncertainties, including uncertainty over the scope and effect of our contractual, property (including intellectual property) and procedural rights, and any failure to respond to changes in the regulatory environment in China could materially and adversely affect our business and impede our ability to continue our operations.

***The audit report included in the annual report on Form 10-K filed with the SEC is prepared by auditors who are not currently inspected by the Public Company Accounting Oversight Board and, as such, our stockholders are deprived of the benefits of such inspection and our common stock is subject to delisting from the New York Stock Exchange in the future.***

As an auditor of companies that are publicly traded in the United States and a firm registered with the Public Company Accounting Oversight Board ("PCAOB"), our independent registered public accounting firm is required under the laws of the United States to undergo regular inspections by the PCAOB. However, because substantially all of our operations are conducted within China, our independent registered public accounting firm's audit documentation related to their audit report included in our annual report on Form 10-K is located in China. The PCAOB is currently unable to conduct full inspections in China or review audit documentation located within China without the approval of Chinese authorities, which has not been granted. Accordingly, the PCAOB has not inspected our independent registered public accounting firm or reviewed documentation related to the audit of our financial statements.

Inspections of other auditors conducted by the PCAOB outside of China have at times identified deficiencies in those auditors' audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality. The lack of PCAOB inspections of audit work undertaken in China prevents the PCAOB from evaluating our auditor's audits and its quality control procedures. As a result, our stockholders do not have the benefit of PCAOB inspections, and may lose confidence in our reported financial information and procedures and the quality of our financial statements.

On December 18, 2020, the Holding Foreign Companies Accountable Act (the "Act") was signed into law. The Act requires the SEC to prohibit the securities of any "covered issuer," including the Company, from being traded on any of the U.S. securities exchanges, including the New York Stock Exchange, or traded "over-the-counter," if the auditor of the covered issuer's financial statements is not subject to PCAOB inspection for three consecutive years, beginning in 2021. On December 2, 2021, the SEC adopted final rules implementing the Act, pursuant to which the SEC will identify companies subject to the Act, known as "Commission-Identified Issuers," as early as possible after the filing of their next annual report, and implement the trading prohibition as soon as practicable after they have been conclusively identified as Commission-Identified Issuers for three consecutive years. Under these rules, the Company may be identified as a Commission-Identified Issuer after the date we file our annual report for the year ended December 31, 2021 on the Form 10-K with the SEC.

On June 22, 2021, the U.S. Senate passed a bill which, if also passed by the U.S. House of Representatives and signed into law, would reduce the number of consecutive non-inspection years required to trigger the trading prohibition under the Act from three years to two (the "Senate Proposed Act Amendment"). On February 4, 2022, the U.S. House of Representatives passed a larger bill containing provisions identical to the Senate Proposed Act Amendment which, if also passed by the U.S. Senate and signed into law, would have the same effect (the "House Proposed Act Amendment").

Unless the Act is amended to exclude the Company or the PCAOB is able to conduct a full inspection of our independent registered public accounting firm's audit documentation related to their audit reports during the required timeframe, which is subject to a variety of factors outside our control including the approval of Chinese authorities, then our common stock will be delisted from the New York Stock Exchange in early 2024 or, if the House Proposed Act Amendment or Senate Proposed Act Amendment becomes law, in early 2023. Such delisting would limit the liquidity of our common stock and our access to U.S. capital markets, and as a result the market price of our common stock could be materially adversely affected.

### *Changes in political, business, economic and trade relations between the United States and China may have a material adverse impact on our business, results of operations and financial condition.*

We cannot predict the possible changes in the economic, regulatory, social and political environment in the United States and China, nor can we predict their potential impact on political, economic and trade relations between the United States and China and on our business.

In 2019, the United States and China imposed new or higher tariffs on goods imported from each other. If the United States or China continues imposing such tariffs, or if additional tariffs or trade restrictions are implemented by the United States or by China, the resulting trade barriers could have a significant adverse impact on our business. The adoption and expansion of trade restrictions and tariffs, quotas and embargoes, sanctions, the occurrence of a trade war, or other governmental action related to tariffs or trade agreements or policies, has the potential to adversely impact costs, our suppliers and the world economy in general, which in turn could have a material adverse effect on our business, results of operations and financial condition.

During 2020, political tensions between the United States and China escalated, with a number of actions taken by the U.S. government in response to perceived threats from Chinese-connected entities, such as the Clean Network program announced on August 5, 2020 to protect U.S. telecommunication and technology infrastructure, and the two executive orders issued by former President Trump on August 6, 2020 to ban any person or property subject to the jurisdiction of the United States from any transaction with ByteDance and from any transaction related to WeChat by any person or with respect to any property subject to the jurisdiction of the United States, to the extent that any such transaction is identified by the Secretary of Commerce as being subject to the prohibitions stated in the executive orders. In addition, on January 5, 2021, former President Trump signed an executive order banning transactions by any person, or with respect to any property, subject to the jurisdiction of the United States with persons that develop or control the following Chinese-connected software applications: Alipay, CamScanner, QQ Wallet, SHAREit, Tencent QQ, VMate, WeChat Pay, and WPS Office, some of which are critical to the operation of our business. These executive orders were revoked on June 9, 2021 by President Biden, who then signed an executive order directing the Department of Commerce to launch a national security review of apps with links to foreign adversaries (which is defined to include China) and issue recommendations for regulatory and legislative action to address the associated risks. Digital orders, including delivery, mobile orders and kiosk orders, accounted for approximately 86% of KFC and Pizza Hut's Company sales in 2021, and digital payments, including mobile payments, accounted for approximately 98% of Yum China Company sales in 2021. As a result, the implementation of this executive order could adversely affect our business in a material way.

We cannot foresee whether and how developments in similar policy actions or any other policy actions taken by the U.S. or Chinese government will impact our business and financial performance. In addition, changes in political, business, economic and trade relations between the United States and China may trigger negative customer sentiment towards western brands in China, potentially resulting in a negative impact on our business, results of operations and financial condition.

### *Fluctuation in the value of RMB may result in foreign currency exchange losses.*

The conversion of the Renminbi ("RMB") into foreign currencies, including U.S. dollars, is based on rates set by the People's Bank of China ("PBOC"). Historically, the exchange rate between RMB and the U.S. dollar has showed higher volatility in certain years while staying within a narrow range in other years. The value of RMB against the U.S. dollar and other currencies is affected by changes in China's political and economic conditions and by China's foreign exchange policies, among other things. It is difficult to predict how market forces or Chinese or U.S. government policy may impact the exchange rate between RMB and the U.S. dollar in the future.

Substantially all of our revenues and costs are denominated in RMB. As a Delaware holding company, we may rely on dividends and other fees paid to us by our subsidiaries in China. Any significant revaluation of RMB may materially affect our cash flows, net revenues, earnings and financial position, and the value of, and any dividends payable on, our common stock in U.S. dollars. For example, an appreciation of RMB against the U.S. dollar would make any new RMB-denominated investments or expenditures more costly to us, to the extent that we need to convert U.S. dollars into RMB for such purposes. Conversely, a significant depreciation of RMB against the U.S. dollar may significantly reduce the U.S. dollar equivalent of our earnings, which in turn could adversely affect the price of our common stock. If we decide to convert RMB into U.S. dollars for the purpose of making payments for dividends on our common stock, strategic acquisitions or investments or other business purposes, the appreciation of the U.S. dollar against RMB would have a negative effect on U.S. dollar amounts available to us.

Few hedging options are available in China to reduce our exposure to exchange rate fluctuations. In addition, our currency exchange loss may be magnified by Chinese exchange control regulations that restrict our ability to convert RMB into foreign currency. As a result, fluctuations in exchange rates and restrictions on exchange may have a material adverse effect on your investment.

### *The increasing focus on environmental sustainability issues may create operational challenges for us, increase our costs and harm our reputation.*

There has been increasing public focus by governmental and non-governmental organizations and other stakeholders on environmental sustainability matters, including climate change and deforestation. In line with the national standards and local requirements to reduce plastic waste in China, we have launched a series of plastic reduction and environmentally friendly packaging initiatives across our brands. We are committed to gradually replacing existing plastic packaging with paper straws, wooden cutleries, paper bags, and biodegradable plastic bags, and working towards a 30% reduction on non-degradable plastic packaging weight by 2025. We may face operational challenges in sourcing suitable alternative packaging materials. In addition, we may incur significant costs for using alternative packaging materials, which in turn may have an adverse impact on our profit margins. In 2021, we committed to a net-zero GHG reduction goal by 2050 in line with SBTi criteria to limit global temperature rise to 1.5°C above pre-industrial levels. We face related risks including setting appropriate targets and taking actions to meet the commitments we made, and also the increased pressure to make new sustainability commitments, which could expose us to additional operational challenges, execution costs and reputational risks.

### *Governmental control of currency conversion and payments of foreign currency and RMB out of mainland China may limit our ability to utilize our cash balances effectively and affect the value of your investment.*

The Chinese government imposes controls on the convertibility of RMB into foreign currencies and, in certain cases, the remittance of both foreign currency and RMB out of mainland China. Under our current corporate structure as a Delaware holding company, our income is primarily derived from the earnings from our Chinese subsidiaries. Substantially all revenues of our Chinese subsidiaries are denominated in RMB. Shortages in the availability of foreign currency and control on payments out of mainland China may restrict the ability of our Chinese subsidiaries to remit sufficient foreign currency and/or RMB to pay dividends or to make other payments to us, or otherwise to satisfy their obligations. Under existing Chinese foreign exchange regulations, payments of current account items, including profit distributions, license fee payments and expenditures from trade-related transactions, can be made in foreign currencies or RMB without prior approval from China's State Administration of Foreign Exchange ("SAFE") and the PBOC by complying with certain procedural requirements. However, for any Chinese company, dividends can be declared and paid only out of the retained earnings of that company under Chinese law. Furthermore, approval from SAFE or its local branch may be required where RMB are to be converted into foreign currencies, and approval from SAFE and the PBOC or their branches may be required where foreign currency and/or RMB are to be remitted out of mainland China. Specifically, under the existing restrictions, without a prior approval from SAFE and the PBOC, cash generated from the operations of our subsidiaries in China may not be used to pay dividends to Yum China, pay the license fee to YUM, pay employees who are located outside mainland China, pay off debt owed by our subsidiaries to entities outside mainland China, or make capital expenditures outside mainland China.

The Chinese government may also at its discretion restrict access in the future to foreign currencies or further restrict payments of foreign currency and RMB out of mainland China. If the foreign exchange control system prevents us from obtaining sufficient foreign currency to satisfy our currency demands or restricts us from paying the license fee to YUM, we may not be able to pay dividends to our stockholders, fulfill our license fee payment obligation, pay out service fees to vendors and repay our indebtedness when due.

Furthermore, because repatriation of funds and payment of license fees require the prior approval of SAFE and PBOC, such repatriation and payment could be delayed, restricted or limited. There can be no assurance that the rules and regulations pursuant to which SAFE and PBOC grant or deny approvals will not change in a way that adversely affects the ability of our Chinese subsidiaries to repatriate funds out of mainland China or pay license fees. Any such limitation could materially and adversely affect our ability to pay dividends or otherwise fund and conduct our business.

***Changes in the laws and regulations of China or noncompliance with applicable laws and regulations may have a significant impact on our business, results of operations and financial condition.***

Our business and operations are subject to the laws and regulations of China, which continue to evolve. For example, on January 9, 2021, China's Ministry of Commerce ("MOFCOM") issued the Rules on Blocking Improper Extraterritorial Application of Foreign Legislation and Other Measures (the "Blocking Rules"), which established a blocking regime in China to counter the impact of foreign sanctions on Chinese persons. The Blocking Rules have become effective upon issuance, but have only established a framework of implementation, and the rules' effects will remain unclear until the Chinese government provides clarity on the specific types of extraterritorial measures to which the rules will apply. At this time, we do not know the extent to which the Blocking Rules will impact our operations. There is no assurance that we will be able to comply fully with applicable laws and regulations should there be any amendment to the existing regulatory regime or implementation of any new laws and regulations. In addition, the interpretations of many laws and regulations are not always uniform and enforcement of these laws and regulations involve uncertainties.

The continuation of our operations depends upon compliance with, among other things, applicable Chinese environmental, health, safety, labor, social security, pension and other laws and regulations. Failure to comply with such laws and regulations could result in fines, penalties or lawsuits.

Furthermore, our business and operations in China require the procurement of licenses and permits from the relevant authorities. Rapidly evolving laws and regulations and inconsistent interpretations and enforcements thereof could impede our ability to obtain or maintain the required permits, licenses and certificates required to conduct our businesses in China. Difficulties or failure in obtaining the required permits, licenses and certificates could result in our inability to continue our business in China in a manner consistent with past practice. In such an event, our business, results of operations and financial condition may be adversely affected.

### *We rely to a significant extent on dividends and other distributions on equity paid by our principal operating subsidiaries in China to fund offshore cash requirements.*

We are a holding company and conduct all of our business through our operating subsidiaries. We rely to a significant extent on dividends and other distributions on equity paid by our principal operating subsidiaries for our cash requirements. As noted above, distributions to us from our subsidiaries may result in incremental tax costs.

The laws, rules and regulations applicable to our Chinese subsidiaries permit payments of dividends only out of their accumulated profits, if any, determined in accordance with applicable Chinese accounting standards and regulations. In addition, under Chinese law, an enterprise incorporated in China is required to set aside at least 10% of its after-tax profits each year, after making up previous years' accumulated losses, if any, to fund certain statutory reserve funds, until the aggregate amount of such a fund reaches 50% of its registered capital. As a result, our Chinese subsidiaries are restricted in their ability to transfer a portion of their net assets to us in the form of dividends. At the discretion of the board of directors, as an enterprise incorporated in China, each of our Chinese subsidiaries may allocate a portion of its after-tax profits based on Chinese accounting standards to staff welfare and bonus funds. These reserve funds and staff welfare and bonus funds are not distributable as cash dividends. Any limitation on the ability of our Chinese subsidiaries to pay dividends or make other distributions to us could limit our ability to make investments or acquisitions outside of China that could be beneficial to our business, pay dividends, or otherwise fund and conduct our business.

In addition, the EIT Law and its implementation rules provide that a withholding tax at a rate of 10% will be applicable to dividends payable by Chinese companies to companies that are not China resident enterprises unless otherwise reduced according to treaties or arrangements between the Chinese central government and the governments of other countries or regions where the non-China resident enterprises are incorporated. Hong Kong has a tax arrangement with mainland China that provides for a 5% withholding tax on dividends distributed to a Hong Kong resident enterprise, upon meeting certain conditions and requirements, including, among others, that the Hong Kong resident enterprise directly owns at least 25% equity interests of the Chinese enterprise and is a "beneficial owner" of the dividends. We believe that our Hong Kong subsidiary, which is the equity holder of our Chinese subsidiaries, met the relevant requirements pursuant to the tax arrangement between the mainland China and Hong Kong in 2018 and is expected to meet the requirements in subsequent years, thus, it is more likely than not that our dividends declared or earnings expected to be repatriated since 2018 are subject to the reduced withholding tax of 5%. However, if our Hong Kong subsidiary is not considered to be the "beneficial owner" of the dividends by the Chinese local tax authority, any dividend paid to it by our Chinese subsidiaries would be subject to a withholding tax rate of 10% with retrospective effect, which would increase our tax liability and reduce the amount of cash available to our company.

Restrictive covenants in bank credit facilities, joint venture agreements or other arrangements that we or our subsidiaries may enter into in the future may also restrict the ability of our subsidiaries to pay dividends or make distributions or remittances to us. These restrictions could reduce the amount of dividends or other distributions we receive from our subsidiaries, which in turn could restrict our ability to return capital to our stockholders in the future.

***Under the EIT Law, if we are classified as a China resident enterprise for Chinese enterprise income tax purposes, such classification would likely result in unfavorable tax consequences to us and our non-Chinese stockholders.***

Under the EIT Law and its implementation rules, an enterprise established outside China with a "de facto management body" within China is considered a China resident enterprise for Chinese enterprise income tax purposes. A China resident enterprise is generally subject to certain Chinese tax reporting obligations and a uniform 25% enterprise income tax rate on its worldwide income. Furthermore, under the EIT Law, if we are a China resident enterprise (i) dividends paid by us to our non-Chinese stockholders would be subject to a 10% dividend withholding tax or a 20% individual income tax if the stockholder is an individual and (ii) such non-Chinese stockholders may become subject to Chinese tax and filing obligations as well as withholding with respect to any disposition of our stock, subject to certain treaty or other exemptions or reductions.

Yum China and each subsidiary of Yum China that is organized outside of China intends to conduct its management functions in a manner that does not cause it to be a China resident enterprise, including by carrying on its day-to-day management activities and maintaining its key records, such as resolutions of its board of directors and resolutions of stockholders, outside of China. As such, we do not believe that Yum China or any of its non-Chinese subsidiaries should be considered a China resident enterprise for purposes of the EIT Law. However, given the uncertainty regarding the application of the EIT Law to us and our future operations, there can be no assurance that we or any of our non-Chinese subsidiaries will not be treated as a China resident enterprise now or in the future for Chinese tax law purposes.

***We and our stockholders face uncertainty with respect to indirect transfers of equity interests in China resident enterprises through transfer of non-Chinese-holding companies. Enhanced scrutiny by the Chinese tax authorities may have a negative impact on potential acquisitions and dispositions we may pursue in the future.***

In February 2015, the STA issued Bulletin 7, pursuant to which an "indirect transfer" of Chinese taxable assets, including equity interests in a Chinese resident enterprise, by a non-resident enterprise may be re-characterized and treated as a direct transfer of Chinese taxable assets, if such arrangement does not have reasonable commercial purpose and the transferor avoids payment of Chinese enterprise income tax. Where a non-resident enterprise conducts an "indirect transfer" of Chinese interests by disposing of equity interests in an offshore holding company that directly or indirectly owns Chinese interests, the transferor, transferee and/or the China resident enterprise may report such indirect transfer to the relevant Chinese tax authority, which may in turn report upward to the STA. Using general anti-tax avoidance provisions, the STA may treat such indirect transfer as a direct transfer of Chinese interests if the transfer avoids Chinese tax by way of an arrangement without reasonable commercial purpose. As a result, gains derived from such indirect transfer may be subject to Chinese enterprise income tax, and the transferee or other person who is obligated to pay for the transfer would be obligated to withhold the applicable taxes, currently at a rate of up to 10% of the capital gain in the case of an indirect transfer of equity interests in a China resident enterprise. Both the transferor and the party obligated to withhold the applicable taxes may be subject to penalties under Chinese tax laws if the transferor fails to pay the taxes and the party obligated to withhold the applicable taxes fails to withhold the taxes. However, the above regulations do not apply if either (i) the selling non-resident enterprise recognizes the relevant gain by purchasing and selling equity of the same listed enterprise in the open market (the "listed enterprise exception"); or (ii) the selling non-resident enterprise would have been exempted from enterprise income tax in China pursuant to applicable tax treaties or tax arrangements, if it had directly held and transferred such Chinese interests that were indirectly transferred. The China indirect transfer rules do not apply to gains recognized by individual stockholders. However, in practice, there have been a few reported cases of individuals being taxed on the indirect transfer of Chinese interests and the law could be changed so as to apply to individual stockholders, possibly with retroactive effect. In addition, the PRC Individual Income Tax Law and relevant regulations ("IITL"), revised effective January 1, 2019, impose general anti-avoidance tax rules ("GAAR") on transactions conducted by individuals. As a result, if the China tax authority invokes the GAAR and deems that indirect transfers made by individual stockholders lack reasonable commercial purposes, any gains recognized on such transfers might be subject to individual income tax in China at the standard rate of 20%.

It is unclear whether stockholders that acquired our stock through the distribution or the Global Offering will be treated as acquiring such stock in an open market purchase. If such stock is not treated as acquired in an open market purchase, the listed transaction exception will not be available for transfers of such stock. We expect that transfers in open market transactions of our stock by corporate or other non-individual stockholders that have purchased our stock in open market transactions will not be taxable under the China indirect transfer rules due to the listed enterprise exception. Transfers, whether in the open market or otherwise, of our stock by corporate and other non-individual stockholders that acquired our stock in the distribution or the Global Offering or in non-open market transactions may be taxable under the China indirect transfer rules and our China subsidiaries may have filing obligations in respect of such transfers, upon the request of relevant Chinese tax authorities. Transfers of our stock in non-open market transactions by corporate and other non-individual stockholders may be taxable under the China indirect transfer rules, whether or not such stock was acquired in open market transactions, and our China subsidiaries may have filing obligations in respect of such transfers upon the request of relevant Chinese tax authorities. Corporate and other non-individual stockholders may be exempt from taxation under the China indirect transfer rules with respect to transfers of our stock if they are tax resident in a country or region that has a tax treaty or arrangement with China that provides for a capital gains tax exemption and they qualify for that exemption.

In addition, we may be subject to these indirect transfer rules in the event of any future sale of a China resident enterprise through the sale of a non-Chinese holding company, or the purchase of a China resident enterprise through the purchase of a non-Chinese holding company. Our company and other non-resident enterprises in our group may be subject to filing obligations or taxation if our company and other non-resident enterprises in our group are transferors in such transactions, and may be subject to withholding obligations if our company and other non-resident enterprises in our group are transferees in such transactions.

### *There may be difficulties in effecting service of legal process, conducting investigations, collecting evidence, enforcing foreign judgments or bringing original actions in China based on United States or other foreign laws against us and our management.*

We conduct substantially all of our operations in China and substantially all of our assets are located in China. Some of our directors and executive officers reside within China. As a result, it may not be possible to effect service of process within the United States or elsewhere outside of China upon these persons, including with respect to matters arising under applicable U.S. federal and state securities laws. In addition, there are significant legal and other obstacles in China to providing information needed for regulatory investigations or litigation initiated by regulators outside China. Overseas regulators may have difficulties in conducting investigations or collecting evidence within China. It may also be difficult for investors to bring an original lawsuit against us or our directors or executive officers based on U.S. federal securities laws in a Chinese court.

Moreover, China does not have treaties with the United States providing for the reciprocal recognition and enforcement of judgments of courts. Therefore, even if a judgment were obtained against us or our management for matters arising under U.S. federal or state securities laws or other applicable U.S. federal or state law, it may be difficult to enforce such a judgment.

### *The Chinese government may determine that the variable interest entity structure of Daojia does not comply with Chinese laws on foreign investment in restricted industries.*

Through the acquisition of Daojia, we also acquired a variable interest entity ("VIE") and subsidiaries of the VIE in China effectively controlled by Daojia.

Chinese laws and regulations restrict and impose conditions on foreign investment in certain internet business, such as internet content services. For example, foreign investors are generally not permitted to own more than 50% of the equity interests in an internet content provider or other value-added telecommunication service provider. Accordingly, a VIE structure has been adopted by many China-based companies, including Daojia, to obtain necessary licenses and permits in such industries that are currently subject to foreign investment restrictions in China. Daojia operates these businesses in China through its consolidated affiliated entities. Daojia has entered into a series of contractual arrangements with its consolidated affiliated entities and the nominee shareholders of its consolidated affiliated entities. These contractual arrangements allow Daojia to:

- receive substantially all of the economic benefits and absorb all of the expected losses from its consolidated affiliated entities;
- exercise effective control over its consolidated affiliated entities; and
- hold an exclusive option to purchase all or part of the equity interests in its consolidated affiliated entities when and to the extent permitted by Chinese law.

However, the VIE structure and contractual arrangements described above may not be as effective in providing control over Daojia's consolidated affiliated entities as direct ownership. The VIE structure may result in unauthorized use of indicia of corporate power or authority, such as chops and seals. Control over Daojia's consolidated affiliated entities may also be jeopardized if the shareholders holding equity interest in the consolidated affiliated entities breach the terms of the contractual agreements.

In addition, there are substantial uncertainties regarding the interpretation and application of current Chinese laws, rules and regulations related to VIE structure. It is also uncertain whether any new Chinese laws, rules or regulations relating to VIE structure will be adopted, or if adopted, what their implications would be on Daojia. If the VIE structure is found to be in violation of any existing or future Chinese laws, rules or regulations, the relevant PRC regulatory bodies would have broad discretion to take action in dealing with these violations, including revoking the business and operating licenses of Daojia's consolidated affiliated entities, requiring Daojia to restructure its operations or taking other regulatory or enforcement actions against Daojia. The contractual arrangements may also be (i) disregarded by the PRC tax authorities and result in increased tax liabilities; or (ii) found by Chinese government authorities, courts or arbitral tribunals to be unenforceable. Any of the foregoing could result in a material adverse effect on Daojia's business operations.

### *Certain defects caused by non-registration of our lease agreements related to certain properties occupied by us in China may materially and adversely affect our ability to use such properties.*

As of December 31, 2021, we leased approximately 10,000 properties in China, and to our knowledge, the lessors of most properties leased by us, most of which are used as premises for our restaurants, had not registered the lease agreements with government authorities in China.

According to Chinese laws, a lease agreement is generally required to be registered with the relevant land and real estate administration bureau. However, the enforcement of this legal requirement varies depending on the local regulations and practices and, in cities where we operate a significant number of restaurants, the local land and real estate administration bureaus no longer require registration or no longer impose fines for failure to register the lease agreements. In addition, our standard lease agreements require the lessors to make such registration and, although we have proactively requested that the applicable lessors complete or cooperate with us to complete the registration in a timely manner, we are unable to control whether and when such lessors will do so.

A failure to register a lease agreement will not invalidate the lease agreement but may subject the parties to a fine. Depending on the local regulations, the lessor alone or both the lessor and lessee are under the obligation to register a lease agreement with the relevant land and real estate administration bureau. In the event that a fine is imposed on both the lessor and lessee, and if we are unable to recover from the lessor any fine paid by us based on the terms of the lease agreement, such fine will be borne by us.

To date, the operation of our restaurants has not been materially disrupted due to the non-registration of our lease agreements. No fines, actions or claims have been instituted against us or, to our knowledge, the lessors with respect to the non-registration of our lease agreements. However, we cannot assure you that our lease agreements relating to, and our right to use and occupy, our premises will not be challenged in the future.

### *Our restaurants are susceptible to risks in relation to unexpected land acquisitions, building closures or demolitions.*

The Chinese government has the statutory power to acquire any land use rights of land plots and the buildings thereon in China in the public interest subject to certain legal procedures. Under the Regulations for the Expropriation of and Compensation for Housing on State-owned Land, issued by the State Council, which became effective as of January 21, 2011, there is no legal provision that the tenant of an expropriated property is entitled to compensation. Generally speaking, only the owner of such property is entitled to compensation from the government. The claims of the tenant against the landlord will be subject to the terms of the lease agreement. In the event of any compulsory acquisition, closure or demolition of any of the properties at which our restaurants or facilities are situated, we may not receive any compensation from the government or the landlord. In such event, we may be forced to close the affected restaurant(s) or relocate to other locations, which may have an adverse effect on our business and results of operations.

### *Any failure to comply with Chinese regulations regarding our employee equity incentive plans may subject Chinese plan participants or us to fines and other legal or administrative sanctions.*

Pursuant to SAFE Circular 37, China residents who participate in share incentive plans in overseas non-publicly listed companies may submit applications to SAFE or its local branches for foreign exchange registration with respect to offshore special purpose companies. We and our directors, executive officers and other employees who are Chinese citizens or who have resided in China for a continuous period of not less than one year and who have been granted restricted shares, restricted stock units ("RSUs"), performance share units ("PSUs"), stock appreciation rights ("SARs"), or stock options (collectively, the "share-based awards") are subject to the Notice on Issues Concerning the Foreign Exchange Administration for Domestic Individuals Participating in Stock Incentive Plan of Overseas Publicly Listed Company, issued by SAFE in February 2012, according to which, employees, directors, supervisors and other management members participating in any stock incentive plan of an overseas publicly-listed company who are Chinese citizens or who are non-Chinese citizens residing in China for a continuous period of not less than one year, subject to limited exceptions, are required to register with SAFE through a domestic qualified agent, which could be a

Chinese subsidiary of such overseas listed company, and complete certain other procedures. Failure to complete SAFE registrations may result in fines and legal sanctions and may also limit our ability to make payments under our equity incentive plans or receive dividends or sales proceeds related thereto, or our ability to contribute additional capital into our wholly-foreign owned enterprises in China and limit our wholly-foreign owned enterprises' ability to distribute dividends to us. We also face regulatory uncertainties that could restrict our ability to adopt additional equity incentive plans for our directors and employees under Chinese law.

In addition, the STA has issued circulars concerning employees' share-based awards. Under these circulars, employees working in China who exercise share options and SARs, or whose restricted shares, RSUs or PSUs vest, will be subject to Chinese individual income tax. The Chinese subsidiaries of an overseas listed company have obligations to file documents related to employees' share-based awards with relevant tax authorities and to withhold individual income taxes of those employees related to their share-based awards. Although we currently intend to withhold income tax from our Chinese employees in connection with their exercise of options and SARs and the vesting of their restricted shares, RSUs and PSUs, if the employees fail to pay, or our Chinese subsidiaries fail to withhold, their income taxes according to relevant laws, rules and regulations, our Chinese subsidiaries may face sanctions imposed by the tax authorities or other Chinese government authorities.

### *Failure to make adequate contributions to various employee benefit plans as required by Chinese regulations may subject us to penalties.*

Companies operating in China are required to participate in various government-sponsored employee benefit plans, including certain social insurance, housing funds and other welfare-oriented payment obligations, and contribute to the plans in amounts equal to certain percentages of salaries, including bonuses and allowances, of their employees up to a maximum amount specified by the local government from time to time at locations where they operate their businesses. While we believe we comply with all material aspects of relevant regulations, the requirements governing employee benefit plans have not been implemented consistently by the local governments in China given the different levels of economic development in different locations. If we are subject to late fees or fines in relation to the underpaid employee benefits, our results of operations and financial condition may be adversely affected.

### *Proceedings instituted by the SEC against certain China-based accounting firms, including our independent registered public accounting firm, could result in our financial statements being determined to not be in compliance with the requirements of the Exchange Act.*

In late 2012, the SEC commenced administrative proceedings under Rule 102(e) of its Rules of Practice and also under the Sarbanes-Oxley Act of 2002 against the Chinese member firms of the "big four" accounting firms, including our independent registered public accounting firm. The Rule 102(e) proceedings initiated by the SEC relate to the failure of these firms to produce certain documents, including audit work papers, in response to a request from the SEC pursuant to Section 106 of the Sarbanes-Oxley Act of 2002. The auditors located in China claim they are not in a position lawfully to produce such documents directly to the SEC because of restrictions under Chinese law and specific directives issued by the China Securities Regulatory Commission ("CSRC"). The issues raised by the proceedings are not specific to our auditor or to us, but potentially affect equally all PCAOB-registered audit firms based in China and all businesses based in China (or with substantial operations in China) with securities listed in the United States. In addition, auditors based outside of China are subject to similar restrictions under Chinese law and CSRC directives in respect of audit work that is carried out in China which supports the audit opinions issued on financial statements of entities with substantial China operations.

In January 2014, the administrative judge reached an initial decision that the Chinese member firms of the "big four" accounting firms should be barred from practicing before the SEC for a period of six months. In February 2015, the Chinese member firms of the "big four" accounting firms reached a settlement with the SEC. As part of the settlement, each of the "big four" accounting firms agreed to a censure and to pay a fine to the SEC to settle the dispute with the SEC and stay the proceedings for four years; under the terms of the settlement, the proceedings were deemed dismissed with prejudice in February 2019. It remains unclear whether the SEC will commence new administrative proceedings against all four firms.

If our independent registered public accounting firm who prepared the audit reports included in our annual reports on Form 10-K were denied, even temporarily, the ability to practice before the SEC, and we are unable to timely find another independent registered public accounting firm to audit and issue an opinion on our financial statements, our financial statements could be determined not to be in compliance with the requirements of the Exchange Act. Such a determination could ultimately lead to delisting of our common stock from the New York Stock Exchange. Moreover, any negative news about the proceedings against these audit firms may adversely affect investor confidence in companies with substantial China-based operations listed on securities exchanges in the United States. All of these factors could materially and adversely affect the market price of our common stock and our ability to access the capital markets.

***Chinese regulation of loans to, and direct investment in, Chinese entities by offshore holding companies and governmental control of currency conversion may restrict or prevent us from making loans or additional capital contributions to our Chinese subsidiaries, which may materially and adversely affect our liquidity and our ability to fund and expand our business.***

We are a Delaware holding company conducting our operations in China through our Chinese subsidiaries. We may make loans to our Chinese subsidiaries, or we may make additional capital contributions to our Chinese subsidiaries, or we may establish new Chinese subsidiaries and make capital contributions to these new Chinese subsidiaries, or we may acquire offshore entities with business operations in China in an offshore transaction.

Most of these uses are subject to Chinese regulations and approvals. For example, loans by us to our wholly-owned Chinese subsidiaries to finance their activities cannot exceed statutory limits and must be registered with the local counterparts of SAFE. If we decide to finance our wholly-owned Chinese subsidiaries by means of capital contributions, in practice, we might be still required to obtain approval from the MOFCOM or its local counterparts.

On August 29, 2008, SAFE promulgated the Circular on the Relevant Operating Issues Concerning the Improvement of the Administration of the Payment and Settlement of Foreign Currency Capital of Foreign-Invested Enterprises, or SAFE Circular 142, regulating the conversion by a foreign-invested enterprise of foreign currency registered capital into RMB by restricting how the converted RMB may be used. SAFE Circular 142 provides that RMB capital converted from foreign currency registered capital of a foreign-invested enterprise may only be used for purposes within the business scope approved by the applicable governmental authority and may not be used for equity investments within China with limited exceptions *(e.g.,* by holding companies, venture capital or private equity firms). In addition, SAFE strengthened its oversight of the flow and use of the RMB capital converted from the foreign currency registered capital of a foreign-invested company. The use of such RMB capital may not be altered without SAFE approval, and such RMB capital may not in any case be used to repay RMB loans if the proceeds of such loans have not been used. Such requirements are also known as the "payment-based foreign currency settlement system" established under SAFE Circular 142. Violations of SAFE Circular 142 could result in monetary or other penalties. Furthermore, SAFE promulgated a circular on November 9, 2010, known as Circular 59, and another supplemental circular on July 18, 2011, known as Circular 88, which both tightened the examination of the authenticity of settlement of foreign currency capital or net proceeds from overseas listings. SAFE further promulgated the Circular on Further Clarification and Regulation of the Issues Concerning the Administration of Certain Capital Account Foreign Exchange Businesses, or Circular 45, on November 9, 2011, which expressly prohibited foreign-invested enterprises from using registered capital settled in RMB converted from foreign currencies to grant loans through entrustment arrangements with a bank, repay intercompany loans or repay bank loans that have been transferred to a third party. Circular 142, Circular 59, Circular 88 and Circular 45 may significantly limit our ability to make loans or capital contributions to our Chinese subsidiaries and to convert such proceeds into RMB, which may adversely affect our liquidity and our ability to fund and expand our business in China.

Furthermore, on April 8, 2015, SAFE promulgated the Circular on the Reform of the Administrative Method of the Settlement of Foreign Currency Capital of Foreign-Invested Enterprises, or Circular 19, which became effective as of June 1, 2015. This Circular 19 is to implement the so-called "conversion-at-will" of foreign currency in capital account, which was established under a circular issued by SAFE on August 4, 2014, or Circular 36, and was implemented in 16 designated industrial parks as a reform pilot. The Circular 19 now implements the conversion-at-will of foreign currency settlement system nationally, and it abolishes the application of Circular 59 and Circular 45 on March 19, 2015 as well as Circular 142, Circular 88 and Circular 36 starting from June 1, 2015. Among other things, under Circular 19, foreign-invested enterprises may either continue to follow the payment-based foreign currency settlement system or elect to follow the conversion-at-will of foreign currency settlement system. Where a foreign-invested enterprise follows the conversion-at-will of foreign currency settlement system, it may convert any or 100% of the amount of the foreign currency in its capital account into RMB at any time. The converted RMB will be kept in a designated account known as "Settled but Pending Payment Account," and if the foreign-invested enterprise needs to make further payment from such designated account, it still needs to provide supporting documents and go through the review process with its bank. If under special circumstances the foreign-invested enterprise cannot provide supporting documents in time, Circular 19 grants the banks the power to provide a grace period to the enterprise and make the payment before receiving the supporting documents. The foreign-invested enterprise will then need to submit the supporting documents within 20 working days after payment. In addition, foreign-invested enterprises are now allowed to use their converted RMB to make equity investments in China under Circular 19. However, foreign-invested enterprises are still required to use the converted RMB in the designated account within their approved business scope under the principle of authenticity and self-use. It remains unclear whether a common foreign-invested enterprise, other than such special types of enterprises as holding companies, venture capital or private equity firms, can use the converted RMB in the designated account to make equity investments if equity investment or similar activities are not within their approved business scope.

In light of the various requirements imposed by Chinese regulations on loans to and direct investment in Chinese entities by offshore holding companies as discussed above, we cannot assure you that we will be able to complete the necessary government registrations or obtain the necessary government approvals on a timely basis, or at all, with respect to future loans by us to our Chinese subsidiaries or with respect to future capital contributions by us to our Chinese subsidiaries. If we fail to complete such registrations or obtain such approvals, our ability to capitalize or otherwise fund our Chinese operations may be negatively affected, which could materially and adversely affect our liquidity and our ability to fund and expand our business.

***Regulations regarding acquisitions may impose significant regulatory approval and review requirements, which could make it more difficult for us to pursue growth through acquisitions.***

Under the PRC Anti-monopoly Law, companies undertaking certain investments and acquisitions relating to businesses in China must notify the anti-monopoly enforcement agency in advance of any transactions which are deemed a concentration and where the parties' revenues in the China market exceed certain thresholds as stipulated in the Provisions of the State Council on the Thresholds for Declaring Concentration of Business Operators. In addition, on August 8, 2006, six PRC regulatory agencies, including the MOFCOM, the State-Owned Assets Supervision and Administration Commission, the STA, the State Administration for Industry and Commerce of the People's Republic of China, the CSRC and the SAFE, jointly adopted the Provisions of the Ministry of Commerce on M&A of a Domestic Enterprise by Foreign Investors ("M&A Rules"), which came into effect on September 8, 2006 and was amended on June 22, 2009. Under the M&A Rules, the approval of MOFCOM must be obtained in circumstances where overseas companies established or controlled by PRC enterprises or residents acquire domestic companies affiliated with PRC enterprises or residents. Applicable PRC laws, rules and regulations also require certain merger and acquisition transactions to be subject to security review.

Due to the level of our revenues, our proposed acquisition of control of, or decisive influence over, any company with revenues within China of more than RMB400 million in the year prior to any proposed acquisition would be subject to the State Administration for Market Regulation ("SAMR") merger control review. As a result of our size, many of the transactions we may undertake could be subject to SAMR merger review. Complying with the requirements of the relevant regulations to complete these transactions could be time consuming, and any required approval processes, including approval from SAMR, may be uncertain and could delay or inhibit our ability to complete these transactions, which could affect our ability to expand our business maintain our market share or otherwise achieve the goals of our acquisition strategy.

Our ability to carry out our investment and acquisition strategy may be materially and adversely affected by the regulatory authorities' current practice, which creates significant uncertainty as to the timing of receipt of relevant approvals and whether transactions that we may undertake would subject us to fines or other administrative penalties and negative publicity and whether we will be able to complete investments and acquisitions in the future in a timely manner or at all.

## Risks Related to the Separation and Related Transactions

***If the distribution does not qualify as a transaction that is generally tax-free for U.S. federal income tax purposes, the Company could be subject to significant tax liabilities, and, in certain circumstances, the Company could be required to indemnify YUM for material taxes and other related amounts pursuant to indemnification obligations under the tax matters agreement.***

The distribution was conditioned on YUM's receipt of opinions of outside advisors regarding the tax-free treatment of the distribution for U.S. federal income tax purposes. The opinions relied on various assumptions and representations as to factual matters made by YUM and us which, if inaccurate or incomplete in any material respect, would jeopardize the conclusions reached by such advisors in their opinions. The opinions are not binding on the IRS or the courts, and there can be no assurance that the IRS or the courts will not challenge the conclusions stated in the opinions or that any such challenge would not prevail.

If, notwithstanding receipt of the opinions, the distribution were determined to be a taxable transaction, YUM would be treated as having sold shares of the Company in a taxable transaction, likely resulting in a significant taxable gain. Pursuant to the tax matters agreement, the Company and YCCL agreed to indemnify YUM for any taxes and related losses resulting from any breach of covenants regarding the preservation of the tax-free status of the distribution, certain acquisitions of our equity securities or assets, or those of certain of our affiliates or subsidiaries, and any breach by us or any member of our group of certain representations in the documents delivered by us in connection with the distribution. Therefore, if the distribution fails to qualify as a transaction that is generally tax-free as a result of one of these actions or events, we may be required to make material payments to YUM under this indemnity.

### *YUM may be subject to Chinese indirect transfer tax with respect to the distribution, in which event we could be required to indemnify YUM for material taxes and related amounts pursuant to indemnification obligations under the tax matters agreement.*

As noted above, Bulletin 7 provides that in certain circumstances a non-resident enterprise may be subject to Chinese enterprise income tax on an "indirect transfer" of Chinese interests. YUM concluded, and we concurred, that it believes that the distribution had a reasonable commercial purpose and that it is more likely than not that YUM will not be subject to this tax with respect to the distribution. However, there are uncertainties regarding the circumstances in which the tax will apply, and there can be no assurances that the Chinese tax authorities will not seek to impose this tax on YUM.

Pursuant to the tax matters agreement, the Company and YCCL have agreed to indemnify YUM for a portion (tied to the relative market capitalization of YUM and the Company during the 30 trading days after the distribution) of any taxes and related losses resulting from the application of Bulletin 7 to the distribution. Alternatively, if Bulletin 7 applies to the distribution as a result of a breach by the Company or Company group members of certain representations or covenants, or due to certain actions of the Company or Company group members following the distribution, the Company and YCCL generally will indemnify YUM for all such taxes and related losses. Therefore, if YUM is subject to such Chinese tax with respect to the distribution, we may be required to make material payments to YUM under this indemnity. Such payments could have a material adverse effect on our financial condition.

### *Potential indemnification liabilities owing to YUM pursuant to the separation and distribution agreement could materially and adversely affect our business, results of operations and financial condition.*

We separated from YUM on October 31, 2016, becoming an independent, publicly traded company under the ticker symbol "YUMC" on the New York Stock Exchange on November 1, 2016. As part of the separation and distribution agreement, we agreed to indemnify YUM for claims against YUM relating to Yum China's business prior to the spin-off in 2016 as well as other liabilities. These liabilities include, among others, (i) our failure to pay, perform or otherwise promptly discharge any liabilities or contracts relating to the Company business, in accordance with their respective terms, whether prior to, at or after the distribution; (ii) any guarantee, indemnification obligation, surety bond or other credit support agreement, arrangement, commitment or understanding by YUM for our benefit, unless related to liabilities primarily associated with the YUM business; (iii) certain tax liabilities related to Bulletin 7 under PRC tax laws, which provides that in certain circumstances a non-resident enterprise may be subject to Chinese enterprise income tax on an "indirect transfer" of Chinese interests; (iv) any breach by us of the separation and distribution agreement or any of the ancillary agreements or any action by us in contravention of our amended and restated certificate of incorporation or amended and restated bylaws; and (v) any untrue statement or alleged untrue statement of a material fact or omission or alleged omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, with respect to all information contained in the information statement relating to the distribution or any other disclosure document that describes the separation or the distribution or the Company and its subsidiaries or primarily relates to the transactions contemplated by the separation and distribution agreement, subject to certain exceptions. If we are required to indemnify YUM under the circumstances set forth in the separation and distribution agreement, we may be subject to substantial liabilities.

### *In connection with the separation, YUM has agreed to indemnify us for certain liabilities. However, there can be no assurance that the indemnity will be sufficient to insure us against the full amount of such liabilities, or that YUM's ability to satisfy its indemnification obligation will not be impaired in the future.*

Pursuant to the separation and distribution agreement and certain other agreements we entered into with YUM, YUM has agreed to indemnify us for certain liabilities set forth in the separation and distribution agreement. However, third parties could also seek to hold us responsible for any of the liabilities that YUM has agreed to retain, and there can be no assurance that the indemnity from YUM will be sufficient to protect us against the full amount of such liabilities, or that YUM will be able to fully satisfy its indemnification obligations. In addition, YUM's insurers may attempt to deny us coverage for liabilities associated with certain occurrences of indemnified liabilities prior to the separation. Moreover, even if we ultimately succeed in recovering from YUM or such insurance providers any amounts for which we are held liable, we may be temporarily required to bear these losses. Each of these risks could negatively affect our business, results of operations, financial condition and cash flows.

### *A court could require that we assume responsibility for obligations allocated to YUM under the separation and distribution agreement.*

Under the separation and distribution agreement and related ancillary agreements, from and after the separation, each of YUM and the Company will be generally responsible for the debts, liabilities and other obligations related to the business or businesses which they own and operate following the consummation of the separation. Although we do not expect to be liable for any obligations that are not allocated to us under the separation and distribution agreement, a court could disregard the allocation agreed to between the parties, and require that we assume responsibility for obligations allocated to YUM (for example, tax and/or environmental liabilities), particularly if YUM were to refuse or were unable to pay or perform the allocated obligations.

### *Potential liabilities may arise due to fraudulent transfer considerations, which would adversely affect our results of operations and financial condition.*

In connection with the separation and distribution, YUM completed several corporate reorganization transactions involving its subsidiaries which, along with the separation and distribution, may be subject to federal and state fraudulent conveyance and transfer laws. If, under these laws, a court were to determine that, at the time of the separation and distribution, any entity involved in these reorganization transactions or the separation and distribution:

- was insolvent;
- was rendered insolvent by reason of the separation and distribution or a related transaction;
- had remaining assets constituting unreasonably small capital; or
- intended to incur, or believed it would incur, debts beyond its ability to pay these debts as they matured,

then the court could void the separation and distribution, in whole or in part, as a fraudulent conveyance or transfer. The court could then require our stockholders to return to YUM some or all of the shares of Company common stock issued in the distribution, or require YUM or the Company, as the case may be, to fund liabilities of the other company for the benefit of creditors. The measure of insolvency will vary depending upon the jurisdiction whose law is being applied. Generally, however, an entity would be considered insolvent if the fair value of its assets was less than the amount of its liabilities, or if it was unable to pay its liabilities as they mature.

## Risks Related to Our Common Stock

### *The Company cannot guarantee the timing or amount of dividends on, or repurchases of, its common stock.*

We intend to retain a significant portion of our earnings to finance the operation, development and growth of our business. Our board of directors commenced a quarterly cash dividend in October 2017, which was temporarily suspended during part of 2020 due to the impacts of the COVID-19 pandemic. Any future determination to declare and pay cash dividends will be at the discretion of our board of directors and will depend on, among other things, our financial condition, results of operations, actual or anticipated cash requirements, tax considerations, contractual or regulatory restrictions and such other factors as our board of directors deems relevant. Our board of directors has also authorized a $1.4 billion share repurchase program, which was temporarily suspended during part of 2020 and 2021 due to the impacts of the COVID-19 pandemic. Repurchases under the program will be at the discretion of management and we cannot guarantee the timing or amount of any share repurchases. For more information, see "Market for our Common Equity, Related Stockholder Matters and Purchases of Equity Securities."

### *The different characteristics of the capital markets in Hong Kong and the U.S. may negatively affect the trading prices of our shares.*

We are subject to both New York Stock Exchange and Hong Kong Stock Exchange listing and regulatory requirements concurrently. The Hong Kong Stock Exchange and the New York Stock Exchange have different trading hours, trading characteristics (including trading volume and liquidity), trading and listing rules, and investor bases (including different levels of retail and institutional participation). As a result of these differences, the trading prices of shares of our common stock may not be the same on the two exchanges, even allowing for currency differences. Certain events having significant negative impact specifically on the U.S. capital markets may result in a decline in the trading price of our shares on the Hong Kong Stock Exchange notwithstanding that such event may not impact the trading prices of securities listed in Hong Kong generally or to the same extent, or vice versa. Because of the different characteristics of the U.S. and Hong Kong capital markets, the historical market prices of our shares may not be indicative of the trading performance of the shares in the future.

As a company with a secondary listing on the Hong Kong Stock Exchange under Chapter 19C of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Hong Kong Listing Rules"), we adopt different practices as to certain matters as compared with many other companies listed on the Hong Kong Stock Exchange. If 55% or more of the total worldwide trading volume, by dollar value, of our shares over our most recent fiscal year takes place on the Hong Kong Stock Exchange, the Hong Kong Stock Exchange will regard us as having a dual primary listing in Hong Kong and we will no longer enjoy certain exemptions or waivers from strict compliance with the requirements under the Hong Kong Listing Rules, the Companies (Winding Up and Miscellaneous Provisions) Ordinance, the Codes on Takeovers and Mergers and Share Buy-backs and the Securities and Futures Ordinance, which could result in our incurring of incremental compliance costs.

### *The interests of the Investors may differ from the interests of other holders of Company common stock.*

In connection with the separation and distribution, Pollos Investment L.P., an affiliate of Primavera Capital Group ("Primavera"), and API (Hong Kong) Investment Limited, an affiliate of Zhejiang Ant Small and Micro Financial Services Group Co., Ltd. ("Ant Financial" and together with Primavera, the "Investors") received shares of common stock, representing approximately 4.3% of the outstanding shares of Company common stock as of December 31, 2021. In addition, the Investors have the ability to acquire additional shares of Company common stock in the open market (subject to an aggregate beneficial ownership interest limit of 19.9%).

The interests of the Investors may differ from those of other holders of Company common stock in material respects. For example, the Investors may have an interest in pursuing acquisitions, divestitures, financings or other transactions that could enhance their respective equity portfolios, even though such transactions might involve risks to holders of Company common stock. The Investors may, from time to time in the future, acquire interests in businesses that directly or indirectly compete with certain portions of the Company's business or are suppliers or customers of the Company. Additionally, the Investors may determine that the disposition of some or all of their interests in the Company would be beneficial to the Investors at a time when such disposition could be detrimental to the other holders of Company common stock.

### *Anti-takeover provisions in our organizational documents and Delaware law might discourage or delay acquisition attempts for us that you might consider favorable.*

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions, summarized below, that could make it more difficult to acquire control of the Company by means of a tender offer, a proxy contest or otherwise, or to remove incumbent officers and directors. Further, as a Delaware corporation, we are subject to provisions of Delaware law, which may impair a takeover attempt that our stockholders may find beneficial. These provisions might discourage certain types of coercive takeover practices and takeover bids that our board of directors may consider inadequate or delay acquisition attempts for us that holders of Company common stock might consider favorable.

- Our amended and restated bylaws provide that such bylaws may be amended by our board of directors or by the affirmative vote of a majority of our stockholders entitled to vote.

- Our amended and restated certificate of incorporation expressly eliminates the right of our stockholders to act by written consent. Accordingly, stockholder action must take place at the annual or a special meeting of our stockholders.

- Our amended and restated bylaws establish advance notice procedures with respect to stockholder proposals and nomination of candidates for election as directors other than nominations made by or at the direction of our board of directors or a committee of our board of directors.

- Our amended and restated certificate of incorporation does not provide for cumulative voting, which means that stockholders are denied the right to cumulate votes in the election of directors.

- Our board of directors has the authority to issue preferred stock, which could potentially be used to discourage attempts by third parties to obtain control of our company through a merger, tender offer, proxy contest or otherwise by making such attempts more difficult or more costly.

## General Risk Factors

### *We could be party to litigation that could adversely affect us by increasing our expenses, diverting management attention or subjecting us to significant monetary damages and other remedies.*

We are involved in legal proceedings from time to time. These proceedings do or could include consumer, employment, real estate-related, tort, intellectual property, breach of contract and other litigation. As a public company, we may in the future also be involved in legal proceedings alleging violation of securities laws or derivative litigation. Plaintiffs in these types of lawsuits often seek recovery of very large or indeterminate amounts, and the magnitude of the potential loss relating to such lawsuits may not be accurately estimated. 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 resources and management attention away from our operations and negatively impact reported earnings. With respect to insured claims, a judgment for 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 of operations.

In addition, the restaurant industry around the world 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 customer health issues, including weight gain and other adverse effects. We may also be subject to these types of claims 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 restaurant industry) may harm our reputation and adversely affect our business, results of operations and financial condition.

### *Changes in accounting standards and subjective assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our results of operations and financial condition.*

Generally accepted accounting principles and related accounting pronouncements, implementation guidelines and interpretations with regard to a wide range of matters that are relevant to our business, including revenue recognition, long-lived asset impairment, impairment of goodwill and other intangible assets, lease accounting, share-based compensation and recoverability of deferred tax assets are highly complex and involve many subjective assumptions, estimates and judgments. Changes in these rules or their interpretation or changes in underlying assumptions, estimates or judgments could significantly change our reported or expected financial performance or financial condition. New accounting guidance may require systems and other changes that could increase our operating costs and/or change our financial statements. For example, implementing the new lease standard issued by Financial Accounting Standards Board requires us to make significant changes to our lease management system and other accounting systems, and results in changes to our financial statements. The adoption of the new accounting standard for leases may result in a higher amount of impairment loss on newly recognized right-of-use assets and negatively impact our results of operations. Upon adoption of Accounting Standards Update No. 2016-02, Leases (Topic 842) ("ASC 842") on January 1, 2019, an impairment charge of $60 million (net of related impact on deferred taxes and noncontrolling interests) on right-of-use assets arising from existing operating leases as of January 1, 2019 was recorded as an adjustment to retained earnings, as the additional impairment charge would have been recorded before adoption had the operating lease right-of-use assets been recognized at the time of impairment. See Note 13 for details on the impairment charge recorded upon adoption of ASC 842 as well as subsequent impairment charges.

### *Our insurance policies may not provide adequate coverage for all claims associated with our business operations.*

We have obtained insurance policies that we believe are customary and appropriate for businesses of our size and type and at least in line with the standard commercial practice in China. However, there are types of losses we may incur that cannot be insured against or that we believe are not cost effective to insure, such as loss of reputation. If we were held liable for uninsured losses or amounts or claims for insured losses exceeding the limits of our insurance coverage, our business and results of operations may be materially and adversely affected.

### *Unforeseeable business interruptions could adversely affect our business.*

Our operations are vulnerable to interruption by natural disasters, such as fires, floods and earthquakes, war, terrorism, power failures and power shortages, hardware and software failures, computer viruses and other events beyond our control. In particular, our business is dependent on prompt delivery and reliable transportation of our food products by our logistics partners. Unforeseeable events, such as adverse weather conditions, natural disasters, severe traffic accidents and delays, non-cooperation of our logistics partners, and labor strikes, could lead to delay or lost deliveries to our restaurants, which may result in the loss of revenue or in customer claims. There may also be instances where the conditions of fresh, chilled or frozen food products, being perishable goods, deteriorate due to delivery delays, malfunctioning of refrigeration facilities or poor handling during transportation by our logistics partners. This may result in a failure by us to provide quality food and services to customers, thereby affecting our business and potentially damaging our reputation. Any such events experienced by us could disrupt our operations. In addition, insurance may not be available to cover losses due to business interruptions resulting from public health issues.

### *Failure by us to maintain effective disclosure controls and procedures and internal control over financial reporting in accordance with the rules of the SEC could harm our business and results of operations and/or result in a loss of investor confidence in our financial reports, which could have a material adverse effect on our business.*

We are required to maintain effective disclosure controls and procedures and effective internal control over financial reporting in connection with our filing of periodic reports with the SEC under the Exchange Act.

We may fail to maintain effective disclosure controls and procedures and internal control over financial reporting, and our management and our independent registered public accounting firm may not be able to conclude that we have effective internal control over financial reporting at a reasonable assurance level. This may in turn cause investors to lose confidence in our financial statements and negatively impact the trading price of our common stock. Furthermore, we have incurred substantial costs, and may need to incur additional costs and use additional management and other resources, to comply with these requirements going forward.

If we fail to remedy any material weakness, our financial statements may be inaccurate and we may face restricted access to the capital markets, which could adversely affect our business, results of operations and financial condition.

### *The Company's stock price may fluctuate significantly.*

The trading price of shares of our common stock can be volatile and could fluctuate widely in response to a variety of factors, many of which are beyond our control. In addition, the performance and fluctuation of the market prices of other companies with business operations located mainly in China that have listed their securities in Hong Kong and/or the United States may affect the volatility in the prices of and trading volumes for our shares. Some of these companies have experienced significant volatility. The trading performances of these companies' securities at the time of or after their offerings may affect the overall investor sentiment towards other companies with business operations located mainly in China and listed in Hong Kong and/or the United States and consequently may impact the trading performance of our shares. In addition to market and industry factors, the prices and trading volumes for our shares may be highly volatile for specific business reasons, including:

- actual or anticipated fluctuations in the our results of operations;
- significant liability claims, health concerns, food contamination complaints from our customers, shortages or interruptions in the availability of food or other supplies, or reports of incidents of food tampering;
- foreign exchange issues;
- geopolitical instability, conflict, or social unrest in the markets in which we operate, in Hong Kong, the United States or worldwide;

- changes in the regulatory, legal and political environment in which we operate, in Hong Kong, the United States or worldwide;

- the domestic and worldwide economies as a whole; or

- the delisting of our common stock from the New York Stock Exchange. See "— Risks Related to Doing Business in China — The audit report included in the annual report on Form 10-K filed with SEC is prepared by auditors who are not currently inspected by the Public Company Accounting Oversight Board and, as such, our stockholders are deprived of the benefits of such inspection and our common stock is subject to delisting from the New York Stock Exchange in the future."

Any of these factors may result in large and sudden changes in the volume and trading price of our shares.

### *Substantial future sales or perceived potential sales of our shares in the public market could cause the price of our shares to decline significantly.*

Sales of shares of our common stock in the public market, or the perception that these sales could occur, could cause the market price of our shares to decline significantly. Divesture in the future of our shares by stockholders, the announcement of any plan to divest our shares, or hedging activity by third-party financial institutions in connection with similar derivative or other financing arrangements entered into by stockholders, could cause the price of our shares to decline.

### *Your percentage of ownership in the Company may be diluted in the future.*

In the future, your percentage ownership in the Company may be diluted because of equity awards that we grant to our directors, officers and employees or otherwise as a result of equity issuances for acquisitions or capital market transactions. The Company's and certain of YUM's employees have equity awards with respect to Company common stock as a result of conversion of their YUM equity awards (in whole or in part) to Company equity awards in connection with the distribution. From time to time, the Company will issue additional stock-based awards to its employees under the Company's employee benefit plans. Such awards will have a dilutive effect on the Company's earnings per share, which could adversely affect the market price of Company common stock.

In addition, our amended and restated certificate of incorporation authorizes us to issue, without the approval of the Company's stockholders, one or more classes or series of preferred stock that have such designation, powers, preferences and relative, participating, optional and other special rights, including preferences over Company common stock respecting dividends and distributions, as our board of directors generally may determine. The terms of one or more classes or series of preferred stock could dilute the voting power or reduce the value of Company common stock. Similarly, the repurchase or redemption rights or liquidation preferences we could assign to holders of preferred stock could affect the residual value of the common stock.

# Properties

As of year-end 2021, the Company had 10,051 Company-owned units in China. Of these Company-owned units, 9,999 units were leased properties and 52 units were owned properties. The leased Company-owned units are further detailed as follows:

- KFC leased properties for 7,399 units.
- Pizza Hut leased properties for 2,439 units.
- Other restaurant concepts leased properties for 161 units.

Company-owned restaurants in China are generally leased for initial terms of 10 to 20 years and generally do not have renewal options.

We also lease our corporate headquarters in Shanghai and Dallas, Texas in the U.S., and regional offices and an innovation center in China, and own building, land use rights, or both for 10 non-store properties, which primarily include logistics centers, seasoning facilities and office buildings for Little Sheep and Huang Ji Huang. We sublease over 160 properties to franchisees and other third parties. Additional information about the Company's leased properties is included in Note 12 to the Consolidated Financial Statements in Part II. We believe that our properties are generally in good operating condition and are suitable for the purposes for which they are being used.

# Legal Proceedings

We are subject to various lawsuits covering a variety of allegations from time to time. We believe 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. Matters faced by the Company from time to time include, but are not limited to, claims from landlords, employees, guests and others related to operational, contractual or employment issues. We are not involved in any material legal proceedings as of December 31, 2021.

# PART II

## Market for our Common Equity, Related Stockholder Matters and Purchases of Equity Securities

### Market for Yum China Common Stock

Yum China common stock trades on the New York Stock Exchange ("NYSE") under the symbol YUMC. Yum China common stock commenced trading on the NYSE on a "when-issued" basis on October 17, 2016 and began "regular way" trading on November 1, 2016. On September 10, 2020, the Company completed a secondary listing of its common stock on the Main Board of the HKEX under the stock code "9987". The shares listed on the HKEX are fully fungible with the shares listed on the NYSE.

As of February 22, 2022, the number of shares of Yum China's common stock outstanding was 425,589,799 shares, and there were 38,971 holders of record. The number of registered holders does not include holders who are beneficial owners, but whose shares are held in street name by brokers and other nominees.

### Dividends and Share Repurchases

We intend to retain a significant portion of our earnings to finance the operation, development and growth of our business. Since declaring an initial dividend of $0.10 per share in the fourth quarter of 2017, we have paid a quarterly cash dividend on Yum China common stock. Beginning in the fourth quarter of 2018, we have paid a quarterly cash dividend of $0.12 per share. However, due to the unprecedented effects of the COVID-19 pandemic, the Company suspended its dividend payments in the second and third quarter of 2020. Cash dividends totaling $203 million were paid to stockholders in 2021. Any determination to declare and pay future cash dividends will be at the discretion of our board of directors and will depend on, among other things, our financial condition, results of operations, actual or anticipated cash requirements, contractual or regulatory restrictions, tax considerations and such other factors as our board of directors deems relevant.

In addition, our ability to declare and pay any dividends on our stock may be restricted by earnings available for distribution under applicable Chinese laws. The laws, rules and regulations applicable to our Chinese subsidiaries permit payments of dividends only out of their accumulated profits, if any, determined in accordance with applicable Chinese accounting standards and regulations. Under Chinese law, an enterprise incorporated in China is required to set aside at least 10% of its after-tax profits each year, after making up previous years' accumulated losses, if any, to fund certain statutory reserve funds, until the aggregate amount of such a fund reaches 50% of its registered capital. As a result, our Chinese subsidiaries are restricted in their ability to transfer a portion of their net assets to us in the form of dividends. At the discretion of the board of directors, as an enterprise incorporated in China, each of our Chinese subsidiaries may allocate a portion of its after-tax profits based on Chinese accounting standards to staff welfare and bonus funds. These reserve funds and staff welfare and bonus funds are not distributable as cash dividends.

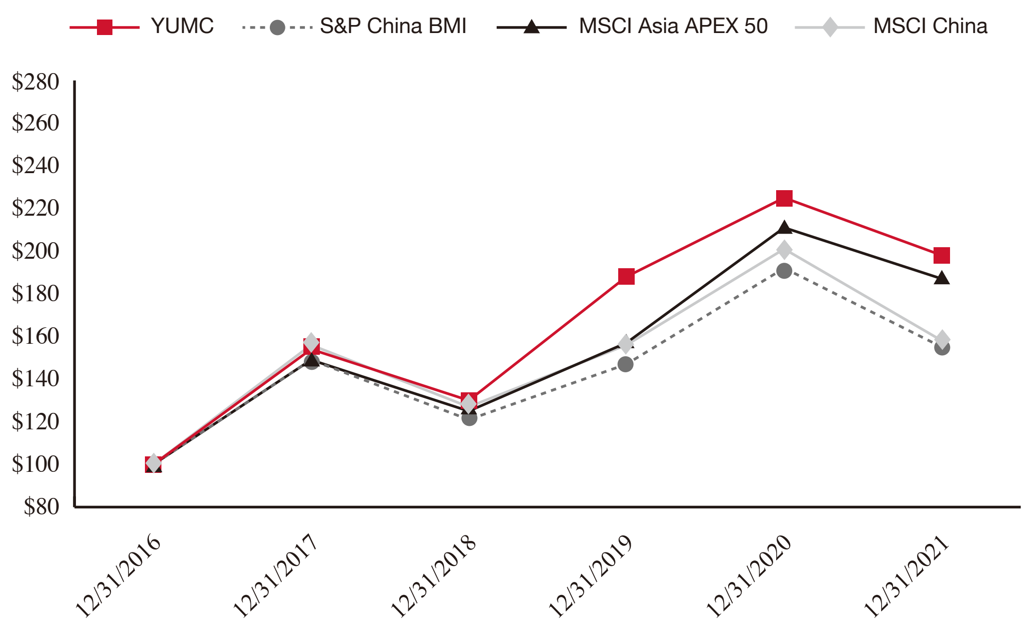
Our board of directors has authorized an aggregate of $1.4 billion for our share repurchase program, including its most recent increase in authorization on October 31, 2018. Yum China may repurchase shares under this program from time to time in open market or privately negotiated transactions, including block trades, accelerated share repurchase transactions and the use of Rule 10b5-1 trading plans. Starting in the second quarter of 2020, our share repurchases were suspended due to the impacts of the COVID-19 pandemic. On July 28, 2021, our board of directors approved the resumption of share repurchases. The following table provides information, as of December 31, 2021, with respect to shares of common stock repurchased by Yum China under the authorization during the quarter then ended:

| Period | Total Number of Shares Purchased (thousands) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (thousands) | Approximate Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs (millions) |
|---|---|---|---|---|
| 10/1/21–10/31/21 | 251 | $ 59.19 | 251 | $ 643 |
| 11/1/21–11/30/21 | 492 | $ 53.86 | 492 | $ 617 |
| 12/1/21–12/31/21 | — | — | — | $ 617 |
| Cumulative total | 743 | $ 55.66 | 743 | $ 617 |

## Stock Performance Graph

This graph compares the cumulative total return of our common stock from December 31, 2016 through December 31, 2021, with the comparable cumulative total return of the S&P China BMI, MSCI Asia APEX 50, and MSCI China Index. The graph assumes that the value of the investment in our common stock and each index was $100 on December 31, 2016 and that all dividends were reinvested. We selected the S&P China BMI and MSCI Asia APEX 50 for comparison, as YUMC is an index member of both of these indices. We also selected MSCI China Index, as our relative total shareholder return against this index is one of the measures to determine the payout of certain PSU awards.

| | 12/31/2016 | 12/31/2017 | 12/31/2018 | 12/31/2019 | 12/31/2020 | 12/31/2021 |
|---|---|---|---|---|---|---|
| **YUMC** | $ 100 | $ 154 | $ 130 | $ 188 | $ 225 | $ 198 |
| **S&P China BMI** | $ 100 | $ 149 | $ 121 | $ 147 | $ 192 | $ 155 |
| **MSCI Asia APEX 50** | $ 100 | $ 149 | $ 125 | $ 157 | $ 211 | $ 187 |
| **MSCI China** | $ 100 | $ 156 | $ 127 | $ 156 | $ 201 | $ 158 |



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

The following Management's Discussion and Analysis ("MD&A") should be read in conjunction with the Consolidated Financial Statements, the "Forward-Looking Statements" section and the "Risk Factors" section in this annual report.

All Note references in this MD&A refer to the Notes to the Consolidated Financial Statements included in this annual report. Tabular amounts are displayed in millions of U.S. dollars except per share and unit count amounts, or as otherwise specifically identified. Percentages may not recompute due to rounding. Throughout this annual report when we refer to the "financial statements," we are referring to the "Consolidated Financial Statements," unless the context indicates otherwise. This MD&A includes a discussion of our results of operations for the year ended December 31, 2021 compared to the year ended December 31, 2020. For a discussion of the year ended December 31, 2020 compared to the year ended December 31, 2019, please refer to "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our annual report for the year ended December 31, 2020.

## Overview

Yum China Holdings, Inc. is the largest restaurant company in China in terms of system sales, with $9.9 billion of revenues in 2021 and over 11,700 restaurants as of year-end 2021. Our growing restaurant network consists of our flagship KFC and Pizza Hut brands, as well as emerging brands such as Little Sheep, Huang Ji Huang, Lavazza, COFFii & JOY, Taco Bell and East Dawning. We have the exclusive right to operate and sublicense the KFC, Pizza Hut and, subject to achieving certain agreed-upon milestones, Taco Bell brands in China, (excluding Hong Kong, Macau and Taiwan), and own the intellectual property of the Little Sheep, Huang Ji Huang, COFFii & JOY and East Dawning concepts outright. We also established a joint venture with Lavazza Group, the world-renowned family-owned Italian coffee company, to explore and develop the Lavazza coffee shop concept in China. KFC was the first major global restaurant brand to enter China in 1987. With more than 30 years of operations, we have developed extensive operating experience in the China market. We have since grown to become the largest restaurant company in China in terms of 2021 system sales, with 11,788 restaurants covering over 1,600 cities primarily in China as of December 31, 2021. We believe that there are significant opportunities to expand within China, and we intend to focus our efforts on increasing our geographic footprint in both existing and new cities.

KFC is the leading and the largest quick-service restaurant ("QSR") brand in China in terms of system sales. As of December 31, 2021, KFC operated over 8,100 restaurants in more than 1,600 cities across China. KFC primarily competes with western QSR brands in China, such as McDonald's, Dicos and Burger King, among which we believe KFC had an approximate two-to-one lead over its nearest competitor in terms of store count as of the end of 2021. In the third quarter of 2020, the Company completed the acquisition of an additional 25% interest in an unconsolidated affiliate that operates KFC stores in and around Suzhou, China ("Suzhou KFC"), increasing our equity interest to 72% and allowing the Company to consolidate the entity. In the fourth quarter of 2021, the Company completed the acquisition of a 28% equity interest in Hangzhou Catering Service Group ("Hangzhou Catering"), which holds a 45% equity interest in an unconsolidated affiliate that operates KFC stores in and around Hangzhou, China ("Hangzhou KFC"), increasing our equity interest to approximately 60% directly and indirectly, and allowing the Company to consolidate Hangzhou KFC.

Pizza Hut is the leading and the largest casual dining restaurant ("CDR") brand in China in terms of system sales and number of restaurants. As of December 31, 2021, Pizza Hut operated over 2,500 restaurants in over 600 cities. Measured by number of restaurants, we believe Pizza Hut had an approximate six-to-one lead over its nearest western CDR competitor in China as of the end of 2021.

We have two reportable segments: KFC and Pizza Hut. Our remaining non-reportable operating segments, including the operations of Little Sheep, Huang Ji Huang, Lavazza, COFFii & JOY, Taco Bell, East Dawning, Daojia and our e-commerce business, are combined and referred to as All Other Segments, as these operating segments are insignificant both individually and in the aggregate. Additional details on our reportable operating segments are included in Note 18 to the Consolidated Financial Statements.

We intend for this MD&A to provide the reader with information that will assist in understanding our results of operations, including metrics that management uses to assess the Company's performance. Throughout this MD&A, we discuss the following performance metrics:

- The Company provides certain percentage changes excluding the impact of foreign currency translation ("F/X"). These amounts are derived by translating current year results at prior year average exchange rates. We believe the elimination of the F/X impact provides better year-to-year comparability without the distortion of foreign currency fluctuations.

- System sales growth reflects the results of all restaurants regardless of ownership, including Company-owned, franchise and unconsolidated affiliate restaurants that operate our concepts, except for sales from non-Company-owned restaurants, for which we do not receive a sales-based royalty. Sales of franchise and unconsolidated affiliate restaurants typically generate ongoing franchise fees for the Company at an average rate of approximately 6% of system sales. Franchise and unconsolidated affiliate restaurant sales are not included in Company sales in the Consolidated Statements of Income; however, the franchise 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 of our revenue drivers, Company and franchise same-store sales as well as net unit growth.

- Effective January 1, 2018, the Company revised its definition of same-store sales growth to represent the estimated percentage change in sales of food of all restaurants in the Company system that have been open prior to the first day of our prior fiscal year, excluding the period during which stores are temporarily closed. We refer to these as our "base" stores. Previously, same-store sales growth represented the estimated percentage change in sales of all restaurants in the Company system that have been open for one year or more, including stores temporarily closed, and the base stores changed on a rolling basis from month to month. This revision was made to align with how management measures performance internally and focuses on trends of a more stable base of stores. Prior years have been adjusted accordingly.

- Company sales represent revenues from Company-owned restaurants. Company Restaurant profit ("Restaurant profit") is defined as Company sales less expenses incurred directly by our Company-owned restaurants in generating Company sales. Company restaurant margin percentage is defined as Restaurant profit divided by Company sales. Within the Company sales and Restaurant profit analysis, Store Portfolio Actions represent the net impact of new-unit openings, acquisitions, refranchising and store closures, and Other primarily represents the impact of same-store sales as well as the impact of changes in restaurant operating costs such as inflation/deflation.

# Results of Operations

## *Summary*

All comparisons within this summary are versus the same period a year ago. Refer to “Business” in this annual report for a discussion of the seasonality of our operations.

The COVID-19 pandemic has adversely affected, and will continue to adversely affect, our operations and financial results for the foreseeable future. Starting in the first quarter of 2020, the COVID-19 pandemic significantly impacted the Company’s operations, resulting in a significant decline in Operating profit mainly driven by same-store sales declines and temporary store closures. While operating results improved sequentially in the last three quarters of 2020 and the first half of 2021, multiple waves of Delta-variant outbreaks persisted throughout the second half of 2021, spreading to nearly all provinces in China. As a result, the Company’s operations and financial results were significantly affected in the second half of 2021.

In 2021, the Company’s total revenues increased 19%, or 12% excluding the impact of F/X, mainly attributable to new-unit openings of 1,806 and the acquisition of Suzhou KFC and Hangzhou KFC, fewer temporary store closures compared to 2020 when approximately 35% of our restaurants were temporarily closed at the peak of the COVID-19 outbreak and same-store sales growth of 7% at Pizza Hut, partially offset by same-store sales decline of 3% at KFC. Operating profit increased 44%, or 34% excluding the impact of F/X, primarily driven by a net increase in re-measurement gain of our previously held equity interest in Hangzhou KFC, Lavazza and Suzhou KFC at fair value upon acquisition in 2021 and 2020, respectively, the increase in restaurant profit and a decrease of $18 million in store impairment expenses, partially offset by an increase in G&A expenses primarily due to higher compensation cost and lapping one-time reductions in social security contributions in 2020. Net income for 2021 increased 26%, or 16% excluding the impact of F/X, mainly due to the increase in operating profit, partially offset by the investment loss in 2021 lapping the investment gain in 2020 primarily from the fair value change of investments in equity securities and higher income tax expenses in line with the increase in pre-tax income.

2021 financial highlights are below:

| | % Change | | | | |
|---|---|---|---|---|---|
| | System Sales[(a)] | Same-Store Sales[(a)] | Net New Units | Operating Profit (Reported) | Operating Profit (Ex F/X) |
| KFC | +8 | (3) | +14 | +3 | (3) |
| Pizza Hut | +14 | +7 | +10 | +77 | +66 |
| All Other Segments[(b)] | +29 | (2) | +5 | NM | NM |
| Total | +10 | (1) | +12 | +44 | +34 |

NM refers to not meaningful.

(a) System Sales and Same-Store Sales percentages as shown in 2021 financial highlights exclude the impact of F/X. Effective January 1, 2018, temporary store closures are normalized in the same-store sales calculation by excluding the period during which stores are temporarily closed.

(b) Sales from non-Company-owned restaurants, for which we do not receive a sales-based royalty, are excluded from System Sales and Same-Store Sales.

The Consolidated Results of Operations for the years ended December 31, 2021 and 2020 and other data are presented below:

| | 2021 | 2020 | % B/(W)[a] Reported | % B/(W)[a] Ex F/X |
|---|---|---|---|---|
| Company sales | $ 8,961 | $ 7,396 | 21 | 14 |
| Franchise fees and income | 153 | 148 | 3 | (4) |
| Revenues from transactions with franchisees and unconsolidated affiliates | 663 | 647 | 3 | (4) |
| Other revenues | 76 | 72 | 6 | — |
| Total revenues | $ 9,853 | $ 8,263 | 19 | 12 |
| Restaurant profit | $ 1,227 | $ 1,098 | 12 | 5 |
| Restaurant margin % | 13.7% | 14.9% | (1.2) ppts. | (1.2) ppts. |
| Operating Profit | $ 1,386 | $ 961 | 44 | 34 |
| Interest income, net | 60 | 43 | 39 | 33 |
| Investment (loss) gain | (54) | 104 | NM | NM |
| Income tax provision | (369) | (295) | (25) | (18) |
| Net income — including noncontrolling interests | 1,023 | 813 | 26 | 16 |
| Net income — noncontrolling interests | 33 | 29 | (15) | (8) |
| Net Income — Yum China Holdings, Inc. | $ 990 | $ 784 | 26 | 16 |
| Diluted Earnings Per Common Share | $ 2.28 | $ 1.95 | 17 | 8 |
| Effective tax rate | 26.5% | 26.6% | | |
| **Supplementary information — Non-GAAP Measures[b]** | | | | |
| Adjusted Operating Profit | $ 766 | $ 732 | | |
| Adjusted Net Income | $ 525 | $ 615 | | |
| Adjusted Diluted Earnings Per Common Share | $ 1.21 | $ 1.53 | | |
| Adjusted Effective Tax Rate | 27.8% | 26.8% | | |
| Adjusted EBITDA | $ 1,330 | $ 1,248 | | |

(a) Represents year-over-year change in percentage.

(b) See "Non-GAAP Measures" below for definitions and reconciliations of the most directly comparable GAAP financial measures to the non-GAAP measures.

| Performance Metrics | 2021 % Change |
|---|---|
| System Sales Growth | 18% |
| System Sales Growth, excluding F/X | 10% |
| Same-store Sales Decline | (1)% |

| Unit Count | 2021 | 2020 | % Increase (Decrease) |
|---|---|---|---|
| Company-owned[a] | 10,051 | 8,190 | 23 |
| Unconsolidated affiliates | — | 681 | (100) |
| Franchisees | 1,737 | 1,635 | 6 |
| | 11,788 | 10,506 | 12 |

(a) As a result of the acquisition of Hangzhou KFC and Suzhou KFC as disclosed in Note 1, the units of Hangzhou KFC and Suzhou KFC were transferred from unconsolidated affiliates to Company-owned upon the acquisition date.

## Non-GAAP Measures

In addition to the results provided in accordance with GAAP throughout this MD&A, the Company provides non-GAAP measures adjusted for Special Items, which include Adjusted Operating Profit, Adjusted Net Income, Adjusted Earnings Per Common Share ("EPS"), Adjusted Effective Tax Rate and Adjusted EBITDA, which we define as net income including noncontrolling interests adjusted for income tax, interest income, net, investment gain or loss, certain non-cash expenses, consisting of depreciation and amortization as well as store impairment charges, and Special Items.

The following table sets forth the reconciliations of the most directly comparable GAAP financial measures to the non-GAAP adjusted financial measures.

| Non-GAAP Reconciliations | 2021 | 2020 |
|---|---|---|
| **Reconciliation of Operating Profit to Adjusted Operating Profit** | | |
| Operating Profit | $ 1,386 | $ 961 |
| Special Items, Operating Profit | 620 | 229 |
| Adjusted Operating Profit | $ 766 | $ 732 |
| **Reconciliation of Net Income to Adjusted Net Income** | | |
| Net Income — Yum China Holdings, Inc. | $ 990 | $ 784 |
| Special Items, Net Income — Yum China Holdings, Inc. | 465 | 169 |
| Adjusted Net Income — Yum China Holdings, Inc. | $ 525 | $ 615 |
| **Reconciliation of EPS to Adjusted EPS** | | |
| Basic Earnings Per Common Share | $ 2.34 | $ 2.01 |
| Special Items, Basic Earnings Per Common Share | 1.10 | 0.43 |
| Adjusted Basic Earnings Per Common Share | $ 1.24 | $ 1.58 |
| Diluted Earnings Per Common Share | $ 2.28 | $ 1.95 |
| Special Items, Diluted Earnings Per Common Share | 1.07 | 0.42 |
| Adjusted Diluted Earnings Per Common Share | $ 1.21 | $ 1.53 |
| **Reconciliation of Effective Tax Rate to Adjusted Effective Tax Rate** | | |
| Effective tax rate (See Note 17) | 26.5% | 26.6% |
| Impact on effective tax rate as a result of Special Items | (1.3)% | (0.2)% |
| Adjusted effective tax rate | 27.8% | 26.8% |

Net income, along with the reconciliation to Adjusted EBITDA, is presented below:

| | 2021 | 2020 |
|---|---|---|
| **Reconciliation of Net Income to Adjusted EBITDA** | | |
| Net Income — Yum China Holdings, Inc. | $ 990 | $ 784 |
| Net income — noncontrolling interests | 33 | 29 |
| Income tax provision | 369 | 295 |
| Interest income, net | (60) | (43) |
| Investment loss (gain) | 54 | (104) |
| Operating Profit | 1,386 | 961 |
| Special Items, Operating Profit | (620) | (229) |
| Adjusted Operating Profit | 766 | 732 |
| Depreciation and amortization | 516 | 450 |
| Store impairment charges | 48 | 66 |
| Adjusted EBITDA | $ 1,330 | $ 1,248 |

Details of Special Items are presented below:

| Details of Special Items | 2021 | 2020 |
|---|---|---|
| Gain from re-measurement of equity interest upon acquisition[a] | $ 628 | $ 239 |
| Share-based compensation expense for Partner PSU Awards[b] | (8) | (7) |
| Derecognition of indemnification assets related to Daojia[c] | — | (3) |
| Special Items, Operating Profit | 620 | 229 |
| Tax effect on Special Items[d] | (155) | (60) |
| Special Items, net income — including noncontrolling interests | 465 | 169 |
| Special Items, net income — noncontrolling interests | — | — |
| Special Items, Net Income — Yum China Holdings, Inc. | $ 465 | $ 169 |
| Weighted-Average Diluted Shares Outstanding (in millions) | 434 | 402 |
| Special Items, Diluted Earnings Per Common Share | $ 1.07 | $ 0.42 |

(a) In the fourth and third quarter of 2021, as a result of the consolidation of Hangzhou KFC and the Lavazza joint venture, the Company recognized a gain of $618 million and $10 million, respectively, from the re-measurement of our previously held equity interest at fair value. In the third quarter of 2020, the Company recognized a re-measurement gain of $239 million as a result of the consolidation of Suzhou KFC. The re-measurement gains were not allocated to any segment for performance reporting purposes. (See Note 3 for additional information.)

(b) In February 2020, the Company granted Partner PSU Awards to select employees who were deemed critical to the Company's execution of its strategic operating plan. These PSU awards will only vest if threshold performance goals are achieved over a four-year performance period, with the payout ranging from 0% to 200% of the target number of shares subject to the PSU awards. Partner PSU Awards were granted to address increased competition for executive talent, motivate transformational performance and encourage management retention. Given the unique nature of these grants, the Compensation Committee does not intend to grant similar, special grants to the same employees during the performance period. The impact from these special awards is excluded from metrics that management uses to assess the Company's performance. The Company recognized share-based compensation cost of $8 million and $7 million associated with the Partner PSU Awards for the year ended December 31, 2021 and 2020, respectively.

(c) In the second quarter of 2020, the Company derecognized a $3 million indemnification asset previously recorded for the Daojia acquisition as the indemnification right expired pursuant to the purchase agreement. The amount was included in Other income, net, but was not allocated to any segment for performance reporting purposes.

(d) Tax effect was determined based upon the nature, as well as the jurisdiction, of each Special Item at the applicable tax rate.

The Company excludes impact from Special Items for the purpose of evaluating performance internally. Special Items are not included in any of our segment results. In addition, the Company provides Adjusted EBITDA because we believe that investors and analysts may find it useful in measuring operating performance without regard to items such as income tax, interest income, net, investment gain or loss, depreciation and amortization, store impairment charges, and Special Items. Store impairment charges included as an adjustment item in Adjusted EBITDA primarily resulted from our semi-annual impairment evaluation of long-lived assets of individual restaurants, and additional impairment evaluation whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. If these restaurant-level assets were not impaired, depreciation of the assets would have been recorded and included in EBITDA. Therefore, store impairment charges were a non-cash item similar to depreciation and amortization of our long-lived assets of restaurants. The Company believes that investors and analysts may find it useful in measuring operating performance without regard to such non-cash item.

These adjusted measures are not intended to replace the presentation of our financial results in accordance with GAAP. Rather, the Company believes that the presentation of these adjusted measures provides additional information to investors to facilitate the comparison of past and present results, excluding those items that the Company does not believe are indicative of our ongoing operations due to their nature.

## Segment Results

### *KFC*

KFC delivered a resilient performance in 2021 by accelerating store expansion with attractive returns and maintaining solid profitability. KFC continued to focus on innovative products, creating abundant value for our customers, as well as on upgrading ingredients to meet Chinese consumers' needs. KFC also continued its digital and delivery initiatives to enhance the customer experience. KFC's loyalty program members exceeded 330 million at year-end 2021 and contributed approximately 62% of system sales at KFC in 2021. Delivery sales accounted for approximately 31% of Company sales at KFC in 2021 with store and city coverage of 87% and 97%, respectively, at the end of 2021.

| | | | % B/(W) | |
|---|---|---|---|---|
| | 2021 | 2020 | Reported | Ex F/X |
| Company sales | $ 6,816 | $ 5,633 | 21 | 13 |
| Franchise fees and income | 120 | 125 | (4) | (10) |
| Revenues from transactions with franchisees and unconsolidated affiliates | 59 | 61 | (4) | (10) |
| Other revenues | $ 8 | $ 2 | NM | NM |
| Total revenues | $ 7,003 | $ 5,821 | 20 | 13 |
| Restaurant profit | $ 1,013 | $ 920 | 10 | 3 |
| Restaurant margin % | 14.9% | 16.3% | (1.4) ppts. | (1.4) ppts. |
| G&A expenses | $ 240 | $ 200 | (20) | (13) |
| Franchise expenses | $ 59 | $ 62 | 4 | 11 |
| Expenses for transactions with franchisees and unconsolidated affiliates | $ 58 | $ 61 | 5 | 11 |
| Other operating costs and expenses | $ 4 | $ 1 | NM | NM |
| Closure and impairment expenses, net | $ 20 | $ 25 | 17 | 22 |
| Other income, net | $ (8) | $ (42) | (82) | (83) |
| Operating Profit | $ 827 | $ 801 | 3 | (3) |

| | 2021 % Change |
|---|---|
| System Sales Growth | 16% |
| System Sales Growth, excluding F/X | 8% |
| Same-store Sales Decline | (3)% |

| Unit Count | 2021[a] | 2020 | % Increase (Decrease) |
|---|---|---|---|
| Company-owned | 7,437 | 5,872 | 27 |
| Unconsolidated affiliates | — | 677 | (100) |
| Franchisees | 731 | 617 | 18 |
| | 8,168 | 7,166 | 14 |

| | 2020 | New Builds | Acquired[a] | Closures | Refranchised | 2021 |
|---|---|---|---|---|---|---|
| Company-owned | 5,872 | 978 | 788 | (199) | (2) | 7,437 |
| Unconsolidated affiliates | 677 | 116 | (780) | (13) | — | — |
| Franchisees | 617 | 138 | (8) | (18) | 2 | 731 |
| Total | 7,166 | 1,232 | — | (230) | — | 8,168 |

(a) As a result of the acquisition of Hangzhou KFC as disclosed in Note 1, the units of Hangzhou KFC were transferred from unconsolidated affiliates to Company-owned.

### Company Sales and Restaurant Profit

The changes in Company sales and Restaurant profit were as follows:

| Income (Expense) | 2020 | Store Portfolio Actions | Other | F/X | 2021 |
|---|---|---|---|---|---|
| Company sales | $ 5,633 | $ 912 | $ (159) | $ 430 | $ 6,816 |
| Cost of sales | (1,801) | (291) | 72 | (138) | (2,158) |
| Cost of labor | (1,247) | (218) | (74) | (103) | (1,642) |
| Occupancy and other operating expenses | (1,665) | (231) | 21 | (128) | (2,003) |
| Restaurant profit | $ 920 | $ 172 | $ (140) | $ 61 | $ 1,013 |

In 2021, the increase in Company sales, excluding the impact of F/X, was primarily driven by net unit growth including the acquisition of Suzhou KFC and Hangzhou KFC and fewer temporary store closures compared to 2020, partially offset by same-store sales decline. The increase in Restaurant profit, excluding the impact of F/X, was primarily driven by the increase in Company sales and commodity deflation of 4%, largely offset by higher promotion costs from value campaigns, a decrease of $55 million in temporary relief provided by landlords and government agencies, wage inflation of 4%, increased rider cost associated with a rise of approximately three percentage points in delivery sales from the prior year as consumers remain cautious about dine-in and higher costs associated with the phase-out of certain plastic packaging and other packaging upgrades.

### Franchise Fees and Income

In 2021, the decrease in Franchise fees and income, excluding the impact of F/X, was primarily driven by the acquisition of Suzhou KFC and Hangzhou KFC, partially offset by the net unit growth.

### G&A Expenses

In 2021, the increase in G&A expenses, excluding the impact of F/X, was primarily driven by the acquisition of Suzhou KFC and Hangzhou KFC, merit increases and lapping one-time reductions in social security contributions in 2020.

### Operating Profit

In 2021, the decrease in Operating profit, excluding the impact of F/X, was primarily driven by lower equity income from our unconsolidated affiliates due to the consolidation of Suzhou KFC and Hangzhou KFC upon acquisition and higher G&A expenses, partially offset by the increase in Restaurant profit.

## *Pizza Hut*

During 2021, we continued to focus on strengthening Pizza Hut's fundamentals, including investments in products, strengthening our digital capabilities, developing delivery and other channels and enhancing our asset portfolio to drive growth. Pizza Hut's loyalty program members approximated 110 million at year-end 2021 and contributed approximately 55% of system sales at Pizza Hut in 2021. Delivery sales accounted for approximately 36% of Company sales at Pizza Hut in 2021 with store and city coverage of 94% and 98%, respectively, at the end of 2021.

| | 2021 | 2020 | % B/(W) Reported | % B/(W) Ex F/X |
|---|---|---|---|---|
| Company sales | $ 2,092 | $ 1,721 | 22 | 14 |
| Franchise fees and income | 8 | 5 | 31 | 23 |
| Revenues from transactions with franchisees and unconsolidated affiliates | 6 | 4 | 41 | 33 |
| Other revenue | $ 3 | $ — | NM | NM |
| Total revenues | $ 2,109 | $ 1,730 | 22 | 14 |
| Restaurant profit | $ 224 | $ 181 | 24 | 16 |
| Restaurant margin % | 10.7% | 10.5% | 0.2 ppts. | 0.2 ppts. |
| G&A expenses | $ 111 | $ 96 | (15) | (7) |
| Franchise expenses | $ 4 | $ 3 | (25) | (17) |
| Expenses for transactions with franchisees and unconsolidated affiliates | $ 6 | $ 4 | (36) | (28) |
| Other operating costs and expenses | $ 2 | $ — | NM | NM |
| Closure and impairment expenses, net | $ 7 | $ 25 | 70 | 72 |
| Operating Profit | $ 111 | $ 62 | 77 | 66 |

| | 2021 % Change |
|---|---|
| System Sales Growth | 22% |
| System Sales Growth, excluding F/X | 14% |
| Same-Store Sales Growth | 7% |

| Unit Count | 2021 | 2020 | % Increase |
|---|---|---|---|
| Company-owned | 2,452 | 2,230 | 10 |
| Franchisees | 138 | 125 | 10 |
| | 2,590 | 2,355 | 10 |

| | 2020 | New Builds | Closures | Acquired | 2021 |
|---|---|---|---|---|---|
| Company-owned | 2,230 | 316 | (95) | 1 | 2,452 |
| Franchisees | 125 | 19 | (5) | (1) | 138 |
| Total | 2,355 | 335 | (100) | — | 2,590 |

## Company Sales and Restaurant Profit

The changes in Company sales and Restaurant profit were as follows:

| Income (Expense) | 2020 | Store Portfolio Actions | Other | F/X | 2021 |
|---|---|---|---|---|---|
| Company sales | $ 1,721 | $ 127 | $ 111 | $ 133 | $ 2,092 |
| Cost of sales | (529) | (38) | (29) | (41) | (637) |
| Cost of labor | (471) | (35) | (54) | (38) | (598) |
| Occupancy and other operating expenses | (540) | (34) | (19) | (40) | (633) |
| Restaurant profit | $ 181 | $ 20 | $ 9 | $ 14 | $ 224 |

In 2021, the increase in Company sales, excluding the impact of F/X, was primarily driven by same-store sales growth and fewer temporary store closures compared to 2020. The increase in Restaurant profit, excluding the impact of F/X, was primarily driven by the increase in Company sales and commodity deflation of 5%, partially offset by a decrease of $22 million in temporary relief provided by landlords and government agencies, wage inflation of 6% and higher promotion costs from value campaigns.

### G&A Expenses

In 2021, the increase in G&A expenses, excluding the impact of F/X, was primarily driven by higher compensation costs and lapping one-time reductions in social security contributions in 2020.

### Operating Profit

In 2021, the increase in Operating profit, excluding the impact of F/X, was primarily driven by the increase in Restaurant profit and a decrease of $16 million in store impairment expenses, partially offset by higher G&A expenses.

## *All Other Segments*

All Other Segments reflects the results of Little Sheep, Huang Ji Huang, Lavazza, COFFii & JOY, Taco Bell, East Dawning, Daojia and our e-commerce business.

| | | | % B/(W) | |
|---|---|---|---|---|
| | 2021 | 2020 | Reported | Ex F/X |
| Company sales | $ 53 | $ 42 | 27 | 19 |
| Franchise fees and income | 25 | 18 | 38 | 30 |
| Revenues from transactions with franchisees and unconsolidated affiliates | 98 | 60 | 63 | 54 |
| Other revenues | 297 | 122 | NM | NM |
| Total revenues | $ 473 | $ 242 | 96 | 85 |
| Restaurant loss | $ (10) | $ (3) | NM | NM |
| Restaurant margin % | (20.8)% | (6.3)% | (14.5) ppts. | (14.5) ppts. |
| G&A expenses | $ 42 | $ 39 | (11) | (3) |
| Franchise expenses | $ 1 | $ — | NM | NM |
| Expenses for transactions with franchisees and unconsolidated affiliates | $ 88 | $ 48 | (81) | (72) |
| Other operating costs and expenses | $ 294 | $ 110 | NM | NM |
| Closure and impairment expenses, net | $ 7 | $ 5 | (12) | (4) |
| Other loss, net | $ 7 | $ 2 | NM | NM |
| Operating Loss | $ (29) | $ (7) | NM | NM |

### Total Revenues

In 2021, the increase in Total revenues, excluding the impact of F/X, was primarily driven by the revenue generated by our delivery team for services provided to KFC and Pizza Hut restaurants and the consolidation of Huang Ji Huang.

### Operating Loss

In 2021, the increase in Operating loss, excluding the impact of F/X, was primarily driven by the increase of Operating loss from certain emerging brands, partially offset by Operating profit generated by Huang Ji Huang.

## *Corporate & Unallocated*

| | | | % B/(W) | |
|---|---|---|---|---|
| | 2021 | 2020 | Reported | Ex F/X |
| Revenues from transactions with franchisees and unconsolidated affiliates[(a)] | 500 | 522 | (4) | (10) |
| Other revenues | 20 | 6 | NM | NM |
| Expenses for transactions with franchisees and unconsolidated affiliates[(a)] | 497 | 520 | 4 | 11 |
| Other operating costs and expenses | 17 | 4 | NM | NM |
| Corporate G&A expenses | 171 | 144 | (18) | (14) |
| Other unallocated income | 642 | 245 | NM | NM |
| Interest income, net | 60 | 43 | 39 | 33 |
| Investment (loss) gain | (54) | 104 | NM | NM |
| Income tax provision (See Note 17) | (369) | (295) | (25) | (18) |
| Effective tax rate (See Note 17) | 26.5% | 26.6% | 0.1 ppts | 0.1 ppts |

(a) Primarily includes revenues and associated expenses of transactions with franchisees and unconsolidated affiliates derived from the Company's central procurement model whereby food and paper products are centrally purchased and then mainly sold to KFC and Pizza Hut franchisees and unconsolidated affiliates. Amounts have not been allocated to any segment for purposes of making operating decisions or assessing financial performance as the transactions are corporate revenues and expenses in nature.

### Revenues from Transactions with Franchisees and Unconsolidated Affiliates

In 2021, the decrease in Revenues from transactions with franchisees and unconsolidated affiliates, excluding the impact of F/X, was mainly driven by the impact from the acquisition of Suzhou KFC and Hangzhou KFC, partially offset by the increase in revenue driven by system sales growth.

### Other Revenues/Operating Costs and Expenses

In 2021, the increase in Other revenues/operating costs and expenses was mainly driven by logistics and warehousing services provided to third parties.

### Corporate G&A Expenses

In 2021, the increase in Corporate G&A expenses, excluding the impact of F/X, was primarily driven by higher compensation costs and lapping one-time reductions in social security contributions in 2020.

### Other Unallocated Income

Other unallocated income primarily includes a gain of $618 million and $10 million in 2021 and $239 million in 2020 recognized from the re-measurement of our previously held equity interest in connection with the consolidation of Hangzhou KFC, the Lavazza joint venture and Suzhou KFC, respectively. See Note 3 for additional information.

### Interest Income, Net

The increase in interest income, net for 2021 was primarily driven by the cash increase from the proceeds of $2.2 billion raised from the issuance of common stock in connection with our global offering and secondary listing on the Main Board of HKEX in September 2020.

### Investment (Loss) Gain

The investment loss or gain primarily relates to the change in fair value of our investment in Meituan Dianping ("Meituan"), as well as Fujian Sunner Development Co., Ltd. ("Sunner") before the equity method of accounting was applied. See Note 3 for additional information.

### Income Tax Provision

Our income tax provision primarily includes tax on our earnings at the Chinese statutory tax rate of 25%, withholding tax on planned or actual repatriation of earnings outside of China, and U.S. corporate income tax, if any. Our effective tax rate was 26.5% and 26.6% in 2021 and 2020, respectively.

## Significant Known Events, Trends or Uncertainties Expected to Impact Future Results

### *Impact of COVID-19 Pandemic*

Starting in late January 2020, the COVID-19 pandemic has significantly impacted the Company's operations and financial results. While operating results improved sequentially in the last three quarters of 2020 and first half of 2021, multiple waves of Delta-variant outbreaks persisted throughout the second half of 2021, spreading to nearly all provinces in China. In January, Omicron-variant cases emerged in China, spreading to several major cities. A number of regions were identified as medium- to high-risk with restrictive measures put in place. COVID-19 conditions remain fluid and we expect that our operations will continue to be impacted by COVID-19 pandemic, including outbreaks caused by existing or new COVID-19 variants, and the actions taken by governmental authorities, such as regional lockdowns, measures restricting travel and large gatherings, and recommendations against dining out.

Management at this time cannot ascertain the extent to which our operations will continue to be impacted by the COVID-19 pandemic, which depends largely on future developments that are highly uncertain and cannot be accurately predicted, including resurgences and further spread of existing or new COVID-19 variants, the actions by government authorities to contain or treat its impact, the availability and effectiveness of vaccines, the economic recovery within China and globally, the impact on consumer behavior and other related factors. The Company expects that further developments related to the COVID-19 pandemic may continue to have a material and extended adverse impact on the Company's results of operations, as well as the Company's cash flows and financial condition. For further information on the risks associated with the COVID-19 pandemic, see "Risk Factors — Risks Related to Our Business and Industry — Health concerns arising from outbreaks of viruses or other illnesses may have a material adverse effect on our business. The COVID-19 pandemic has had, and may continue to have, adverse effects on our results of operations, cash flows and financial condition."

### *Tax Examination on Transfer Pricing*

We are subject to reviews, examinations and audits by Chinese tax authorities, the IRS and other tax authorities with respect to income and non-income based taxes. Since 2016, we have been under a national audit on transfer pricing by the STA in China regarding our related party transactions for the period from 2006 to 2015. The information and views currently exchanged with the tax authorities focus on our franchise arrangement with YUM. We continue to provide information requested by the tax authorities to the extent it is available to the Company. It is reasonably possible that there could be significant developments, including expert review and assessment by the STA, within the next 12 months. The ultimate assessment and decision of the STA will depend upon further review of the information provided, as well as ongoing technical and other discussions with the STA and in-charge local tax authorities, and therefore it is not possible to reasonably estimate the potential impact at this time. We will continue to defend our transfer pricing position. However, if the STA prevails in the assessment of additional tax due based on its ruling, the assessed tax, interest and penalties, if any, could have a material adverse impact on our financial position, results of operations and cash flows.

### *PRC Value-Added Tax*

Effective May 1, 2016, a 6% output VAT replaced the 5% business tax ("BT") previously applied to certain restaurant sales. Input VAT would be creditable to the aforementioned 6% output VAT. The latest VAT rates imposed on our purchase of materials and services included 13%, 9% and 6%, which were gradually changed from 17%, 13%, 11% and 6% since 2017. These rate changes impact our input VAT on all materials and certain services, mainly including construction, transportation and leasing. However, the impact on our operating results is not expected to be significant.

Entities that are VAT general taxpayers are permitted to offset qualified input VAT paid to suppliers against their output VAT upon receipt of appropriate supplier VAT invoices on an entity-by-entity basis. When the output VAT exceeds the input VAT, the difference is remitted to tax authorities, usually on a monthly basis; whereas when the input VAT exceeds the output VAT, the difference is treated as an input VAT credit asset which can be carried forward indefinitely to offset future net VAT payables. VAT related to purchases and sales which have not been settled at the balance sheet date is disclosed separately as an asset and liability, respectively, on the Consolidated Balance Sheets. At each balance sheet date, the Company reviews the outstanding balance of any input VAT credit asset for recoverability, giving consideration to the indefinite life of the input VAT credit assets as well as its forecasted operating results and capital spending, which inherently includes significant assumptions that are subject to change.

As of December 31, 2021, an input VAT credit asset of $322 million and payable of $2 million were recorded in Other assets and Accounts payable and other current liabilities, respectively, on the Consolidated Balance Sheets. The Company has not made an allowance for the recoverability of the input VAT credit asset, as the balance is expected to be utilized to offset against VAT payables more than one year from December 31, 2021. Any input VAT credit asset would be classified as Prepaid expenses and other current assets if the credit expected to be used within one year can be reasonably determined.

We have been benefiting from the retail tax structure reform since it was implemented on May 1, 2016. However, the amount of our expected benefit from this VAT regime depends on a number of factors, some of which are outside of our control. The interpretation and application of the new VAT regime are not settled at some local governmental levels. In addition, the timetable for enacting the prevailing VAT regulations into national VAT law, including ultimate enacted VAT rates, is not clear. As a result, for the foreseeable future, the benefit of this significant and complex VAT reform has the potential to fluctuate from quarter to quarter.

### *Foreign Currency Exchange Rate*

The reporting currency of the Company is the US$. Most of the revenues, costs, assets and liabilities of the Company are denominated in RMB. Any significant change in the exchange rate between US$ and RMB may materially affect the Company's business, results of operations, cash flows and financial condition, depending on the weakening or strengthening of RMB against the US$. See "Quantitative and Qualitative Disclosures About Market Risk" for a further discussion.

## Consolidated Cash Flows

**Net cash provided by operating activities** was $1,131 million in 2021 as compared to $1,114 million in 2020. The increase was primarily driven by higher Operating profit, excluding the non-cash gain of $618 million and $239 million recognized from the re-measurement of our previously held equity interest in Hangzhou KFC and Suzhou KFC at fair value upon acquisition in 2021 and 2020, respectively, partially offset by working capital changes.

**Net cash used in investing activities** was $855 million in 2021 as compared to $3,109 million in 2020. The decrease was mainly due to the net impact on cash flow resulting from purchases and maturities of short-term investments and lapping the impact of cash consideration paid for the acquisitions of Huang Ji Huang and Suzhou KFC in 2020, partially offset by the increase in capital spending, the cash consideration paid for the acquisition of Hangzhou KFC, and acquisitions of other equity investments in 2021.

**Net cash used in financing activities** was $313 million in 2021 as compared to net cash provided by financing activities of $2,058 million in 2020. The change was primarily due to lapping the impact of $2.2 billion in proceeds raised from issuance of common stock in connection with our global offering and secondary listing on the Main Board of HKEX in September 2020, the increase in dividends paid on common stock due to our temporary suspension of dividends in the second and third quarter of 2020, the increase in dividends paid to noncontrolling interests and the increase in share repurchases due to the resumption of share repurchases in 2021.

## Liquidity and Capital Resources

Historically we have funded our operations through cash generated from the operation of our Company-owned stores and from our franchise operations and dividend payments from our unconsolidated affiliates. Our global offering in September 2020 provided us with $2.2 billion in net proceeds.

Our ability to fund our future operations and capital needs will primarily depend on our ongoing ability to generate cash from operations. We believe our principal uses of cash in the future will be primarily to fund our operations and capital expenditures for accelerating store network expansion and store remodeling, step up investments in digitalization, automation and logistics infrastructure, provide returns to our stockholders, as well as explore opportunities for acquisitions or investments that build and support our ecosystem. We believe that our future cash from operations, together with our funds on hand and access to capital markets, will provide adequate resources to fund these uses of cash and that our existing cash, net cash from operations and credit facilities will be sufficient to fund our operations and anticipated capital expenditures for the next 12 months. We currently expect our fiscal year 2022 capital expenditures will be in the range of approximately $800 million to $1 billion.

If our cash flows from operations are less than we require, we may need to access the capital markets to obtain financing. Our access to, and the availability of, financing on acceptable terms and conditions in the future or at all will be impacted by many factors, including, but not limited to:

- our financial performance;
- our credit ratings;
- the liquidity of the overall capital markets and our access to the U.S. capital markets; and
- the state of the Chinese, U.S. and global economies as well as relations between the Chinese and U.S. governments.

There can be no assurance that we will have access to the capital markets on terms acceptable to us or at all.

Generally, our income is subject to the Chinese statutory tax rate of 25%. However, to the extent our cash flows from operations exceed our China cash requirements, the excess cash may be subject to an additional 10% withholding tax levied by the Chinese tax authority, subject to any reduction or exemption set forth in relevant tax treaties or tax arrangements.

### *Dividends and Share Repurchases*

Our board of directors has authorized an aggregate of $1.4 billion for our share repurchase program. Yum China may repurchase shares under this program from time to time in open market or privately negotiated transactions, including block trades, accelerated share repurchase transactions and the use of Rule 10b5-1 trading plans. Starting in the second quarter of 2020 through July 2021, our share repurchases were suspended due to the impact of the COVID-19 pandemic. During the years ended December 31, 2021 and 2020, the Company repurchased $75 million or 1.3 million shares and $7 million or 0.2 million shares of common stock, respectively, under the repurchase program.

The Company paid a cash dividend of $0.12 per share for the first and fourth quarter of 2020 and each quarter of 2021. Total cash dividends of $203 million and $95 million were paid to stockholders in 2021 and 2020, respectively.

On February 8, 2022, the board of directors declared a cash dividend of $0.12 per share, payable on March 29, 2022, to stockholders of record as of the close of business on March 8, 2022.

Our ability to declare and pay any dividends on our stock may be restricted by earnings available for distribution under applicable Chinese laws. The laws, rules and regulations applicable to our Chinese subsidiaries permit payments of dividends only out of their accumulated profits, if any, determined in accordance with applicable Chinese accounting standards and regulations. Under Chinese law, an enterprise incorporated in China is required to set aside at least 10% of its after-tax profits each year, after making up previous years' accumulated losses, if any, to fund certain statutory reserve funds, until the aggregate amount of such a fund reaches 50% of its registered capital. As a result, our Chinese subsidiaries are restricted in their ability to transfer a portion of their net assets to us in the form of dividends. At the discretion of the board of directors, as an enterprise incorporated in China, each of our Chinese subsidiaries may allocate a portion of its after-tax profits based on Chinese accounting standards to staff welfare and bonus funds. These reserve funds and staff welfare and bonus funds are not distributable as cash dividends.

### *Borrowing Capacity*

As of December 31, 2021, the Company had credit facilities of RMB3,471 million (approximately $546 million), comprised of onshore credit facilities of RMB2,200 million (approximately $346 million) in the aggregate and offshore credit facilities of $200 million in the aggregate.

The credit facilities had remaining terms ranging from less than one year to two years as of December 31, 2021. Each credit facility bears interest based on the prevailing rate stipulated by the People's Bank of China, the Loan Prime Rate ("LPR") published by the National Interbank Funding Centre of the PRC or the London Interbank Offered Rate ("LIBOR") administered by the ICE Benchmark Administration. Each credit facility contains a cross-default provision whereby our failure to make any payment on a principal amount from any credit facility will constitute a default on other credit facilities. Some of the credit facilities contain covenants limiting, among other things, certain additional indebtedness and liens, and certain other transactions specified in the respective agreement. Some of the onshore credit facilities contain sub-limits for overdrafts, non-financial bonding, standby letters of credit and guarantees. As of December 31, 2021, we had outstanding bank guarantees of RMB177 million (approximately $28 million) mainly to secure our lease payments to landlords for certain Company-owned restaurants. The credit facilities were therefore reduced by the same amount, while there were no borrowings outstanding as of December 31, 2021.

### *Material Cash Requirements*

Our material short-term and long-term cash requirements as of December 31, 2021 included:

| | Total | Less than 1 Year | 1-3 Years | 3-5 Years | More than 5 Years |
|---|---|---|---|---|---|
| Finance Leases[(a)] | $ 58 | $ 6 | $ 11 | $ 10 | $ 31 |
| Operating Leases[(a)] | 3,389 | 644 | 1,024 | 738 | 983 |
| Purchase Obligations[(b)] | 196 | 56 | 53 | 35 | 52 |
| Transition Tax[(c)] | 35 | 4 | 18 | 13 | — |
| Total | $ 3,678 | $ 710 | $ 1,106 | $ 796 | $ 1,066 |

(a) These obligations, which are shown on a nominal basis, relate primarily to approximately 10,000 Company-owned restaurants. See Note 12 for additional information.

(b) Purchase obligations relate primarily to supply and service agreements. We have excluded agreements that are cancelable without penalty or have a remaining term not in excess of one year. Such commitments are generally near term in nature, will be funded from operating cash flows, and are not significant to the Company's overall financial position.

(c) This amount represents transition tax payable on the deemed repatriation of accumulated undistributed foreign earnings after utilizing existing qualified foreign tax credits, which is to be paid over a maximum of eight years beginning in 2018.

We have not included in the table above approximately $25 million of liabilities for unrecognized tax benefits related to the uncertainty with regard to the deductibility of certain business expenses incurred as well as related accrued interest and penalties. These liabilities may increase or decrease over time as a result of tax examinations, and given the status of the examinations, we cannot reliably estimate the period of any cash settlement with the respective taxing authorities. These liabilities exclude amounts that are temporary in nature and for which we anticipate that over time there will be no net cash outflow.

In addition to the material cash requirements listed above, the Company and Lavazza Group have committed to contributing $100 million to the Lavazza joint venture, in proportion to their respective equity interest of 65% and 35%, respectively, by the end of the second quarter of 2023. The cash will be used to further accelerate the expansion of Lavazza stores in China.

We have no material contingent obligations as of December 31, 2021. Please see Note 19 to the Consolidated Financial Statements for further discussion.

## New Accounting Pronouncements

### *Recently Adopted Accounting Pronouncements*

See Note 2 for details of recently adopted accounting pronouncements.

### *New Accounting Pronouncements Not Yet Adopted*

In August 2020, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2020-06, *Debt — Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40)* ("ASU 2020-06"), which eliminates two of the three models in ASC 470-20 that require separate accounting for embedded conversion features and eliminates some of the conditions for equity classification in ASC 815-40 for contracts in an entity's own equity. The guidance also requires entities to use the if-converted method for all convertible instruments in the diluted earnings per share calculation and generally requires them to include the effect of share settlement for instruments that may be settled in cash or shares. We will adopt this standard in the first quarter of 2022, and do not expect the adoption of this standard will have a material impact on our financial statements.

In May 2021, the FASB issued ASU 2021-04, *Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options* ("ASU 2021-04"). It requires issuers to account for a modification or exchange of freestanding equity-classified written call options that remain equity classified after the modification or exchange based on the economic substance of the modification or exchange. We will adopt this standard in the first quarter of 2022, and do not expect the adoption of this standard will have a material impact on our financial statements.

In July 2021, the FASB issued ASU 2021-05, *Lessors — Certain Leases with Variable Lease* ("ASU 2021-05"). It requires lessors to classify leases as operating leases if they have variable lease payments that do not depend on an index or rate and would have selling losses if they were classified as sales-type or direct financing leases. We will adopt this standard in the first quarter of 2022, and do not expect the adoption of this standard will have a material impact on our financial statements.

In October 2021, the FASB issued ASU 2021-08, *Business Combinations (Topic 805) — Accounting for Contract Assets and Contract Liabilities from Contracts with Customers* ("ASU 2021-08"). It requires issuers to apply ASC 606 *Revenue from Contracts with Customers* to recognize and measure contract assets and contract liabilities from contracts with customers acquired in a business combination. ASU 2021-08 is effective for the Company from January 1, 2023, with early adoption permitted. We are currently evaluating the impact the adoption of this standard will have on our financial statements.

In November 2021, the FASB issued ASU 2021-10, *Government Assistance (Topic 832) — Disclosures by Business Entities about Government Assistance* ("ASU 2021-10"). It requires issuers to make annual disclosures about government assistance, including the nature of the transaction, the related accounting policy, the financial statement line items affected and the amounts applicable to each financial statement line item, as well as any significant terms and conditions, including commitments and contingencies. We will adopt this standard in 2022, and do not expect the adoption of this standard will have a material impact on our financial statements.

## Critical Accounting Policies and Estimates

Our reported results are impacted by the application of certain accounting policies that require us to make subjective or complex judgments. These judgments involve estimations of the effect of matters that are inherently uncertain and may significantly impact our quarterly or annual results of operations or financial condition. Changes in the estimates and judgments could significantly affect our results of operations, financial condition and cash flows in future years. A description of what we consider to be our most significant critical accounting policies and estimates follows.

### *Loyalty Programs*

Each of the Company's KFC and Pizza Hut reportable segments operates a loyalty program that allows registered members to earn points for each qualifying purchase. Points, which generally expire 18 months after being earned, may be redeemed for future purchases of KFC or Pizza Hut branded products or other products for free or at a discounted price. Points cannot be redeemed or exchanged for cash. The estimated value of points earned by the loyalty program members is recorded as a reduction of revenue at the time the points are earned, based on the percentage of points that are projected to be redeemed, with a corresponding deferred revenue liability included in Accounts payable and other current liabilities in the Consolidated Balance Sheets and subsequently recognized into revenue when the points are redeemed or expire. The Company estimates the value of the future redemption obligations based on the estimated value of the product for which points are expected to be redeemed and historical redemption patterns and reviews such estimates periodically based upon the latest available information regarding redemption and expiration patterns.

### *Breakage Revenue*

We recognize revenues from prepaid stored-value products, including gift cards and product vouchers, when they are redeemed by the customer. Prepaid gift cards sold at any given point generally expire over the next 36 months, and product vouchers generally expire over a period of up to 12 months. We recognize breakage revenue, which is the amount of prepaid stored-value products that is not expected to be redeemed, either (1) proportionally in earnings as redemptions occur, in situations where the Company expects to be entitled to a breakage amount, or (2) when the likelihood of redemption is remote, in situations where the Company does not expect to be entitled to breakage, provided that there is no requirement for remitting balances to government agencies under unclaimed property laws. The Company reviews its breakage estimates at least annually based upon the latest available information regarding redemption and expiration patterns.

### *Impairment or Disposal of Long-Lived Assets*

We review long-lived assets of restaurants (primarily operating lease right-of-use assets and property, plant and equipment ("PP&E")) semi-annually for impairment, or whenever events or changes in circumstances indicate that the carrying amount of a restaurant may not be recoverable. We evaluate recoverability based on the restaurant's forecasted undiscounted cash flows, which are based on our entity-specific assumptions, to the carrying value of such assets. The forecasted undiscounted cash flows incorporate our best estimate of sales growth based upon our operation plans for the unit and actual results at comparable restaurants. For restaurant assets that are deemed not to be recoverable, we write down the impaired restaurant to its estimated fair value. In determining the fair value of restaurant-level assets, we consider the highest and best use of the assets from market participants' perspective, which is represented by the higher of the forecasted discounted cash flows of operating restaurants and the price market participants would pay to sub-lease the operating lease right-of-use assets and acquire remaining restaurant assets, even if that use differs from the current use by the Company. Key assumptions in the determination of fair value include reasonable sales growth assumption in generating after-tax cashflows that would be used by a franchisee in the determination of a purchase price for the restaurant, and market rental assumption for estimating the price market participants would pay to sub-lease the operating lease right-of-use assets. Estimates of forecasted cash flows of operating restaurants are highly subjective judgments and can be significantly impacted by changes in the business or economic conditions. Estimates of the price market participants would pay to sub-lease the operating lease right-of-use assets are based on comparable market rental information that could be reasonably obtained for the property. In situations where the highest and best use of the restaurant-level assets from market participants' perspective is represented by sub-leasing the operating lease right-of-use assets and acquiring the remaining restaurant assets, the

Company continues to use these assets in operating its restaurant business, which is consistent with its long-term strategy of growing revenue through operating restaurant concepts.

When we believe it is more likely than not a restaurant or groups of restaurants will be refranchised for a price less than their carrying value, but do not believe the restaurant(s) have met the criteria to be classified as held for sale, we review the restaurants for impairment. Expected net sales proceeds are generally based on actual bids from the buyer.

The discount rate used in the fair value calculations is our estimate of the required rate-of-return that a franchisee would expect to receive when purchasing a similar restaurant or groups of restaurants and the related long-lived assets. The discount rate incorporates rates of returns for historical refranchising market transactions and is commensurate with the risks and uncertainty inherent in the forecasted cash flows.

We evaluate indefinite-lived intangible assets for impairment on an annual basis or more often if an event occurs or circumstances change that indicates impairment might exist. We perform our annual test for impairment of our indefinite-lived intangible assets at the beginning of our fourth quarter. When we evaluate these assets for impairment, we have the option to first perform a qualitative assessment to determine whether an intangible asset group is impaired. If we believe, as a result of the qualitative assessment, that it is more likely than not that the fair value of the intangible asset group is less than its carrying amount, we will then perform a quantitative assessment. Fair value is an estimate of the price a willing buyer would pay for the intangible asset and is generally estimated by discounting the expected future after-tax cash flows associated with the intangible asset. The discount rate is our estimate of the required rate-of-return that a third-party buyer would expect to receive. These estimates are highly subjective, and our ability to achieve the forecasted cash is affected by factors such as changes in our operating performance and business strategies and changes in economic conditions. Our indefinite-lived intangible assets had a book value of $141 million and $138 million as of December 31, 2021 and 2020, respectively, representing two material indefinite-lived intangible assets, which are our Little Sheep and Huang Ji Huang trademarks.

In the year ended December 31, 2021, considering the continuing adverse effects of the COVID-19 pandemic, we performed a quantitative impairment assessment for the Little Sheep trademark and the fair value estimate exceeded its carrying amount. Fair value of the Little Sheep trademark was determined using a relief-from-royalty valuation approach that was based on unobservable inputs, including estimated future revenues as well as the selection of an appropriate discount rate based on weighted-average cost of capital and company-specific risk premium, which are considered Level 3 inputs. In the year ended December 31, 2021, we elected to perform the qualitative impairment assessment for the Huang Ji Huang trademark by evaluating all pertinent factors, including but not limited to macroeconomic conditions, industry and market conditions and financial performance. Based on our qualitative assessment, it was more likely than not that the carrying value of the Huang Ji Huang trademark was not impaired and therefore the quantitative assessment was not required. In the year ended December 31, 2020, we also elected to perform the qualitative impairment assessment for both our Little Sheep and Huang Ji Huang trademarks. No impairment charges on trademarks related to Little Sheep and Huang Ji Huang were recorded in 2021 and 2020.

Our finite-lived intangible assets that are not allocated to an individual restaurant are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of the intangible asset may not be recoverable. An intangible asset that is deemed not recoverable on a undiscounted basis is written down to its estimated fair value, which is our estimate of the price a willing buyer would pay for the intangible asset based on discounted expected future after-tax cash flows. For purposes of our impairment analysis, we update the cash flows that were initially used to value the finite-lived intangible asset to reflect our current estimates and assumptions over the asset's future remaining life.

### *Impairment of Goodwill*

We evaluate goodwill for impairment on an annual basis as of the beginning of our fourth quarter or more often if an event occurs or circumstances change that indicates impairment might exist. When we evaluate goodwill for impairment, we have the option to first perform a qualitative assessment to determine whether it is more likely than not the fair value of a reporting unit is less than its carrying amount. If we believe, as a result of the qualitative assessment, that it is more likely than not that the fair value of the reporting unit is less than its carrying amount, we will then perform a quantitative assessment. Our reporting units are our individual operating segments. Fair value is the price a willing buyer would pay for the reporting unit, and is generally estimated using discounted expected future after-tax cash flows from the business operation of the reporting unit.

Future cash flow estimates and the discount rate are the key assumptions when estimating the fair value of a reporting unit. Future cash flows are based on growth expectations relative to recent historical performance and incorporate sales growth and margin improvement assumptions that we believe a third-party buyer would assume when determining a purchase price for the reporting unit. The sales growth and margin improvement assumptions that factor into the discounted cash flows are highly correlated as cash flow growth can be achieved through various interrelated strategies such as product pricing and restaurant productivity initiatives. The discount rate is our estimate of the required rate-of-return that a third-party buyer would expect to receive when purchasing a business from us that constitutes a reporting unit. We believe the discount rate is commensurate with the risks and uncertainty inherent in the forecasted cash flows. These estimates are highly subjective, and our ability to achieve the forecasted cash is affected by factors such as changes in our operating performance and business strategies and changes in economic conditions.

Our goodwill of $2,142 million as of December 31, 2021 was related to the KFC, Pizza Hut, Huang Ji Huang and Lavazza reporting units. We performed a qualitative impairment assessment for each of our individual reporting units in 2021. Based on our qualitative assessment, the Company concluded that no changes in events or circumstances have occurred that indicated impairment may exist and it was more likely than not that the fair value of the reporting units exceeds their carrying amount and therefore no quantitative assessment was required. No impairment charge on goodwill was recorded in 2021 and 2020.

If we record goodwill upon acquisition of a restaurant(s) from a franchisee and such restaurant(s) is then sold within two years of acquisition, the goodwill associated with the acquired restaurant(s) is written off in its entirety. If the restaurant is refranchised two years or more subsequent to its acquisition, we include goodwill in the carrying amount of the restaurants disposed of based on the relative fair values of the portion of the reporting unit disposed of in the refranchising and the portion of the reporting unit that will be retained.

### *Share-Based Compensation*

We account for share awards issued to employees in accordance with Accounting Standards Codification Topic 718 (“ASC 718”), *Compensation-Stock Compensation*. Share-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as an expense, net of estimated forfeitures, over the requisite service period, which is generally the vesting period. We recognize share-based compensation expense for awards granted to employees and non-employee directors using the straight-line method.

We estimated the fair value of stock options and SARs at the grant date using the Black-Scholes option-pricing model ("the BS model"). It should be noted that the option-pricing model requires the input of highly subjective assumptions. Changes in the subjective input assumptions can materially affect the fair value estimate and, as a result, our operating profit and net income. PSUs have performance and/or market conditions that are based on the closing price of Yum China's stock, shareholder return performance relative to peer group in the MSCI International China Index, or relative shareholder return against the MSCI China Index measured over the performance period. The fair values of PSUs have been determined based on the outcome of a Monte-Carlo Simulation model (the "MCS model") and the closing price of the Company's stock on the date of the grant.

Under the BS and MCS models, we made a number of assumptions regarding the fair value of the share-based awards, including:

- the expected future volatility of the price of shares of Yum China common stock;
- the risk-free interest rate;
- the expected dividend yield; and
- the expected term.

We estimated the expected future volatility of the price of shares of Yum China common stock based on the historical price volatility of the publicly traded shares of common stock of comparable companies in the same business as Yum China as well as the historical volatility of the Company's common stock. The risk-free interest rate was based on the U.S. Treasury zero-coupon yield in effect with maturity terms equal to the expected term or performance measurement period of the awards. The dividend yield was estimated based on the Company's dividend policy. We use historical turnover data to estimate the expected forfeiture rate.

### *PRC Value-Added Tax*

As of December 31, 2021, an input VAT credit asset of $322 million and payable of $2 million were recorded in Other assets and Accounts payable and other current liabilities, respectively, on the Consolidated Balance Sheets. At each balance sheet date, the Company reviews the outstanding balance of any VAT credit asset for recoverability, giving consideration to the indefinite life of the input VAT credit assets as well as its forecasted operating results and capital spending, which inherently include significant assumptions subject to change. Key assumptions include the following:

- Estimated growth rate for revenues;
- Estimated restaurant expenses and other costs;
- Estimated new-unit development and asset upgrades.

We also consider qualitative factors including the fact that such assets can be carried forward indefinitely to offset future VAT payables, our ability to manage the accumulation of the input VAT credits and potential changes in VAT rates. We did not make an allowance for the recoverability of the input VAT credit asset as of December 31, 2021 and 2020. Changes in any of the assumptions could materially impact the amount of VAT asset and its recoverability and, as a result, our operating income and net income.

### *Income Taxes*

#### Uncertain Tax Positions

We are subject to reviews, examinations and audits by Chinese tax authorities, the IRS and other tax authorities with respect to income and non-income based taxes. We recognize the benefit of positions taken or expected to be taken in our tax returns when it is more likely than not that the position would be sustained upon examination by these tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than 50% likely of being realized upon settlement. At December 31, 2021 and 2020, we had $20 million and $21 million, respectively, of unrecognized tax benefits related to the uncertainty with regard to the deductibility of certain business expenses incurred. We evaluate unrecognized tax benefits, including interest thereon, on a quarterly basis to ensure that they have been appropriately adjusted for events, including audit settlements, which may impact our ultimate payment for such exposures.

Since 2016, we have been under a national audit on transfer pricing by the STA in China regarding our related party transactions for the period from 2006 to 2015. The information and views currently exchanged with the tax authorities focus on our franchise arrangement with YUM. We continue to provide information requested by the tax authorities to the extent it is available to the Company. It is reasonably possible that there could be significant developments, including expert review and assessment by the STA, within the next 12 months. The ultimate assessment and decision of the STA will depend upon further review of the information provided, as well as ongoing technical and other discussions with the STA and in-charge local tax authorities, and therefore it is not possible to reasonably estimate the potential impact at this time. We will continue to defend our transfer pricing position. However, if the STA prevails in the assessment of additional tax due based on its ruling, the assessed tax, interest and penalties, if any, could have a material adverse impact on our financial position, results of operations and cash flows.

#### Unremitted Earnings of Foreign Subsidiaries

We have investments in our foreign subsidiaries where the carrying values for financial reporting exceed the tax basis. Except for the planned but yet to be distributed earnings, we have not provided deferred tax on the portion of the excess that we believe is indefinitely reinvested, as we have the ability and intent to indefinitely postpone the basis differences from reversing with a tax consequence. The Company’s separation from YUM was intended to qualify as a tax-free reorganization for U.S. income tax purposes resulting in the excess of financial reporting basis over tax basis in our investment in the China business continuing to be indefinitely reinvested. The excess of financial reporting basis over tax basis as of December 31, 2017 was subject to the one-time transition tax under the Tax Act as a deemed repatriation of accumulated undistributed earnings from the foreign subsidiaries. However, we continue to believe that the portion of the excess of financial reporting basis over tax basis (including earnings and profits subject to the one-time transition tax) is indefinitely reinvested in our foreign subsidiaries for foreign withholding tax purposes. We estimate that our total temporary difference for which we have not provided foreign withholding taxes is approximately $3 billion at December 31, 2021. The foreign withholding tax rate on this amount is 5% or 10% depending on the manner of repatriation and the applicable tax treaties or tax arrangements.

See Note 17 of the Consolidated Financial Statements for a further discussion of our income taxes.

# Quantitative and Qualitative Disclosures About Market Risk

## Foreign Currency Exchange Rate Risk

Changes in foreign currency exchange rates impact the translation of our reported foreign currency-denominated earnings, cash flows and net investments in foreign operations, virtually all of which are denominated in RMB. While substantially all of our supply purchases are denominated in RMB, from time to time, we enter into agreements at predetermined exchange rates with third parties to purchase certain amount of goods and services sourced overseas and make payments in local currencies when practical, to minimize the related foreign currency exposure with immaterial impact on our financial statements.

As substantially all of the Company's assets are located in China, the Company is exposed to movements in the RMB foreign currency exchange rate. For the year ended December 31, 2021, the Company's operating profit would have decreased approximately $130 million if RMB weakened 10% relative to the U.S. dollar. This estimated reduction assumes no changes in sales volumes or local currency sales or input prices.

## Commodity Price Risk

We are subject to volatility in food costs as a result of market risk associated with commodity prices. Our ability to recover increased costs through higher pricing is, at times, limited by the competitive environment in which we operate. We manage our exposure to this risk primarily through pricing agreements with our vendors.

## Investment Risk

In September 2018, we invested $74 million in 8.4 million of Meituan's ordinary shares. The Company sold 4.2 million of its ordinary shares of Meituan in the second quarter of 2020 for proceeds of approximately $54 million. The equity investment is recorded at fair value, which is measured on a recurring basis and is subject to market price volatility. The investment in Sunner was recorded at fair value on a recurring basis before it became subject to the equity method of accounting when the Company established significant influence over the operating and financial policies of Sunner in May 2021. See Note 3 of the Consolidated Financial Statements for a further discussion on our investment in Meituan and Sunner.

# Financial Statements

## INDEX TO FINANCIAL INFORMATION

KPMG

# Independent auditor's report
# to the stockholders of Yum China Holdings, Inc.

*(incorporated in Delaware, United States of America)*

## Opinion

We have audited the consolidated financial statements of Yum China Holdings, Inc. ("Yum China") and its subsidiaries ("the Company") set out on pages 100 to 152, which comprise the consolidated balance sheet as at December 31, 2021, the consolidated statement of income, the consolidated statement of comprehensive income, the consolidated statement of equity and the consolidated statement of cash flows for the year then ended and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements give a true and fair view of the consolidated financial position of the Company as at December 31, 2021 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.

## Basis for opinion

We conducted our audit in accordance with Hong Kong Standards on Auditing ("HKSAs") issued by the HKICPA. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report. We are independent of the Company in accordance with the HKICPA's *Code of Ethics for Professional Accountants* ("the Code") and we have fulfilled our other ethical responsibilities in accordance with the Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

## Key audit matters (continued)

| Assessment of impairment of long-lived assets of restaurants | |
|---|---|
| *Refer to notes 8 and 12 to the consolidated financial statements on pages 129 to 130, pages 133 to 135, and the accounting policies on pages 110 to 111.* | |
| **The Key Audit Matter** | **How the matter was addressed in our audit** |
| Property, plant and equipment, net and operating lease right-of-use assets were US$2,251 million and US$2,612 million, respectively, as of December 31, 2021, which included the long-lived assets of the Company's restaurants. For restaurant assets with indicators that the carrying value may not be recoverable, the Company evaluates recoverability of these assets by comparing the forecasted undiscounted cash flows of the restaurant's operations to the carrying value of such assets. For restaurant assets that are not deemed to be recoverable, the Company writes down the restaurant assets to the estimated fair value. The Company determines the fair value of the restaurant assets based on the higher of the forecasted discounted cash flows of the restaurant's operations and the price market participants would pay to sub-lease the operating lease right-of-use assets and acquire the remaining restaurant assets.<br><br>We identified the assessment of impairment of long-lived assets of restaurants as a key audit matter. A high degree of auditor judgment was required in assessing the sales growth rates used to estimate the forecasted undiscounted cash flows of the restaurants' operations. In addition, specialized skills and knowledge were needed to assess the Company's market rental assumptions to estimate the fair values of the operating lease right-of-use assets. | The following are the primary procedures we performed to address this key audit matter. We evaluated the design and tested the operating effectiveness of certain internal controls related to the Company's long-lived assets of restaurants impairment assessment process. This included controls related to the determination of the sales growth rates and the market rentals. To evaluate the sales growth rates, we compared the sales growth rates of a sample of restaurants to the historical sales growth rates and the Company's operation plans for the respective restaurants. We performed sensitivity analyses over the sales growth rates for a selection of restaurants to assess their impact on the restaurants' forecasted undiscounted cash flows. We involved valuation professionals with specialized skills and knowledge, who assisted in:<br><br>• Comparing the market rentals of a sample of restaurants to respective market rental ranges that we independently developed using external data; and<br><br>• Developing independent estimates of the fair values of the operating lease right-of-use assets based on the price that market participants would pay to sub-lease the right-of-use assets for a sample of restaurants and comparing the results of our estimates to the Company's estimates. |

## Key audit matters (continued)

<table>
<tr><th colspan="2">Evaluation of uncertain tax position</th></tr>
<tr><td colspan="2">Refer to note 17 to the consolidated financial statements on pages 144 to 147 and the accounting policies on pages 112 to 113.</td></tr>
<tr><th>The Key Audit Matter</th><th>How the matter was addressed in our audit</th></tr>
<tr><td>The Company recognizes the benefit of positions taken or expected to be taken in tax returns in the financial statements when it is more likely than not (more than a 50% likelihood) that the position would be sustained upon examination by tax authorities. Since 2016, the Company has been under a national audit on transfer pricing by the Chinese State Taxation Administration (“STA”) regarding the related party transactions for the period from 2006 to 2015.<br><br>We identified the evaluation of the Company’s uncertain tax position pertaining to the transfer pricing used in the related party transactions under audit by the STA as a key audit matter. A high degree of auditor judgment and specialized skills and knowledge were required in evaluating the Company’s interpretation of the applicable tax laws and regulations and the estimate of the more likely than not assessment of tax position being sustained under examination by tax authorities.</td><td>The following are the primary procedures we performed to address this key audit matter. We evaluated the design and tested the operating effectiveness of the internal control related to the Company’s assessment process pertaining to the transfer pricing audit, including the control related to the interpretation of the applicable tax laws and regulations and the assessment of the uncertain tax position being sustained under examination by tax authorities. Since tax law is complex and often subject to interpretation, we involved tax professionals with specialized skills and knowledge, who assisted in:<br><br>• Reading the correspondence received by the Company from the tax authorities in connection with the transfer pricing audit by the STA, as well as responses and information the Company submitted to the tax authorities;<br><br>• Evaluating the Company’s identification and consideration of information that could significantly affect the recognition and measurement of the uncertain tax position; and<br><br>• Evaluating the Company’s interpretation of applicable tax laws and regulations, technical analysis and the application of the accounting standards in assessing the recognition and measurement of the potential impact from the uncertain tax position.</td></tr>
</table>

## Information other than the consolidated financial statements and auditor's report thereon

The directors are responsible for the other information. The other information comprises all the information included in the annual report, other than the consolidated financial statements and our auditor's report thereon.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## Responsibilities of the directors for the consolidated financial statements

The directors are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with U.S. generally accepted accounting principles and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The directors are assisted by the Audit Committee in discharging their responsibilities for overseeing the Company's financial reporting process.

## Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. This report is made solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

## Auditor's responsibility for the audit of the consolidated financial statements (continued)

Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with HKSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with HKSAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

## Auditor's responsibility for the audit of the consolidated financial statements (continued)

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence and, where applicable, actions taken to eliminate threats or safeguards applied.

From the matters communicated with the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Tse, Wong Pui.

**KPMG**
*Certified Public Accountants*

8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

28 February 2022

# Consolidated Statements of Income

Yum China Holdings, Inc.
Years ended December 31, 2021, 2020 and 2019
(in US$ millions, except per share data)

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| **Revenues** | | | |
| Company sales | $ 8,961 | $ 7,396 | $ 7,925 |
| Franchise fees and income | 153 | 148 | 148 |
| Revenues from transactions with franchisees and unconsolidated affiliates | 663 | 647 | 654 |
| Other revenues | 76 | 72 | 49 |
| Total revenues | 9,853 | 8,263 | 8,776 |
| **Costs and Expenses, Net** | | | |
| Company restaurants | | | |
| Food and paper | 2,812 | 2,342 | 2,479 |
| Payroll and employee benefits | 2,258 | 1,730 | 1,807 |
| Occupancy and other operating expenses | 2,664 | 2,226 | 2,373 |
| Company restaurant expenses | 7,734 | 6,298 | 6,659 |
| General and administrative expenses | 564 | 479 | 487 |
| Franchise expenses | 64 | 65 | 71 |
| Expenses for transactions with franchisees and unconsolidated affiliates | 649 | 633 | 645 |
| Other operating costs and expenses | 65 | 57 | 37 |
| Closures and impairment expenses, net | 34 | 55 | 36 |
| Other income, net | (643) | (285) | (60) |
| Total costs and expenses, net | 8,467 | 7,302 | 7,875 |
| **Operating Profit** | 1,386 | 961 | 901 |
| Interest income, net | 60 | 43 | 39 |
| Investment (loss) gain | (54) | 104 | 63 |
| **Income Before Income Taxes** | 1,392 | 1,108 | 1,003 |
| Income tax provision | (369) | (295) | (260) |
| Net income — including noncontrolling interests | 1,023 | 813 | 743 |
| Net income — noncontrolling interests | 33 | 29 | 30 |
| **Net Income — Yum China Holdings, Inc.** | $ 990 | $ 784 | $ 713 |
| Weighted-average common shares outstanding (in millions): | | | |
| Basic | 422 | 390 | 377 |
| Diluted | 434 | 402 | 388 |
| **Basic Earnings Per Common Share** | $ 2.34 | $ 2.01 | $ 1.89 |
| **Diluted Earnings Per Common Share** | $ 2.28 | $ 1.95 | $ 1.84 |

See accompanying Notes to Consolidated Financial Statements.

# Consolidated Statements of Comprehensive Income

Yum China Holdings, Inc.
Years ended December 31, 2021, 2020 and 2019
(in US$ millions)

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Net income — including noncontrolling interests | $ 1,023 | $ 813 | $ 743 |
| Other comprehensive income (loss), net of tax of nil | | | |
| Foreign currency translation adjustments | 108 | 230 | (32) |
| Comprehensive income — including noncontrolling interests | 1,131 | 1,043 | 711 |
| Comprehensive income — noncontrolling interests | 40 | 43 | 30 |
| Comprehensive Income — Yum China Holdings, Inc. | $ 1,091 | $ 1,000 | $ 681 |

See accompanying Notes to Consolidated Financial Statements.

# Consolidated Statements of Cash Flows

Yum China Holdings, Inc.
Years ended December 31, 2021, 2020 and 2019
(in US$ millions)

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| **Cash Flows — Operating Activities** | | | |
| Net income — including noncontrolling interests | $ 1,023 | $ 813 | $ 743 |
| Depreciation and amortization | 516 | 450 | 428 |
| Non-cash operating lease cost | 424 | 368 | 339 |
| Closures and impairment expenses | 34 | 55 | 36 |
| Gain from re-measurement of equity interest upon acquisition | (628) | (239) | — |
| Investment loss (gain) | 53 | (104) | (63) |
| Equity income from investments in unconsolidated affiliates | (44) | (62) | (69) |
| Distributions of income received from unconsolidated affiliates | 32 | 55 | 73 |
| Deferred income taxes | 160 | 111 | 16 |
| Share-based compensation expense | 41 | 36 | 26 |
| Changes in accounts receivable | (5) | (15) | (9) |
| Changes in inventories | (16) | 17 | (77) |
| Changes in prepaid expenses and other current assets | (28) | (15) | (3) |
| Changes in accounts payable and other current liabilities | 118 | 65 | 171 |
| Changes in income taxes payable | (26) | 17 | (8) |
| Changes in non-current operating lease liabilities | (461) | (394) | (381) |
| Other, net | (62) | (44) | (37) |
| **Net Cash Provided by Operating Activities** | 1,131 | 1,114 | 1,185 |
| **Cash Flows — Investing Activities** | | | |
| Capital spending | (689) | (419) | (435) |
| Purchases of short-term investments | (6,114) | (4,499) | (1,024) |
| Purchases of long-term time deposits | (25) | (57) | — |
| Maturities of short-term investments | 6,383 | 2,061 | 534 |
| Contributions to unconsolidated affiliates | — | (17) | — |
| Acquisition of business, net of cash acquired | (115) | (288) | — |
| (Acquisitions) disposal of equity investments | (300) | 54 | — |
| Other, net | 5 | 56 | 15 |
| **Net Cash Used in Investing Activities** | (855) | (3,109) | (910) |
| **Cash Flows — Financing Activities** | | | |
| Common stock issuance proceeds, net of issuance costs | — | 2,195 | — |
| Repurchase of shares of common stock | (75) | (8) | (265) |
| Cash dividends paid on common stock | (203) | (95) | (181) |
| Dividends paid to noncontrolling interests | (57) | (33) | (32) |
| Contributions from noncontrolling interests | 37 | — | — |
| Payment of acquisition related holdback | (8) | — | — |
| Other, net | (7) | (1) | (2) |
| **Net Cash (Used in) Provided by Financing Activities** | (313) | 2,058 | (480) |
| **Effect of Exchange Rates on Cash, Cash Equivalents and Restricted Cash** | 15 | 40 | (6) |
| **Net (Decrease) Increase in Cash, Cash Equivalents and Restricted Cash** | (22) | 103 | (211) |
| **Cash, Cash Equivalents and Restricted Cash — Beginning of Year** | 1,158 | 1,055 | 1,266 |
| **Cash, Cash Equivalents and Restricted Cash — End of Year** | $ 1,136 | $ 1,158 | $ 1,055 |
| **Supplemental Cash Flow Data** | | | |
| Cash paid for income tax | 255 | 170 | 255 |
| **Non-cash Investing and Financing Activities** | | | |
| Capital expenditures included in accounts payable and other current liabilities | 269 | 203 | 150 |

See accompanying Notes to Consolidated Financial Statements.

# Consolidated Balance Sheets

Yum China Holdings, Inc.
December 31, 2021 and 2020
(in US$ millions)

| | 2021 | 2020 |
|---|---|---|
| **ASSETS** | | |
| **Current Assets** | | |
| Cash and cash equivalents | $ 1,136 | $ 1,158 |
| Short-term investments | 2,860 | 3,105 |
| Accounts receivable, net | 67 | 99 |
| Inventories, net | 432 | 398 |
| Prepaid expenses and other current assets | 221 | 176 |
| **Total Current Assets** | $ 4,716 | $ 4,936 |
| Property, plant and equipment, net | 2,251 | 1,765 |
| Operating lease right-of-use assets | 2,612 | 2,164 |
| Goodwill | 2,142 | 832 |
| Intangible assets, net | 272 | 246 |
| Deferred income taxes | 106 | 98 |
| Investments in unconsolidated affiliates | 292 | 85 |
| Other assets | 832 | 749 |
| **Total Assets** | $ 13,223 | $ 10,875 |
| **LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND EQUITY** | | |
| **Current Liabilities** | | |
| Accounts payable and other current liabilities | $ 2,332 | $ 1,995 |
| Income taxes payable | 51 | 72 |
| **Total Current Liabilities** | 2,383 | 2,067 |
| Non-current operating lease liabilities | 2,286 | 1,915 |
| Non-current finance lease obligations | 40 | 28 |
| Deferred income tax liabilities | 425 | 227 |
| Other liabilities | 167 | 167 |
| **Total Liabilities** | 5,301 | 4,404 |
| **Redeemable Noncontrolling Interest** | 14 | 12 |
| **Equity** | | |
| Common stock, $0.01 par value; 1,000 million shares authorized; 449 million shares and 440 million shares issued at December 31, 2021 and 2020, respectively; 428 million shares and 420 million shares outstanding at December 31, 2021 and 2020, respectively | 4 | 4 |
| Treasury stock | (803) | (728) |
| Additional paid-in capital | 4,695 | 4,658 |
| Retained earnings | 2,892 | 2,105 |
| Accumulated other comprehensive income | 268 | 167 |
| **Total Yum China Holdings, Inc. Stockholders' Equity** | 7,056 | 6,206 |
| Noncontrolling interests | 852 | 253 |
| **Total Equity** | 7,908 | 6,459 |
| **Total Liabilities, Redeemable Noncontrolling Interest and Equity** | $ 13,223 | $ 10,875 |

See accompanying Notes to Consolidated Financial Statements.

# Consolidated Statements of Equity

Yum China Holdings, Inc.
Years ended December 31, 2021, 2020 and 2019
(in US$ millions)

| | Yum China Holdings, Inc. | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Common Stock | | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Treasury Stock | | Noncontrolling Interests | Total Equity | Redeemable Noncontrolling Interest |
| | Shares* | Amount | | | | Shares* | Amount | | | |
| **Balance at December 31, 2018** | 392 | $ 4 | $ 2,402 | $ 944 | $ (17) | (13) | $ (460) | $ 103 | $ 2,976 | $ 1 |
| Net Income (loss) | | | | 713 | | | | 32 | 745 | (2) |
| Foreign currency translation adjustments | | | | | (32) | | | — | (32) | — |
| Comprehensive income (loss) | | | | | | | | | 713 | (2) |
| Dividends declared | | | | | | | | (34) | (34) | |
| Cash dividends declared ($0.48 per common share) | | | | (181) | | | | | (181) | |
| Repurchase of shares of common stock | | | | | | (6) | (261) | | (261) | |
| Exercise and vesting of share-based awards | 3 | — | — | | | | | | — | |
| Share-based compensation | | | 26 | | | | | | 26 | |
| Revaluation of redeemable noncontrolling interest | | | (1) | | | | | | (1) | 1 |
| Cumulative effect of accounting change | | | | (60) | | | | (3) | (63) | |
| **Balance at December 31, 2019** | 395 | $ 4 | $ 2,427 | $ 1,416 | $ (49) | (19) | $ (721) | $ 98 | $ 3,175 | $ — |
| Net Income | | | | 784 | | | | 29 | 813 | — |
| Foreign currency translation adjustments | | | | | 216 | | | 14 | 230 | — |
| Comprehensive income | | | | | | | | | 1,043 | — |
| Dividends declared | | | | | | | | (32) | (32) | |
| Cash dividends declared ($0.24 per common share) | | | | (95) | | | | | (95) | |
| Acquisition of business | | | | | | | | 144 | 144 | 12 |
| Issuance of common stock, net of issuance costs | 42 | — | 2,193 | | | | | | 2,193 | |
| Repurchase of shares of common stock | | | | | | — | (7) | | (7) | |
| Exercise and vesting of share-based awards | 3 | — | 2 | | | | | | 2 | |
| Share-based compensation | | | 36 | | | | | | 36 | |
| **Balance at December 31, 2020** | 440 | $ 4 | $ 4,658 | $ 2,105 | $ 167 | (20) | $ (728) | $ 253 | $ 6,459 | $ 12 |
| Net Income | | | | 990 | | | | 32 | 1,022 | 1 |
| Foreign currency translation adjustments | | | | | 101 | | | 7 | 108 | — |
| Comprehensive income | | | | | | | | | 1,130 | 1 |
| Dividends declared | | | | | | | | (39) | (39) | |
| Cash dividends declared ($0.48 per common share) | | | | (203) | | | | | (203) | |
| Acquisition of business | | | | | | | | 562 | 562 | |
| Contributions from noncontrolling interests | | | | | | | | 37 | 37 | |
| Repurchase of shares of common stock | | | | | | (1) | (75) | | (75) | |
| Exercise and vesting of share-based awards | 2 | — | (3) | | | | | | (3) | |
| Exercise of the warrants | 8 | — | — | | | | | | — | |
| Share-based compensation | | | 41 | | | | | | 41 | |
| Revaluation of redeemable noncontrolling interest | | | (1) | | | | | | (1) | 1 |
| **Balance at December 31, 2021** | 449 | $ 4 | $ 4,695 | $ 2,892 | $ 268 | (21) | $ (803) | $ 852 | $ 7,908 | $ 14 |

*: Shares may not add due to rounding.

See accompanying Notes to Consolidated Financial Statements.

## Notes to Consolidated Financial Statements

(Tabular amounts in US$ millions, except for number of shares and per share data)

## Note 1 — Description of Business

Yum China Holdings, Inc. ("Yum China" and, together with its subsidiaries, the "Company," "we," "us," and "our") was incorporated in Delaware on April 1, 2016.

The Company owns, franchises or has ownership in entities that own and operate restaurants (also referred to as "stores" or "units") under the KFC, Pizza Hut, Little Sheep, Huang Ji Huang, Lavazza, COFFii & JOY, Taco Bell, and East Dawning concepts (collectively, the "concepts"). In connection with the separation of the Company in 2016 from its former parent company, Yum! Brands, Inc. ("YUM"), a 50-year master license agreement was entered into between Yum Restaurants Consulting (Shanghai) Company Limited ("YCCL"), a wholly-owned indirect subsidiary of the Company and YUM, through YRI China Franchising LLC, a subsidiary of YUM, effective from January 1, 2020 and previously through Yum! Restaurants Asia Pte. Ltd., another subsidiary of YUM, from October 31, 2016 to December 31, 2019, with automatic renewals for additional consecutive renewal terms of 50 years each, subject only to YCCL being in "good standing" and unless YCCL gives notice of its intent not to renew, for the exclusive right to use and sublicense the use of intellectual property owned by YUM and its subsidiaries for the development and operation of the KFC, Pizza Hut and, subject to achieving certain agreed-upon milestones, Taco Bell brands and their related marks and other intellectual property rights for restaurant services in the People's Republic of China (the "PRC" or "China"), excluding Hong Kong, Macau and Taiwan. In exchange, we pay a license fee to YUM equal to 3% of net system sales from both our Company and franchise restaurants. We own the intellectual property of Little Sheep, Huang Ji Huang, COFFii & JOY and East Dawning, and pay no license fee related to these concepts.

In 1987, KFC was the first quick-service restaurant brand to enter China. As of December 31, 2021, there are over 8,100 KFC stores in China. We maintain a 58%, 70%, and 83% controlling interest in the entities that own and operate the KFCs in and around Shanghai, Beijing and Wuxi, respectively. During the third quarter of 2020, the Company completed the acquisition of an additional 25% equity interest in an unconsolidated affiliate that operates KFC stores in and around Suzhou, China ("Suzhou KFC"), for cash consideration of $149 million. Upon closing of the acquisition, the Company increased its equity interest to 72%, allowing the Company to consolidate Suzhou KFC. During the fourth quarter of 2021, the Company completed its investment of a 28% equity interest in Hangzhou Catering Service Group ("Hangzhou Catering"), for cash consideration of $255 million. Upon closing, the Company directly and indirectly holds an approximately 60% equity interest in the Hangzhou KFC joint venture that operates KFC stores in and around Hangzhou, China ("Hangzhou KFC"), allowing the Company to consolidate Hangzhou KFC. These acquisitions were considered immaterial. We began consolidating Suzhou KFC and Hangzhou KFC upon the completion of acquisition.

The first Pizza Hut in China opened in 1990. As of December 31, 2021, there are over 2,500 Pizza Hut restaurants in China.

In the second quarter of 2020, the Company partnered with Luigi Lavazza S.p.A. ("Lavazza Group"), the world renowned family-owned Italian coffee company, and entered into a joint venture to explore and develop the Lavazza coffee shop concept in China. In September 2021, the Company and Lavazza Group entered into agreements for the previously formed joint venture ("Lavazza joint venture") to accelerate the expansion of Lavazza coffee shops in China. Upon execution of these agreements, the Company controls and consolidates the joint venture with its 65% equity interest. The acquisition was considered immaterial.

The Company has two reportable segments: KFC and Pizza Hut. Our remaining operating segments, including the operations of Little Sheep, Huang Ji Huang, Lavazza, COFFii & JOY, Taco Bell, East Dawning, Daojia and our e-commerce business, are combined and referred to as All Other Segments, as those operating segments are insignificant both individually and in the aggregate. Additional details on our segment reporting are included in Note 18.

The Company's common stock is listed on the New York Stock Exchange ("NYSE") under the symbol "YUMC". On September 10, 2020, the Company completed a secondary listing of its common stock on the Main Board of the Hong Kong Stock Exchange ("HKEX") under the stock code "9987", in connection with a global offering of 41,910,700 shares of its common stock. Net proceeds raised by the Company from the global offering after deducting underwriting fees and the offering expenses amounted to $2.2 billion.

## Note 2 — Summary of Significant Accounting Policies

Our preparation of the accompanying Consolidated Financial Statements in conformity with Generally Accepted Accounting Principles in the United States of America ("GAAP") requires us to make estimates and assumptions that affect reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**Basis of Preparation and Principles of Consolidation.** Intercompany accounts and transactions have been eliminated in consolidation. We consolidate entities in which we have a controlling financial interest, the usual condition of which is ownership of a majority voting interest. We also consider consolidating an entity in which we have certain interests where the controlling financial interest may be achieved through arrangements that do not involve voting interests. Such an entity, known as a variable interest entity ("VIE"), is required to be consolidated by its primary beneficiary. The primary beneficiary is the entity that possesses the power to direct the activities of the VIE that most significantly impact its economic performance and has the obligation to absorb losses or the right to receive benefits from the VIE that are significant to it.

Our most significant variable interests are in entities that operate restaurants under franchise arrangements. We do not generally have an equity interest in our franchisee businesses. Additionally, we do not typically provide significant financial support such as loans or guarantees to our franchisees. We have variable interests in certain entities that operate restaurants under franchise agreements through real estate lease arrangements with them to which we are a party. At December 31, 2021, the Company had future lease payments due from franchisees, on a nominal basis, of approximately $38 million. As our franchise arrangements provide our franchisee entities the power to direct the activities that most significantly impact their economic performance, we do not consider ourselves the primary beneficiary of any such entity that might otherwise be considered a VIE.

Through the acquisition of Daojia, the Company also acquired a VIE and subsidiaries of the VIE effectively controlled by Daojia. There exists a parent-subsidiary relationship between Daojia and its VIE as a result of certain exclusive agreements that require Daojia to consolidate its VIE and subsidiaries of the VIE because Daojia is the primary beneficiary that possesses the power to direct the activities of the VIE that most significantly impact its economic performance, and is entitled to substantially all of the profits and has the obligation to absorb all of the expected losses of the VIE. The acquired VIE and its subsidiaries were considered immaterial, both individually and in the aggregate. The results of Daojia's operations have been included in the Company's Consolidated Financial Statements since the acquisition date.

We consolidate the entities that operate KFCs in and around Shanghai, Beijing, Wuxi, Suzhou and Hangzhou, as well as the Lavazza joint venture where we have controlling interests since the acquisition dates.

**Comparative Information.** Certain comparative items in the Consolidated Financial Statements have been reclassified to conform to the current year's presentation to facilitate comparison.

**Fiscal Calendar.** Our fiscal year ends on December 31, with each quarter comprised of three months.

**Foreign Currency.** Our functional currency for the operating entities in China is the Chinese Renminbi ("RMB"), the currency of the primary economic environment in which they operate. Income and expense accounts for our operations are then translated into U.S. dollars at the average exchange rates prevailing during the period. Assets and liabilities are then translated into U.S. dollars at exchange rates in effect at the balance sheet date. Foreign currency translation adjustments are recorded in the Accumulated other comprehensive income on the Consolidated Balance Sheets. Gains and losses arising from the impact of foreign currency exchange rate fluctuations on transactions in foreign currency, to the extent they arise, are included in Other income, net in our Consolidated Statements of Income.

**Franchise Operations.** We execute agreements which set out the terms of our arrangement with franchisees. Our franchise agreements typically require the franchisee to pay an initial, non-refundable fee and continuing fees based upon a percentage of sales. Subject to our approval and their payment of a renewal fee, a franchisee may generally renew the franchise agreement upon its expiration.

The 3% license fees we pay to YUM for the right to sublicense the KFC, Pizza Hut and Taco Bell intellectual property to franchisees and unconsolidated affiliates are recorded in Franchise expenses. License fees due to YUM for our Company-owned stores are included in Occupancy and other operating expenses. Total license fees paid to YUM were $298 million, $256 million and $273 million during the years ended December 31, 2021, 2020 and 2019, respectively.

Certain direct costs of our franchise operations are charged to Franchise expenses. These costs include provisions for estimated uncollectible fees, rent or depreciation expense associated with restaurants we sub-lease to franchisees, and certain other direct incremental franchise support costs.

We also have certain transactions with franchisees and unconsolidated affiliates, which consist primarily of sales of food and paper products, advertising services and other services provided to franchisees and unconsolidated affiliates. Related expenses are included in Expenses for transactions with franchisees and unconsolidated affiliates.

**Revenue Recognition.** The Company's revenues primarily include Company sales, Franchise fees and income and Revenues from transactions with franchisees and unconsolidated affiliates.

*Company Sales*

Revenues from Company-owned restaurants are recognized when a customer takes possession of the food and tenders payment, which is when our obligation to perform is satisfied. The Company presents sales net of sales-related taxes. We also offer our customers delivery through both our own mobile applications and third-party aggregators' platforms. For delivery orders placed through our mobile applications, we use our dedicated riders, while for orders placed through third-party aggregators' platforms, we either used our dedicated riders or third-party aggregators' delivery staff in the past. With respect to delivery orders delivered by our dedicated riders, we control and determine the price for the delivery service and generally recognize revenue, including delivery fees, when a customer takes possession of the food. When orders are fulfilled by the delivery staff of third-party aggregators, who control and determine the price for the delivery service, we recognize revenue, excluding delivery fees, when control of the food is transferred to the third-party aggregators' delivery staff. The payment terms with respect to these sales are short-term in nature. Starting in 2019, we used our own dedicated riders to deliver orders placed through aggregators' platforms to customers of KFC and Pizza Hut stores.

We recognize revenues from prepaid stored-value products, including gift cards and product vouchers, when they are redeemed by the customer. Prepaid gift cards sold at any given point generally expire over the next 36 months, and product vouchers generally expire over a period of up to 12 months. We recognize breakage revenue, which is the amount of prepaid stored-value products that is not expected to be redeemed, either (1) proportionally in earnings as redemptions occur, in situations where the Company expects to be entitled to a breakage amount, or (2) when the likelihood of redemption is remote, in situations where the Company does not expect to be entitled to breakage, provided that there is no requirement for remitting balances to government agencies under unclaimed property laws. The Company reviews its breakage estimates at least annually based upon the latest available information regarding redemption and expiration patterns.

Our privilege membership programs offer privilege members rights to multiple benefits, such as free delivery and discounts on certain products. For certain KFC and Pizza Hut privilege membership programs offering a pre-defined amount of benefits that can be redeemed ratably over the membership period, revenue is ratably recognized over the period based on the elapse of time. With respect to the KFC and Pizza Hut family privilege membership program offering members a mix of distinct benefits, including a welcome gift and assorted discount coupons with pre-defined quantities, consideration collected is allocated to the benefits provided based on their relative standalone selling price and revenue is recognized when food or services are delivered or the benefits expire. In determining the relative standalone selling price of the benefits, the Company considers likelihood of future redemption based on historical redemption pattern and reviews such estimates periodically based upon the latest available information regarding redemption and expiration patterns.

*Franchise Fees and Income*

Franchise fees and income primarily include upfront franchise fees, such as initial fees and renewal fees, and continuing fees. We have determined that the services we provide in exchange for upfront franchise fees and continuing fees are highly interrelated with the franchise right. We recognize upfront franchise fees received from a franchisee as revenue over the term of the franchise agreement or the renewal agreement because the franchise rights are accounted for as rights to access our symbolic intellectual property. The franchise agreement term is generally 10 years for KFC and Pizza Hut, five or 10 years for Little Sheep, and three or 10 years for Huang Ji Huang. We recognize continuing fees, which are based upon a percentage of franchisee sales, as those sales occur.

*Revenues from Transactions with Franchisees and Unconsolidated Affiliates*

Revenues from transactions with franchisees and unconsolidated affiliates consist primarily of sales of food and paper products, advertising services and other services provided to franchisees and unconsolidated affiliates.

The Company centrally purchases substantially all food and paper products from suppliers for substantially all of our restaurants, including franchisees and unconsolidated affiliates, and then sells and delivers them to the restaurants. In addition, the Company owns seasoning facilities for its Chinese dining business unit, which manufacture and sell seasoning products to Huang Ji Huang and Little Sheep franchisees. The performance obligation arising from such transactions is considered distinct from the franchise agreement as it is not highly dependent on the franchise agreement and the customer can benefit from the procurement service on its own. We consider ourselves the principal in this arrangement as we have the ability to control a promised good or service before transferring that good or service to the franchisees and unconsolidated affiliates. Revenue is recognized upon transfer of control over ordered items, generally upon delivery to the franchisees and unconsolidated affiliates.

For advertising services, the Company often engages third parties to provide services and acts as a principal in the transaction based on our responsibilities of defining the nature of the services and administering and directing all marketing and advertising programs in accordance with the provisions of our franchise agreements. The Company collects advertising contributions, which are generally based on certain percentage of sales from substantially all of our restaurants, including franchisees and unconsolidated affiliates. Other services provided to franchisees and unconsolidated affiliates consist primarily of customer and technology support services. Advertising services and other services provided are highly interrelated to franchise right, and are not considered individually distinct. We recognize revenue when the related sales occur.

*Loyalty Programs*

Each of the Company's KFC and Pizza Hut reportable segments operates a loyalty program that allows registered members to earn points for each qualifying purchase. Points, which generally expire 18 months after being earned, may be redeemed for future purchases of KFC or Pizza Hut branded products or other products for free or at a discounted price. Points cannot be redeemed or exchanged for cash. The estimated value of points earned by the loyalty program members is recorded as a reduction of revenue at the time the points are earned, based on the percentage of points that are projected to be redeemed, with a corresponding deferred revenue liability included in Accounts payable and other current liabilities on the Consolidated Balance Sheets and subsequently recognized into revenue when the points are redeemed or expire. The Company estimates the value of the future redemption obligations based on the estimated value of the product for which points are expected to be redeemed and historical redemption patterns and reviews such estimates periodically based upon the latest available information regarding redemption and expiration patterns.

**Direct Marketing Costs.** We charge direct marketing costs to expense ratably in relation to revenues over the year in which incurred and, in the case of advertising production costs, in the year the advertisement is first shown. Deferred direct marketing costs, which are classified as prepaid expenses, consist of media and related advertising production costs which will generally be used for the first time in the next fiscal year and have historically not been significant. Our direct marketing expenses incurred for Company-owned restaurants were $368 million, $307 million and $344 million in 2021, 2020 and 2019, respectively, and were included in Occupancy and other operating expenses. In addition, the direct marketing costs incurred for franchisees and unconsolidated affiliates were $55 million, $60 million and $65 million in 2021, 2020 and 2019, respectively, and were recorded in Expenses for transactions with franchisees and unconsolidated affiliates.

**Research and Development Expenses.** Research and development expenses associated with our food innovation activities, which are expensed as incurred, are reported in general and administrative ("G&A") expenses. Research and development expenses were $6 million, $3 million and $4 million in 2021, 2020 and 2019, respectively.

**Share-Based Compensation**. Prior to the separation, all employee equity awards were granted by YUM. Upon the separation, holders of outstanding YUM equity awards generally received both adjusted YUM awards and Yum China awards, or adjusted awards of either YUM or Yum China in their entirety, to maintain the pre-separation intrinsic value of the awards. The modified equity awards have the same terms and conditions as the awards held immediately before the separation, except the number of shares and the price were adjusted. The incremental compensation cost, measured as the excess of the fair value of the award immediately after the modification over the fair value of the award immediately before the modification, based on Black-Scholes option-pricing model was immaterial, and YUM and the Company continue to recognize the unamortized fair value of the awards over the remaining requisite service period as their respective employees continue to provide services. All awards granted following the separation were granted under the Company's Long Term Incentive Plan (the "2016 Plan"). We recognize all share-based payments to employees and directors, including grants of stock options, restricted stock units ("RSUs"), stock appreciation rights ("SARs") and performance share units ("PSUs"), in the Consolidated Financial Statements as compensation cost over the service period based on their fair value on the date of grant. This compensation cost is recognized over the service period on a straight-line basis, net of an assumed forfeiture rate, for awards that actually vest and when performance conditions are probable of being achieved, if applicable. Forfeiture rates are estimated at grant date based on historical experience and compensation cost is adjusted in subsequent periods for differences in actual forfeitures from the previous estimates. We present this compensation cost consistent with the other compensation costs for the employee recipient in either payroll and employee benefits or G&A expenses.

**Impairment or Disposal of Long-Lived Assets.** Long-lived assets, primarily Property, plant and equipment ("PP&E") and operating lease right-of-use ("ROU") assets are tested for impairment whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The assets are not recoverable if their carrying value is higher than the undiscounted cash flows we expect to generate from such assets. If the assets are not deemed to be recoverable, impairment is measured based on the excess of their carrying value over their fair value.

For purposes of impairment testing for our restaurants, we have concluded that an individual restaurant is the lowest level of independent cash flows unless our intent is to refranchise restaurants as a group. We review our long-lived assets of such individual restaurants (primarily operating lease ROU assets and PP&E) semi-annually for impairment, or whenever events or changes in circumstances indicate that the carrying amount of a restaurant may not be recoverable. Our primary indicators of potential impairment for our semi-annual impairment testing of these restaurant assets include two consecutive years of operating losses after a restaurant has been open for three years. We evaluate the recoverability of these restaurant assets by comparing the forecasted undiscounted cash flows of the restaurant's operation, which are based on our entity-specific assumptions, to the carrying value of such assets. The forecasted undiscounted cash flows incorporate our best estimate of sales growth based upon our operation plans for the unit and actual results at comparable restaurants. For restaurant assets that are not deemed to be recoverable, we write down an impaired restaurant to its estimated fair value, which becomes its new cost basis. Fair value is an estimate of the price market participants would pay for the restaurant and its related assets. In determining the fair value of restaurant-level assets, we considered the highest and best use of the assets from market participants' perspective, which is represented by the higher of the forecasted discounted cash flows from operating restaurants and the price market participants would pay to sub-lease the operating lease ROU assets and acquire remaining restaurant assets, even if that use differs from the current use by the Company. The after-tax cash flows incorporate reasonable assumptions we believe a franchisee would make such as sales growth and include a deduction for royalties we would receive under a franchise agreement with terms substantially at market. The discount rate used in the fair value calculation is our estimate of the required rate-of-return that a franchisee would expect to receive when purchasing a similar restaurant and the related long-lived assets. The discount rate incorporates rates of returns for historical refranchising market transactions and is commensurate with the risks and uncertainty inherent in the forecasted cash flows. Estimates of the price market participants would pay to sub-lease the operating lease ROU assets are based on comparable market rental information that could be reasonably obtained for the property. In situations where the highest and best use of the restaurant-level assets from market participants' perspective is represented by sub-leasing the operating lease ROU assets and acquiring remaining restaurant assets, the Company continues to use these assets in operating its restaurant business, which is consistent with its long-term strategy of growing revenue through operating restaurant concepts.

When we believe it is more likely than not a restaurant or groups of restaurants will be refranchised for a price less than their carrying value, but do not believe the restaurant(s) have met the criteria to be classified as held for sale, we review the restaurants for impairment. We evaluate the recoverability of these restaurant assets by comparing estimated sales proceeds plus holding period cash flows, if any, to the carrying value of the restaurant or group of restaurants. For restaurant assets that are not deemed to be recoverable, we recognize impairment for any excess of carrying value over the fair value of the restaurants, which is based on the expected net sales proceeds. To the extent ongoing agreements to be entered into with the franchisee simultaneous with the refranchising are expected to contain terms, such as royalty rates, not at prevailing market rates, we consider the off-market terms in our impairment evaluation. We recognize any such impairment charges in Refranchising gain. Refranchising gain includes the gains or losses from the sales of our restaurants to new and existing franchisees, including any impairment charges discussed above. We recognize gains on restaurant refranchising when the sale transaction closes, the franchisee has a minimum amount of the purchase price in at-risk equity and we are satisfied that the franchisee can meet its financial obligations.

When we decide to close a restaurant, it is reviewed for impairment, and depreciable lives are adjusted based on the expected disposal date. Other costs incurred when closing a restaurant such as costs of disposing of the assets as well as other facility-related expenses are generally expensed as incurred. Additionally, at the time we decide to close a restaurant, we reassess whether it is reasonably certain that we will exercise the termination option, and remeasure lease liability to reflect changes in lease term and remaining lease payments based on the planned exit date, if applicable. The amount of the re-measurement of the lease liability is recorded as an adjustment to the operating lease ROU asset first, with any remaining amount recorded in Closures and impairment expenses if the carrying amount of the operating lease ROU asset is reduced to zero. Any costs recorded upon store closure as well as any subsequent adjustments to remaining operating lease ROU assets and lease liabilities as a result of lease termination are recorded in Closures and impairment expenses. In the event we are forced to close a store and receive compensation for such closure, that compensation is recorded in Closures and impairment expenses. To the extent we sell assets associated with a closed store, any gain or loss upon that sale is also recorded in Closures and impairment expenses.

Considerable management judgment is necessary to estimate future cash flows, including cash flows from continuing use, terminal value, lease term and refranchising proceeds. Accordingly, actual results could vary significantly from our estimates.

**Government Subsidies.** Government subsidies generally consist of financial subsidies received from provincial and local governments for operating a business in their jurisdictions and compliance with specific policies promoted by the local governments. There are no defined rules and regulations to govern the criteria necessary for companies to receive such benefits, and the amount of financial subsidy is determined at the discretion of the relevant government authorities. Government subsidies are recognized when it is probable that the Company will comply with the conditions attached to them, and the subsidies are received. If the subsidy is related to an expense item, it is recognized as a reduction to the related expense to match the subsidy to the costs that it is intended to compensate. If the subsidy is related to an asset, it is deferred and recorded in other liabilities and then recognized ratably over the expected useful life of the related asset in the Consolidated Statements of Income.

**Income Taxes.** We record deferred tax assets and liabilities for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases as well as operating loss, capital loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those differences or carryforwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Additionally, in determining the need for recording a valuation allowance against the carrying amount of deferred tax assets, we consider the amount of taxable income and periods over which it must be earned, actual levels of past taxable income and known trends and events or transactions that are expected to affect future levels of taxable income. Where we determine that it is more likely than not that all or a portion of an asset will not be realized, we record a valuation allowance.

On December 22, 2017, the Tax Cuts and Jobs Act (the "Tax Act") was signed into law effective for tax years beginning after December 31, 2017. The U.S. Treasury Department and the IRS released the final transition tax regulations in the first quarter of 2019. We completed the evaluation of the impact on our transition tax computation based on the final regulations released in the first quarter of 2019 and recorded an additional income tax expense of $8 million for the transition tax accordingly.

We are subject to reviews, examinations and audits by Chinese tax authorities, the IRS and other taxing authorities with respect to income and non-income based taxes. We recognize the benefit of positions taken or expected to be taken in our tax returns when it is more likely than not that the position would be sustained upon examination by these tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than 50% likely of being realized upon settlement. We evaluate unrecognized tax benefits, including interest thereon, on a quarterly basis to ensure that they have been appropriately adjusted for events, including audit settlements, which may impact our ultimate payment for such exposures.

We have investments in our foreign subsidiaries where the carrying values for financial reporting exceed the tax basis. Except for the planned but yet to be distributed earnings, we have not provided deferred tax on the portion of the excess that we believe is indefinitely reinvested, as we have the ability and intent to indefinitely postpone the basis differences from reversing with a tax consequence. The Company's separation from YUM was intended to qualify as a tax-free reorganization for U.S. income tax purposes resulting in the excess of financial reporting basis over tax basis in our investment in the China business continuing to be indefinitely reinvested. The excess of financial reporting basis over tax basis as of December 31 2017 was subject to the one-time transition tax under the Tax Act as a deemed repatriation of accumulated undistributed earnings from the foreign subsidiaries. However, we continue to believe that the portion of the excess of financial reporting basis over tax basis (including earnings and profits subject to the one-time transition tax) is indefinitely reinvested in our foreign subsidiaries for foreign withholding tax purposes.

Pursuant to the China Enterprise Income Tax Law ("EIT Law"), a 10% PRC withholding tax is generally levied on dividends declared by companies in China to their non-resident enterprise investors unless otherwise reduced according to treaties or arrangements between the Chinese central government and the governments of other countries or regions where the non-China resident enterprises are incorporated. Hong Kong has a tax arrangement with mainland China that provides for a 5% withholding tax on dividends distributed to a Hong Kong resident enterprise, upon meeting certain conditions and requirements, including, among others, that the Hong Kong resident enterprise own at least 25% equity interest of the Chinese enterprise and is a "beneficial owner" of the dividends. We believe that our Hong Kong subsidiary, which is the equity holder of our Chinese subsidiaries, met the relevant requirements pursuant to the tax arrangement between mainland China and Hong Kong in 2018 and is expected to meet the requirements in the subsequent years; thus, it is more likely than not that our dividends declared or earnings expected to be repatriated since 2018 are subject to the reduced withholding tax of 5%.

See Note 17 for a further discussion of our income taxes.

**Fair Value Measurements.** Fair value is the price we would receive to sell an asset or pay to transfer a liability (exit price) in an orderly transaction between market participants. For those assets and liabilities we record or disclose at fair value, we determine fair value based upon the quoted market price, if available. If a quoted market price is not available for identical assets, we determine fair value based upon the quoted market price of similar assets or the present value of expected future cash flows considering the risks involved, including counterparty performance risk if appropriate, and using discount rates appropriate for the duration. The fair values are assigned a level within the fair value hierarchy, depending on the source of the inputs into the calculation.

Level 1 Inputs based upon quoted prices in active markets for identical assets.

Level 2 Inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly.

Level 3 Inputs that are unobservable for the asset.

In addition, when we acquire additional equity interest in the unconsolidated affiliates to obtain control, it may result in gain or loss from re-measurement of our previously held equity interest at fair value using a discounted cash flow valuation approach and incorporating assumptions and estimates that are Level 3 inputs. Key assumptions used in estimating future cash flows included projected revenue growth and costs and expenses, which were based on internal projections, store expansion plans, historical performance of stores and the business environment, as well as the selection of an appropriate discount rate based on the weighted-average cost of capital which includes company-specific risk premium.

**Cash and Cash Equivalents.** Cash equivalents represent highly liquid investments with original maturities not exceeding three months and are primarily comprised of time deposits, fixed income debt securities and money market funds. Cash and overdraft balances that meet the criteria for right to offset are presented net on our Consolidated Balance Sheets.

**Short-term Investments.** Short-term investments purchased primarily represent time deposits, fixed income debt securities with original maturities of over three months but less than one year when purchased, and certain structured deposits that are principal-protected and provide returns in the form of both fixed and variable interests. Such variable interest rates indexed to gold prices or foreign exchange rates are considered embedded derivatives and bifurcated from host contracts, and measured at fair value on a recurring basis. The fair value change of the embedded derivatives is recorded in Investment gain or loss in the Consolidated Statements of Income. The remaining host contracts to receive guaranteed principal and fixed interest are measured at amortized cost, with accretion of interest recorded in Interest income in the Consolidated Statements of Income. As of December 31, 2021 and 2020, there were no outstanding balances for structured deposits containing embedded derivatives. See Note 13 for detail discussion on our Short-term Investments.

**Accounts Receivable.** Accounts Receivable primarily consist of trade receivables and royalties from franchisees and unconsolidated affiliates, and are generally due within 30 days of the period in which the corresponding sales occur and are classified as Accounts receivable on the Consolidated Balance Sheets. Prior to the adoption of ASC 326, our provision for uncollectible receivable balances was based upon pre-defined aging criteria or upon the occurrence of other events that indicated that we may not collect the balance due. Additionally, we monitor the financial condition of our franchisees and record provisions for estimated losses on receivables when we believe it is probable that our franchisees will be unable to make their required payments. Upon adoption of ASC 326 starting from January 1, 2020, our provision of credit losses for accounts receivable is based upon the current expected credit losses ("CECL") model. The CECL model requires an estimate of the credit losses expected over the life of accounts receivable since initial recognition, and accounts receivable with similar risk characteristics are grouped together when estimating CECL. In assessing the CECL, the Company considers both quantitative and qualitative information that is reasonable and supportable, including historical credit loss experience, adjusted for relevant factors impacting collectability and forward-looking information indicative of external market conditions. While we use the best information available in making our determination, the ultimate recovery of recorded receivables is also dependent upon future economic events and other conditions that may be beyond our control. Accounts receivable that are ultimately deemed to be uncollectible, and for which collection efforts have been exhausted, are written off against the allowance for doubtful accounts. As of December 31, 2021 and 2020, the ending balances of provision for accounts receivable were both $1 million, and amounts of accounts receivable past due were immaterial. Receivables due from unconsolidated affiliates including accounts receivable and dividend receivables were insignificant as of December 31, 2021, and $50 million as of December 31, 2020.

**Receivables from Payment Processors or Aggregators.** Receivables from payment processors such as WeChat and Alipay or aggregators are cash due from them for clearing transactions and are included in Prepaid expenses and other current assets. The cash was paid by customers through these payment processors or aggregators for food provided by the Company. The Company considers and monitors the credit worthiness of the third-party payment processors and aggregators used. Prior to the adoption of ASC 326, an allowance for doubtful accounts is recorded in the period in which a loss is determined to be probable. Upon adoption of ASC 326 starting from January 1, 2020, we adopted the same methodology of estimating expected credit losses based upon the CECL model as described above. Receivable balances are written off after all collection efforts have been exhausted. As of December 31, 2021 and 2020, no allowance for doubtful accounts was provided for such receivables.

**Inventories.** We value our inventories at the lower of cost (computed on the first-in, first-out method) or net realizable value.

**Property, Plant and Equipment.** We state PP&E at cost less accumulated depreciation and amortization. We calculate depreciation and amortization on a straight-line basis over the estimated useful lives of the assets as follows: 20 to 50 years for buildings, the lesser of estimated useful lives (5 to 10 years) and remaining lease term for leasehold improvements, 3 to 10 years for restaurant machinery and equipment and 3 to 5 years for capitalized software costs. We suspend depreciation and amortization on assets related to restaurants that are held for sale.

**Leases.** The Company adopted Accounting Standards Update ("ASU") No. 2016-02, *Leases (Topic 842)* ("ASC 842") and subsequent amendments issued by the Financial Accounting Standards Board ("FASB") on January 1, 2019, using a modified retrospective method for leases that exist at, or are entered into after, January 1, 2019.

Upon adoption of ASC 842, ROU assets and lease liabilities are recognized upon lease commencement for operating leases based on the present value of lease payments over the lease term. As the rate implicit in the lease cannot be readily determined, we use our incremental borrowing rate at the lease commencement date in determining the imputed interest and present value of lease payments. The incremental borrowing rate was determined using a portfolio approach based on the rate of interest that we would have to borrow an amount equal to the lease payments on a collateralized basis over a similar term. The incremental borrowing rate is primarily influenced by the risk-free interest rate of China, the Company's credit rating and lease term, and is updated on a quarterly basis for measurement of new lease liabilities.

For operating leases, the Company recognizes a single lease cost on a straight-line basis over the remaining lease term. For finance leases, the Company recognizes straight-line amortization of the ROU asset and interest on the lease liability. For rental payments either based on a percentage of the restaurant's sales in excess of a fixed base amount or solely based on a percentage of the restaurant's sales, they are recognized as variable lease expenses as incurred.

The Company has elected not to recognize ROU assets or lease liabilities for leases with an initial term of 12 months or less; we recognize lease expense for these leases on a straight-line basis over the lease term. In addition, the Company has elected not to separate non-lease components (e.g., common area maintenance fees) from the lease components.

From time to time, we purchase the rights to use government-owned land and the building occupying the land for a fixed period of time. Prior to the adoption of ASC 842, these land use rights and related buildings were recorded in Other Assets and Property, Plant and Equipment in our Consolidated Balance Sheets, and are amortized on a straight-line basis over the term of the land use rights. Upon the adoption of ASC 842 on January 1, 2019, land use rights acquired are assessed in accordance with ASC 842 and recognized in ROU assets if they meet the definition of lease.

See Note 12 for further discussions on our leases.

**Internal Development Costs and Abandoned Site Costs.** We capitalize direct costs associated with the site acquisition and construction of a Company unit on that site, including direct internal payroll and payroll-related costs. Only those site-specific costs incurred subsequent to the time that the site acquisition is considered probable are capitalized. If we subsequently make a determination that it is probable a site for which internal development costs have been capitalized will not be acquired or developed, any previously capitalized internal development costs are expensed and included in G&A expenses.

**Goodwill and Intangible Assets.** From time to time, the Company acquires restaurants from our existing franchisees or acquires another business, including restaurants business of unconsolidated affiliates. Goodwill from these acquisitions represents the excess of the cost of a business acquired over the net of the amounts assigned to assets acquired, including identifiable intangible assets and liabilities assumed. Goodwill is not amortized and has been assigned to reporting units for purposes of impairment testing. Our reporting units are our individual operating segments.

We evaluate goodwill for impairment on an annual basis or more often if an event occurs or circumstances change that indicate impairment might exist. We have selected the beginning of our fourth quarter as the date on which to perform our ongoing annual impairment test for goodwill. We may elect to perform a qualitative assessment for our reporting units to determine whether it is more likely than not that the fair value of the reporting unit is greater than its carrying value. If a qualitative assessment is not performed, or if as a result of a qualitative assessment it is not more likely than not that the fair value of a reporting unit exceeds its carrying value, then the reporting unit's fair value is compared to its carrying value. Fair value is the price a willing buyer would pay for a reporting unit, and is generally estimated using discounted expected future after-tax cash flows from the business operation of the reporting unit. The discount rate is our estimate of the required rate-of-return that a third-party buyer would expect to receive when purchasing a business from us that constitutes a reporting unit. We believe the discount rate is commensurate with the risks and uncertainty inherent in the forecasted cash flows. If the carrying value of a reporting unit exceeds its fair value, we will record an impairment charge based on that difference. The impairment charge will be limited to the amount of goodwill allocated to that reporting unit.

If we record goodwill upon acquisition of a restaurant(s) from a franchisee and such restaurant(s) is then sold within two years of acquisition, the goodwill associated with the acquired restaurant(s) is written off in its entirety. If the restaurant is refranchised two years or more subsequent to its acquisition, we include goodwill in the carrying amount of the restaurants disposed of based on the relative fair values of the portion of the reporting unit disposed of in the refranchising and the portion of the reporting unit that will be retained.

We determine the useful life of intangible assets with consideration of factors including the expected use of the asset, the expected useful life of another asset or a group of assets to which the useful life of the intangible asset may relate, any legal, regulatory or contractual provisions that may limit the useful life, our historical experience in renewing or extending similar arrangements, the effects of obsolescence, demand, competition and other economic factors, and the level of maintenance expenditures required to obtain the expected future cash flows from the assets. We evaluate the remaining useful life of an intangible asset that is not being amortized each reporting period to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, we amortize the intangible asset prospectively over its estimated remaining useful life. The Company's indefinite-lived intangible asset represents Little Sheep and Huang Ji Huang trademarks as we consider their useful life to be indefinite since we intend to use Little Sheep and Huang Ji Huang trademarks indefinitely and there are no legal, regulatory or contractual provisions that may limit the useful life of the trademarks. Intangible assets that are deemed to have a finite life are generally amortized over their estimated useful lives on a straight-line basis to their residual value as follows:

| | |
|---|---|
| Reacquired franchise rights | 1 to 10 years |
| Huang Ji Huang franchise related assets | 19 years |
| Daojia platform | 8 years |
| Customer-related assets | 2 to 15 years |
| Others | up to 20 years |

The useful life of reacquired franchise rights was determined based on the contractual term whereas both the contractual term and historical pattern of renewing franchise agreements were considered in assessing the useful life of Huang Ji Huang franchise related assets. Customer-related assets primarily represent the customer relationship and user base acquired and the estimate of the useful life was based on the historical pattern of extending similar arrangements and attrition rate of users. Others primarily represent Little Sheep's secret recipe. The useful life of the Daojia platform and Little Sheep's secret recipe was assessed based on our estimate of periods generating cash flows from utilizing such assets.

We evaluate our indefinite-lived intangible assets for impairment on an annual basis or more often if an event occurs or circumstances change that indicate impairments might exist. We perform our annual test for impairment of our indefinite-lived intangible assets at the beginning of our fourth quarter. We may elect to perform a qualitative assessment to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is greater than its carrying value. If a qualitative assessment is not performed, or if as a result of a qualitative assessment it is not more likely than not that the fair value of an indefinite-lived intangible asset exceeds its carrying value, then the asset's fair value is compared to its carrying value. Fair value is an estimate of the price a willing buyer would pay for the intangible asset and is generally estimated by discounting the expected future after-tax cash flows associated with the intangible asset.

Our finite-lived intangible assets that are not allocated to an individual restaurant are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of the intangible asset may not be recoverable. An intangible asset that is deemed not recoverable based on forecasted undiscounted future cash flow is written down to its estimated fair value, which is our estimate of the price a willing buyer would pay for the intangible asset based on discounted expected future after-tax cash flows. For purposes of our impairment analysis, we update the cash flows that were initially used to value the finite-lived intangible asset to reflect our current estimates and assumptions over the asset's future remaining life.

During the year ended December 31, 2019, we recorded an impairment charge of $11 million on intangible assets and goodwill attributable to the Daojia business. See Note 6 for additional details.

**Equity Investments.** The Company's equity investments include investments in unconsolidated affiliates and investments in equity securities with readily determinable fair value.

The Company applies the equity method to account for the investments in unconsolidated affiliates over which it has significant influence but does not control. Equity method investments are included as Investments in unconsolidated affiliates on our Consolidated Balance Sheets. Our share of earnings or losses and share of changes in other comprehensive income or losses of equity method investees is included in net income and other comprehensive income or losses, respectively. We record impairment charges related to an investment in an unconsolidated affiliate whenever events or circumstances indicate that a decrease in the fair value of an investment has occurred which is other than temporary.

For our investments in equity securities with readily determinable fair value, over which the Company has neither significant influence nor control, they are measured at fair value with subsequent changes recognized in net income.

See Note 3 for further discussions on our equity investments.

**Financial Instruments.** We account for derivative instruments as either assets or liabilities in the Consolidated Balance Sheets. The financial instruments are recorded at their respective fair value as determined on the day of issuance and subsequently adjusted to the fair value at each reporting date. Changes in the fair value of financial instruments are recognized periodically in the Consolidated Statements of Income. The estimated fair values of derivative instruments are determined at discrete points in time using standard valuation techniques.

**Noncontrolling Interests.** We report Net income attributable to noncontrolling interests separately on the face of our Consolidated Statements of Income. The portion of equity attributable to noncontrolling interests is reported within equity, separately from the Company's stockholders' equity on the Consolidated Balance Sheets.

When the noncontrolling interest is redeemable at the option of the noncontrolling shareholder, or contingently redeemable upon the occurrence of a conditional event that is not solely within the control of the Company, the noncontrolling interest is separately classified as mezzanine equity. In connection with the acquisition of Huang Ji Huang and Daojia, redeemable noncontrolling interests were initially recognized at fair value and classified outside of permanent equity on our Consolidated Balance Sheets due to redemption rights being held by noncontrolling shareholders. Subsequent changes in the redemption value of redeemable noncontrolling interests are immediately recognized as they occur and adjusted to the carrying amount of redeemable noncontrolling interests.

**Guarantees.** We account for guarantees in accordance with ASC Topic 460 ("ASC 460"), *Guarantees*. Accordingly, the Company evaluates its guarantees to determine whether (a) the guarantee is specifically excluded from the scope of ASC 460, (b) the guarantee is subject to ASC 460 disclosure requirements only, but not subject to the initial recognition and measurement provisions, or (c) the guarantee is required to be recorded in the financial statements at fair value. The Company provides: (i) indemnifications to certain investors and other parties for certain losses suffered or incurred by the indemnified party in connection with third-party claims; and (ii) indemnifications of officers and directors against third-party claims arising from the services they provide to the Company. To date, the Company has not incurred costs as a result of these obligations and does not expect to incur material costs in the future. Accordingly, the Company has not accrued any liabilities on the Consolidated Balance Sheets related to these indemnifications.

**Asset Retirement Obligations.** We recognize an asset and a liability for the fair value of a required asset retirement obligation ("ARO") when such an obligation is incurred. The Company's AROs are primarily associated with leasehold improvements which, at the end of the lease, the Company is contractually obligated to remove in order to comply with the lease agreement. As such, we amortize the asset on a straight-line basis over the lease term and accrete the liability to its nominal value using the effective interest method over the lease term.

**Contingencies.** The Company records accruals for certain of its outstanding legal proceedings or claims when it is probable that a liability will be incurred and the amount of loss can be reasonably estimated. The Company evaluates, on a quarterly basis, developments in legal proceedings or claims that could affect the amount of any accrual, as well as any developments that would make a loss contingency both probable and reasonably estimable. The Company discloses the amount of the accrual if it is material.

**Retirement Plans.** Certain of the Company's employees participate in noncontributory defined benefit plans and post-retirement medical plans sponsored by YUM prior to October 31, 2016. Subsequent to the separation, employees participating in YUM's plans were enrolled in the Yum China Holdings, Inc. Leadership Retirement Plan ("YCHLRP"), an unfunded, unsecured account-based retirement plan which allocates a percentage of pay to an account payable to the executive following the executive's separation of employment from the Company or attainment of age 55.

The Company also offers other defined contribution plans to employees. The total contribution for such employee benefits was expensed as incurred. The Company has no additional legal obligation or liabilities for the benefits beyond the paid and accrued amounts. See Note 14 for additional information.

**PRC Value-Added Tax.** The Company has been subject to VAT within the normal course of its restaurant business nationwide since May 1, 2016.

Entities that are VAT general taxpayers are permitted to offset qualified input VAT paid to suppliers against their output VAT upon receipt of appropriate supplier VAT invoices on an entity-by-entity basis. When the output VAT exceeds the input VAT, the difference is remitted to tax authorities, usually on a monthly basis; whereas when the input VAT exceeds the output VAT, the difference is treated as an input VAT credit asset which can be carried forward indefinitely to offset future net VAT payables. VAT related to purchases and sales which have not been settled at the balance sheet date is disclosed separately as an asset and liability, respectively, on the Consolidated Balance Sheets. At each balance sheet date, the Company reviews the outstanding balance of any input VAT credit asset for recoverability, giving consideration to the indefinite life of the input VAT credit assets as well as its forecasted operating results and capital spending, which inherently includes significant assumptions that are subject to change.

As of December 31, 2021 and 2020, an input VAT credit asset of $322 million and $270 million were recorded in Other assets, respectively, and payable of $2 million and $6 million, were recorded in Accounts payable and other current liabilities, respectively, on the Consolidated Balance Sheets. The Company has not made an allowance for the recoverability of the input VAT credit asset, as the balance is expected to be utilized to offset against VAT payables more than one year from December 31, 2021. Any input VAT credit asset would be classified as Prepaid expenses and other current assets if the credit expected to be used within one year can be reasonably determined.

**Earnings Per Share.** Basic earnings per share represent net earnings to common stockholders divided by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted into common shares. See Note 5 for further information.

**Common Stock Repurchases.** We may repurchase shares of Yum China common stock under a program authorized by our board of directors from time to time in open market or privately negotiated transactions, including block trades, accelerated share repurchase transactions and the use of Rule 10b5-1 trading plans. Shares repurchased are included in treasury stock in the financial statements. See Note 16 for further information.

### *Recently Adopted Accounting Pronouncements*

In December 2019, the FASB issued ASU 2019-12, *Income Tax (Topic 740), Simplifying the Accounting for Income Taxes* (“ASU 2019-12”), which simplifies the accounting for income taxes by eliminating certain exceptions to the guidance in Topic 740 related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition of deferred tax liabilities for outside basis differences. The guidance also simplifies the accounting for franchise taxes and enacted changes in tax laws or rates and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. We adopted the standard on January 1, 2021 and such adoption did not have a material impact on our financial statements.

In January 2020, the FASB issued ASU 2020-01, *Investments — Equity Securities (Topic 321), Investments — Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815)* (“ASU 2020-01”), which clarifies the interaction between equity securities under Topic 321 and investments accounted for under the equity method in Topic 323 and the accounting for certain forward contracts and purchased options accounted for under Topic 815. We adopted the standard on January 1, 2021 and such adoption did not have a material impact on our financial statements.

In October 2020, the FASB issued ASU 2020-08, *Codification Improvements to Subtopic 310-20, Receivables — Nonrefundable Fees and Other Costs* (“ASU 2020-08”), which clarifies that an entity should reevaluate for each reporting period whether a callable debt security is within the scope of certain guidance in ASC 310-20 that was issued in ASU 2017-08, *Receivables — Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities.* We adopted the standard on January 1, 2021 and such adoption did not have a material impact on our financial statements.

## Note 3 — Business Acquisitions and Equity Investments

### *Consolidation of Hangzhou KFC and Equity Investment in Hangzhou Catering*

During the fourth quarter of 2021, the Company completed its investment of a 28% equity interest in Hangzhou Catering for cash consideration of $255 million. Hangzhou Catering holds a 45% equity interest in Hangzhou KFC, of which the Company previously held a 47% equity interest. Along with the investment, the Company also obtained two additional board seats in Hangzhou KFC. Upon completion of the transaction, the Company directly and indirectly holds an approximately 60% equity interest in Hangzhou KFC and has majority representation on the board, and thus obtained control over Hangzhou KFC and started to consolidate its results from the acquisition date.

As a result of the consolidation of the Hangzhou KFC, the Company also recognized a gain of $618 million in the fourth quarter of 2021 from the re-measurement of our previously held equity interest at fair value. The gain was recorded in Other income, net and not allocated to any segment for performance reporting purposes. Additionally, $66 million of the purchase price was allocated to the reacquired franchise right, which is amortized over the remaining franchise contract period of 1 year.

In addition to its equity interest in Hangzhou KFC, Hangzhou Catering operates approximately 60 Chinese dining restaurants under four time-honored brands and a food processing business. The Company applies equity method of accounting to the 28% equity interests in Hangzhou Catering excluding the Hangzhou KFC business and classified this investment in Investment in unconsolidated affiliates based on its then fair value. The Company elected to report its share of Hangzhou Catering's financial results with a one-quarter lag because its results are not available in time for the Company to record them in the concurrent period. As a result, no equity income from Hangzhou Catering was recorded in 2021.

### *Consolidation of Suzhou KFC*

In the third quarter of 2020, the Company completed the acquisition of an additional 25% equity interest in Suzhou KFC for cash consideration of $149 million, increasing our equity interest to 72%, and thus the Company obtained control over the joint venture and started to consolidate Suzhou KFC from the acquisition date.

As a result of the consolidation of Suzhou KFC, the Company also recognized a gain of $239 million in the third quarter of 2020, from the re-measurement of our previously held equity interest at fair value. The gain was recorded in Other income, net and not allocated to any segment for performance reporting purposes.

Additionally, $61 million of the purchase price was allocated to the reacquired franchise right in 2020, which is amortized over the remaining franchise contract period of 2.4 years.

### *Consolidation of Lavazza Joint Venture*

In April 2020, the Company and Lavazza Group established the Lavazza joint venture to explore and develop the Lavazza coffee shop concept in China, with ownership of a 65% and 35% equity interest, respectively. The Company accounted for the Lavazza joint venture under the equity method of accounting because Lavazza Group held substantive participating rights on certain significant financial and operating decisions. In September 2021, the Company and Lavazza Group entered into agreements for the joint venture, whereby substantive participating rights previously held by Lavazza Group were removed, and thus the Company obtained control over the joint venture and started to consolidate its results from the acquisition date.

As a result of the consolidation of the Lavazza joint venture, the Company also recognized a gain of $10 million in the third quarter of 2021 from the re-measurement of our previously held equity interest at fair value. The gain was recorded in Other income, net and not allocated to any segment for performance reporting purposes.

### *Acquisition of Huang Ji Huang Group*

On April 8, 2020, the Company completed the acquisition of a 93.3% interest in the Huang Ji Huang group ("Huang Ji Huang"), a leading Chinese-style casual dining franchise business, for cash consideration of $185 million. Huang Ji Huang became an operating segment of the Company. See Note 9 for the Company's goodwill and intangible assets acquired from our acquisition of Huang Ji Huang.

### *Fujian Sunner Development Co., Ltd. ("Sunner") Investment*

In the first quarter of 2021, the Company acquired a 5% equity interest in Sunner, a Shenzhen Stock Exchange listed company, for a total consideration of approximately $261 million. Sunner is China's largest white-feathered chicken producer and the Company's largest poultry supplier.

The Company accounted for the equity securities at fair value based on their closing market price on each measurement date, with subsequent fair value changes recorded in our Consolidated Statements of Income.

In May 2021, a senior executive of the Company was nominated and appointed to Sunner's board of directors upon Sunner's shareholder approval. Through this representation, the Company participates in Sunner's policy making process. The representation on the board, along with the Company being Sunner's second largest shareholder, provides the Company with the ability to exercise significant influence over the operating and financial policies of Sunner. As a result, the Company started to apply the equity method of accounting to the investment and reclassified this investment from Other assets to Investment in unconsolidated affiliates in May 2021 based on its then fair value. The Company elected to report its share of Sunner's financial results with a one-quarter lag because Sunner's results are not available in time for the Company to record them in the concurrent period. In 2021, the Company's equity income from Sunner was immaterial. The unrealized loss of $22 million was included in Investment gain or loss in our Consolidated Statements of Income for the year ended December 31, 2021, representing changes in fair value before the equity method of accounting was applied.

Since Sunner became the Company's unconsolidated affiliate in May 2021, the Company purchased inventories of $318 million from Sunner for the year ended December 31, 2021, and the Company's accounts payable and other current liabilities due to Sunner were $56 million as of December 31, 2021.

As of December 31, 2021, the Company's investment in Sunner was stated at the carrying amount of $248 million, which was $171 million higher than the Company's interest in Sunner's underlying net assets. Of this basis difference, $20 million was related to finite-lived intangible assets which are being amortized over estimated useful life of 20 years. The remaining differences were related to goodwill and indefinite-lived intangible assets, which are not subject to amortization, as well as deferred tax liabilities impact. As of December 31, 2021, the market value of the Company's investment in Sunner was $237 million based on its quoted closing price.

### *Meituan Dianping ("Meituan") Investment*

In the third quarter of 2018, the Company subscribed for 8.4 million, or less than 1%, of the ordinary shares of Meituan, an e-commerce platform for services in China, for a total consideration of approximately $74 million, when it launched its initial public offering on the HKEX in September 2018. In the second quarter of 2020, the Company sold 4.2 million of the ordinary shares of Meituan for proceeds of approximately $54 million, and realized a $17 million pre-tax gain which was recognized during the holding period.

The Company accounted for the equity securities at fair value with subsequent fair value changes recorded in our Consolidated Statements of Income. The fair value of the investment in Meituan is determined based on the closing market price for the shares at the end of each reporting period. The fair value change, to the extent the closing market price of shares of Meituan as of the end of reporting period is higher than our cost, is subject to U.S. tax.

A summary of pre-tax gains or losses on investment in equity securities of Meituan recognized, which was included in Investment gain or loss in our Consolidated Statements of Income, is as follows:

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Unrealized (losses) gains recorded on equity securities still held as of the end of the year | $ (38) | $ 105 | $ 63 |
| Losses recorded on equity securities sold during the year | — | (1) | — |
| (Losses) gains recorded on equity securities | $ (38) | $ 104 | $ 63 |

## Note 4 — Revenue

The following table presents revenue disaggregated by types of arrangements and segments:

| 2021 Revenues | KFC | Pizza Hut | All Other Segments | Corporate and Unallocated | Combined | Elimination | Consolidated |
|---|---|---|---|---|---|---|---|
| Company sales | $ 6,816 | $ 2,092 | $ 53 | $ — | $ 8,961 | $ — | $ 8,961 |
| Franchise fees and income | 120 | 8 | 25 | — | 153 | — | 153 |
| Revenues from transactions with franchisees and unconsolidated affiliates | 59 | 6 | 98 | 500 | 663 | — | 663 |
| Other revenues | 8 | 3 | 297 | 20 | 328 | (252) | 76 |
| Total revenues | $ 7,003 | $ 2,109 | $ 473 | $ 520 | $ 10,105 | $ (252) | $ 9,853 |

| 2020 Revenues | KFC | Pizza Hut | All Other Segments | Corporate and Unallocated | Combined | Elimination | Consolidated |
|---|---|---|---|---|---|---|---|
| Company sales | $ 5,633 | $ 1,721 | $ 42 | $ — | $ 7,396 | $ — | $ 7,396 |
| Franchise fees and income | 125 | 5 | 18 | — | 148 | — | 148 |
| Revenues from transactions with franchisees and unconsolidated affiliates | 61 | 4 | 60 | 522 | 647 | — | 647 |
| Other revenues | 2 | — | 122 | 6 | 130 | (58) | 72 |
| Total revenues | $ 5,821 | $ 1,730 | $ 242 | $ 528 | $ 8,321 | $ (58) | $ 8,263 |

| 2019 Revenues | KFC | Pizza Hut | All Other Segments | Corporate and Unallocated | Combined | Elimination | Consolidated |
|---|---|---|---|---|---|---|---|
| Company sales | $ 5,839 | $ 2,045 | $ 41 | $ — | $ 7,925 | $ — | $ 7,925 |
| Franchise fees and income | 136 | 4 | 8 | — | 148 | — | 148 |
| Revenues from transactions with franchisees and unconsolidated affiliates | 64 | 4 | 28 | 558 | 654 | — | 654 |
| Other revenues | 1 | 1 | 81 | 4 | 87 | (38) | 49 |
| Total revenues | $ 6,040 | $ 2,054 | $ 158 | $ 562 | $ 8,814 | $ (38) | $ 8,776 |

### *Franchise Fees and Income*

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Initial fees, including renewal fees | $ 8 | $ 8 | $ 8 |
| Continuing fees and rental income | 145 | 140 | 140 |
| Franchise fees and income | $ 153 | $ 148 | $ 148 |

### *Costs to Obtain Contracts*

Costs to obtain contracts consist of upfront franchise fees that we paid to YUM prior to the separation in relation to initial fees or renewal fees we received from franchisees and unconsolidated affiliates, as well as license fees that are payable to YUM in relation to our deferred revenue of prepaid stored-value products, privilege membership programs and customer loyalty programs. They meet the requirements to be capitalized as they are incremental costs of obtaining contracts with customers and the Company expects to generate future economic benefits from such costs incurred. Such costs to obtain contracts are included in Other assets in the Consolidated Balance Sheets and are amortized on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the assets relate. Subsequent to the separation, we are no longer required to pay YUM initial or renewal fees that we receive from franchisees and unconsolidated affiliates. The Company did not incur any impairment losses related to costs to obtain contracts during any of the periods presented. Costs to obtain contracts were $7 million and $9 million at December 31, 2021 and 2020, respectively.

### *Contract Liabilities*

Contract liabilities at December 31, 2021 and 2020 were as follows:

| | 2021 | 2020 |
|---|---|---|
| Contract liabilities | | |
| — Deferred revenue related to prepaid stored-value products | $ 134 | $ 117 |
| — Deferred revenue related to upfront franchise fees | 30 | 38 |
| — Deferred revenue related to customer loyalty programs | 25 | 23 |
| — Deferred revenue related to privilege membership programs | 18 | 27 |
| — Others | 1 | 1 |
| Total | $ 208 | $ 206 |

Contract liabilities primarily consist of deferred revenue related to prepaid stored-value products, privilege membership programs, customer loyalty programs and upfront franchise fees. Deferred revenue related to prepaid stored-value products, privilege membership programs, and customer loyalty programs is included in Accounts payable and other current liabilities in the Consolidated Balance Sheets. Deferred revenue related to upfront franchise fees that we expect to recognize as revenue in the next 12 months is included in Accounts payable and other current liabilities, and the remaining balance is included in Other liabilities in the Consolidated Balance Sheets. Revenue recognized that was included in the contract liability balance at the beginning of the year amounted to $127 million and $95 million in 2021 and 2020, respectively. Changes in contract liability balances were not materially impacted by business acquisition, change in estimate of transaction price or any other factors during any of the years presented.

The Company has elected, as a practical expedient, not to disclose the value of remaining performance obligations associated with sales-based royalty promised to franchisees in exchange for franchise right and other related services. The remaining duration of the performance obligation is the remaining contractual term of each franchise agreement. We recognize continuing franchisee fees and revenues from advertising services and other services provided to franchisees and unconsolidated affiliates based on certain percentage of sales, as those sales occur.

## Note 5 — Earnings Per Common Share ("EPS")

The following table summarizes the components of basic and diluted earnings per share (in millions, except for per share data):

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Net Income — Yum China Holdings, Inc. | $ 990 | $ 784 | $ 713 |
| Weighted-average common shares outstanding (for basic calculation)[(a)] | 422 | 390 | 377 |
| Effect of dilutive share-based awards[(a)] | 6 | 7 | 8 |
| Effect of dilutive warrants[(b)] | 6 | 5 | 3 |
| Weighted-average common and dilutive potential common shares outstanding (for diluted calculation) | 434 | 402 | 388 |
| Basic Earnings Per Share | $ 2.34 | $ 2.01 | $ 1.89 |
| Diluted Earnings Per Share | $ 2.28 | $ 1.95 | $ 1.84 |
| Share-based awards excluded from the diluted EPS computation[(c)] | 2 | 3 | 2 |

(a) As a result of the separation, shares of Yum China common stock were distributed to YUM's shareholders of record as of October 19, 2016 and were included in the calculated weighted-average common shares outstanding. Holders of outstanding YUM equity awards generally received both adjusted YUM awards and Yum China awards, or adjusted awards of either YUM or Yum China in their entirety. Any subsequent exercise of these awards, whether held by the Company's employees or YUM's employees, would increase the number of common shares outstanding. The incremental shares arising from outstanding equity awards are included in the computation of diluted EPS, if there is dilutive effect. See Note 15 for a further discussion of share-based compensation. In September 2020, 41,910,700 common shares were issued as a result of the Company's global offering and secondary listing on the HKEX and they were included in the calculated weighted-average common shares outstanding.

(b) Pursuant to the investment agreements dated September 1, 2016 (Note 11), Yum China issued to strategic investors two tranches of warrants on January 9, 2017, with each tranche initially providing the right to purchase 8,200,405 shares of Yum China common stock, at an initial exercise price of $31.40 and $39.25 per share, respectively, subject to customary anti-dilution adjustments. The warrants were exercisable at any time through October 31, 2021. The incremental shares arising from outstanding warrants were included in the computation of diluted EPS, if there is dilutive effect when the average market price of Yum China common stock for the year exceeds the applicable exercise price of the warrants. During 2021, an aggregate of 7,534,316 common shares were issued as a result of the cashless exercise of all warrants outstanding, which upon exercise were excluded from the calculation of dilutive warrants and included in the weighted-average common shares outstanding.

(c) These outstanding SARs, RSUs and PSUs were excluded from the computation of diluted EPS because to do so would have been antidilutive for the years presented, or because certain PSUs are contingently issuable based on the achievement of performance and market conditions, which have not been met as of December 31, 2021 and 2020.

## Note 6 — Items Affecting Comparability of Net Income

### *Impact of COVID-19 Pandemic*

Starting in the first quarter of 2020, the COVID-19 pandemic significantly impacted the Company's operations, resulting in a significant decline in Operating profit mainly driven by same-store sales declines and temporary store closures. While operating results improved sequentially in the last three quarters of 2020 and the first half of 2021, multiple waves of Delta-variant outbreaks persisted throughout the second half of 2021, spreading to nearly all provinces in China. As a result, the Company's operations and financial results were significantly affected in the second half of 2021. Operating profit for the years ended December 31, 2021, 2020 and 2019 was $1,386 million, $961 million and $901 million, respectively. Excluding the impacts of $628 million and $239 million in gains from the re-measurement of our previously held equity interests in former unconsolidated affiliates recognized upon acquisition in 2021 and 2020, respectively, as described in Note 3, the Operating profit for the years ended December 31, 2021, 2020 and 2019 was $758 million, $722 million and $901 million, respectively.

### *Consolidation of Former Unconsolidated Affiliates*

In the fourth and third quarter of 2021, as a result of the consolidation of Hangzhou KFC and the Lavazza joint venture, the Company recognized a gain of $618 million and $10 million, respectively, from the re-measurement of our previously held equity interest at fair value. In the third quarter of 2020, the Company recognized a re-measurement gain of $239 million as a result of the consolidation of Suzhou KFC. See Note 3 for additional information.

### *Store Impairment Charges*

We recorded store impairment charges of $48 million, $66 million and $38 million for the years ended December 31, 2021, 2020 and 2019, respectively. The increase in store impairment charges in both 2021 and 2020 as compared to 2019 mainly resulted from the adverse effects of the COVID-19 pandemic. See Note 13 for additional information.

### *Fair Value Changes for Investment in Equity Securities*

In September 2018, we invested in the equity securities of Meituan, the fair value of which is determined based on the closing market price for the shares at the end of each reporting period, with subsequent fair value changes recorded in our consolidated statements of income. We recorded related pre-tax loss of $38 million for 2021 and related pre-tax gains of $104 million and $63 million for 2020 and 2019, respectively.

In the first quarter of 2021, we invested in a 5% equity interest in Sunner. The investment in Sunner was recorded at fair value based on their closing market price on each measurement date before it became subject to the equity method of accounting when the Company established significant influence over the operating and financial policies of Sunner in May 2021. We recorded related pre-tax loss of $22 million for 2021, representing changes in fair value before the equity method of accounting was applied.

See Note 3 for additional information on our investment in Meituan and Sunner.

### *Impairment of Goodwill and Intangible Assets*

During the year ended December 31, 2019, we recorded impairment charges of $2 million on the intangible assets acquired from the Daojia business and goodwill related to Daojia reporting unit was fully impaired, resulting in an impairment charge of $9 million.

The fair values of Daojia intangible assets and reporting unit were based on the estimated price a willing buyer would pay, using unobservable inputs (level 3). The fair values of intangible assets were determined using a relief-from-royalty valuation approach, with estimated future sales and royalty rates as significant inputs. The fair value of the reporting unit was determined using an income approach with future cash flow estimates supported by estimated future sales and margin. Both valuation approaches incorporated a selection of an appropriate discount rate based on weighted-average cost of capital and Company-specific risk premium.

For the year ended December 31, 2019, these non-cash impairment charges totaling $11 million were included in Closures and impairment expenses in our Consolidated Statements of Income, but were not allocated to any segment for performance reporting purposes. We recorded a tax benefit of $1 million associated with the impairment, and allocated $2 million of the after-tax impairment charge to Net Income — noncontrolling interests, which resulted in a net impairment charge of $8 million allocated to Net Income — Yum China Holdings, Inc., for the year ended December 31, 2019 .

### *Partner PSU Awards*

In February 2020, the Company's board of directors approved new grants of SARs, RSUs and PSUs to employees under the Yum China Holdings, Inc. Long Term Incentive Plan (the "2016 Plan"). The awards will be earned based on their respective vesting terms, with PSUs subject to market conditions or performance conditions. A special award of PSUs ("Partner PSU Awards") was granted to select employees who were deemed critical to the Company's execution of its strategic operating plan. These Partner PSU Awards will only vest if threshold performance goals are achieved over a four-year performance period, with the payout ranging from 0% to 200% of the target number of shares. Partner PSU Awards were granted to address increased competition for executive talent, motivate transformational performance and encourage management retention. Given the unique nature of these grants, the Compensation Committee of the Board does not intend to grant similar, special grants to the same employees during the performance period. The impact from these special awards is excluded from metrics that management uses to assess the Company's performance. The Company recognized a share-based compensation cost of $8 million and $7 million, respectively, associated with the Partner PSU Awards for years ended December 31, 2021 and 2020.

### *Transition Tax*

The U.S. Treasury Department and the IRS released the final transition tax regulations in the first quarter of 2019. We completed the evaluation of the impact on our transition tax computation based on the final regulations released in the first quarter of 2019 and recorded an additional income tax expense of $8 million for the transition tax accordingly.

## Note 7 — Other Income, net

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Gain from re-measurement of equity interest upon acquisition[a] | $ 628 | $ 239 | $ — |
| Equity income from investments in unconsolidated affiliates[b] | 43 | 62 | 69 |
| Amortization of reacquired franchise rights[c] | (43) | (22) | (14) |
| Derecognition of indemnification asset[d] | — | (3) | — |
| Foreign exchanges and other | 15 | 9 | 5 |
| Other income, net | $ 643 | $ 285 | $ 60 |

(a) In the fourth and third quarter of 2021, as a result of the consolidation of Hangzhou KFC and the Lavazza joint venture, the Company recognized a gain of $618 million and $10 million, respectively, from the re-measurement of our previously held equity interest at fair value. In the third quarter of 2020, the Company recognized a re-measurement gain of $239 million as a result of the consolidation of Suzhou KFC. The re-measurement gains were not allocated to any segment for performance reporting purposes. (See Note 3 for additional information).

(b) Includes equity income from our investments in Hangzhou KFC, Suzhou KFC and the Lavazza joint venture before we consolidated the results of these entities upon completion of acquisitions. (See Note 3 for additional information).

(c) As a result of the acquisition of Hangzhou KFC, Suzhou KFC and Wuxi KFC, $66 million, $61 million and $61 million of the purchase price were allocated to intangible assets related to reacquired franchise rights, respectively, which are being amortized over the remaining franchise contract period of 1 year, 2.4 years and 5 years. (See Note 3 for additional information).

(d) In the second quarter of 2020, the Company derecognized a $3 million indemnification asset previously recorded for the Daojia acquisition as the indemnification right pursuant to the purchase agreement expired. The expense was included in Other income, net, but was not allocated to any segment for performance reporting purposes.

## Note 8 — Supplemental Balance Sheet Information

| Accounts Receivable, net | 2021 | 2020 |
|---|---|---|
| Accounts receivable, gross | $ 68 | $ 100 |
| Allowance for doubtful accounts | (1) | (1) |
| Accounts receivable, net | $ 67 | $ 99 |

| Prepaid Expenses and Other Current Assets | 2021 | 2020 |
|---|---|---|
| Receivables from payment processors and aggregators | $ 45 | $ 47 |
| Dividends receivable from unconsolidated affiliates | — | 10 |
| Other prepaid expenses and current assets | 176 | 119 |
| Prepaid expenses and other current assets | $ 221 | $ 176 |

| Property, Plant and Equipment | 2021 | 2020 |
|---|---|---|
| Buildings and improvements | $ 2,695 | $ 2,367 |
| Finance leases, primarily buildings | 52 | 36 |
| Machinery and equipment and construction in progress | 1,878 | 1,490 |
| Property, plant and equipment, gross | 4,625 | 3,893 |
| Accumulated depreciation | (2,374) | (2,128) |
| Property, plant and equipment, net | $ 2,251 | $ 1,765 |

Depreciation and amortization expense related to property, plant and equipment was $465 million, $421 million and $408 million in 2021, 2020 and 2019, respectively.

| Other Assets | 2021 | 2020 |
|---|---|---|
| VAT assets | $ 322 | $ 270 |
| Land use right[(a)] | 138 | 140 |
| Investment in equity securities | 122 | 160 |
| Long-term deposits | 101 | 83 |
| Investment in long-term time deposits[(b)] | 90 | 61 |
| Costs to obtain contracts | 7 | 9 |
| Others | 52 | 26 |
| Other Assets | $ 832 | $ 749 |

(a) Amortization expense related to land use right was $5 million, $5 million and $4 million in 2021, 2020 and 2019, respectively.

(b) As of December 31, 2021 and 2020, the Company had $90 million and $61 million invested in long-term time deposits, respectively, bearing a fixed interest rate with original maturity of three years. The asset is restricted for use in order to secure the balance of prepaid stored-value cards issued by the Company pursuant to regulatory requirements.

| Accounts Payable and Other Current Liabilities | 2021 | 2020 |
|---|---|---|
| Accounts payable | $ 830 | $ 708 |
| Operating leases liabilities | 508 | 448 |
| Accrued compensation and benefits | 283 | 238 |
| Accrued capital expenditures | 269 | 203 |
| Contract liabilities | 182 | 175 |
| Accrued marketing expenses | 71 | 73 |
| Other current liabilities | 189 | 150 |
| Accounts payable and other current liabilities | $ 2,332 | $ 1,995 |

| Other Liabilities | 2021 | 2020 |
|---|---|---|
| Accrued income tax payable | $ 56 | $ 66 |
| Contract liabilities | 26 | 31 |
| Other noncurrent liabilities | 85 | 70 |
| Other liabilities | $ 167 | $ 167 |

## Note 9 — Goodwill and Intangible Assets

The changes in the carrying amount of goodwill are as follows:

| | Total Company | KFC | Pizza Hut | All Other Segments |
|---|---|---|---|---|
| Balance as of December 31, 2019 | | | | |
| Goodwill, gross | $ 645 | $ 235 | $ 19 | $ 391 |
| Accumulated impairment losses[a] | (391) | — | — | (391) |
| Goodwill, net | 254 | 235 | 19 | — |
| Goodwill acquired[b] | 524 | 465 | | 59 |
| Effect of currency translation adjustments | 54 | 48 | 1 | 5 |
| Balance as of December 31, 2020 | | | | |
| Goodwill, gross | 1,223 | 748 | 20 | 455 |
| Accumulated impairment losses[a] | (391) | — | — | (391) |
| Goodwill, net | $ 832 | $ 748 | $ 20 | $ 64 |
| Goodwill acquired[b] | 1,288 | 1,272 | | 16 |
| Effect of currency translation adjustments | 22 | 20 | — | 2 |
| Balance as of December 31, 2021 | | | | |
| Goodwill, gross | 2,533 | 2,040 | 20 | 473 |
| Accumulated impairment losses[a] | (391) | — | — | (391) |
| Goodwill, net | $ 2,142 | $ 2,040 | $ 20 | $ 82 |

(a) Accumulated impairment losses represent goodwill impairment attributable to the reporting units of Little Sheep and Daojia.

(b) Goodwill acquired resulted from the acquisitions of Hangzhou KFC and the Lavazza joint venture during 2021, and the acquisitions of Suzhou KFC and Huang Ji Huang during 2020 (Note 3).

Intangible assets, net as of December 31, 2021 and 2020 are as follows:

| | 2021 | | | | 2020 | | | |
|---|---|---|---|---|---|---|---|---|
| | Gross Carrying Amount[(a)] | Accumulated Amortization | Accumulated Impairment Losses[(b)] | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Accumulated Impairment Losses[(b)] | Net Carrying Amount |
| Finite-lived intangible assets | | | | | | | | |
| Reacquired franchise rights[(c)] | $ 295 | $ (191) | $ – | $ 104 | $ 223 | $ (144) | $ – | $ 79 |
| Huang Ji Huang franchise related assets | 23 | (2) | – | 21 | 23 | (1) | – | 22 |
| Daojia platform | 16 | (4) | (12) | – | 16 | (4) | (12) | – |
| Customer-related assets | 12 | (9) | (2) | 1 | 12 | (8) | (2) | 2 |
| Other | 10 | (5) | – | 5 | 9 | (4) | – | 5 |
| | $ 356 | $ (211) | $ (14) | $ 131 | $ 283 | $ (161) | $ (14) | $ 108 |
| Indefinite-lived intangible assets | | | | | | | | |
| Little Sheep trademark | $ 57 | $ – | $ – | $ 57 | $ 56 | $ – | $ – | $ 56 |
| Huang Ji Huang trademark | 84 | – | – | 84 | 82 | – | – | 82 |
| | $ 141 | $ – | $ – | $ 141 | $ 138 | $ – | $ – | $ 138 |
| **Total intangible assets** | $ 497 | $ (211) | $ (14) | $ 272 | $ 421 | $ (161) | $ (14) | $ 246 |

(a) Changes in gross carrying amount include effect of currency translation adjustment.

(b) Accumulated impairment losses represent impairment charges on intangible assets acquired from Daojia primarily attributable to the Daojia platform.

(c) Increase in gross carrying amount of reacquired franchise rights during the year ended December 31, 2021 primarily resulted from the acquisition of Hangzhou KFC (Note 3).

Amortization expense for finite-lived intangible assets was $45 million in 2021, $24 million in 2020 and $16 million in 2019. Amortization expense for finite-lived intangible assets is expected to approximate $104 million in 2022, $4 million in 2023, and $2 million in each of 2024, 2025 and 2026. Increase in expected amortization expenses for finite-lived intangible assets in 2022 primarily relates to reacquired franchise rights resulting from the acquisition of Hangzhou KFC (Note 3).

## Note 10 — Credit Facilities

As of December 31, 2021, the Company had credit facilities of RMB3,471 million (approximately $546 million), comprised of onshore credit facilities of RMB2,200 million (approximately $346 million) in the aggregate and offshore credit facilities of $200 million in the aggregate.

The credit facilities had remaining terms ranging from less than one year to two years as of December 31, 2021. Each credit facility bears interest based on the prevailing rate stipulated by the People's Bank of China, Loan Prime Rate ("LPR") published by the National Interbank Funding Centre of the PRC or London Interbank Offered Rate ("LIBOR") administered by the ICE Benchmark Administration. Each credit facility contains a cross-default provision whereby our failure to make any payment on a principal amount from any credit facility will constitute a default on other credit facilities. Some of the credit facilities contain covenants limiting, among other things, certain additional indebtedness and liens, and certain other transactions specified in the respective agreement. Interest on any outstanding borrowings is due at least monthly. Some of the onshore credit facilities contain sub-limits for overdrafts, non-financial bonding, standby letters of credit and guarantees. As of December 31, 2021, we had outstanding bank guarantees of RMB177 million (approximately $28 million) to secure our lease payment to landlords for certain Company-owned restaurants. The credit facilities were therefore reduced by the same amount, while there were no borrowings outstanding as of December 31, 2021.

## Note 11 — Investment Agreements with Strategic Investors

On September 1, 2016, YUM and the Company entered into investment agreements (the "Investment Agreements") with each of Pollos Investment L.P., an affiliate of Primavera Capital Group ("Primavera"), and API (Hong Kong) Investment Limited, an affiliate of Zhejiang Ant Small and Micro Financial Services Group Co., Ltd. ("Ant Financial" and, together with Primavera, the "Investors"). Pursuant to the Investment Agreements, on November 1, 2016 ("Closing Date"), Primavera and Ant Financial invested $410 million and $50 million, respectively, for a collective $460 million investment (the "Investment") in the Company in exchange for: (i) over 18 million shares of Yum China common stock and (ii) two tranches of warrants (the "Warrants"). Upon exercise, the first tranche of Warrants initially provided Primavera and Ant Financial with the right to purchase 7,309,057 and 891,348 shares of Yum China common stock, respectively, at an initial exercise price of $31.40 per share. The second tranche of Warrants initially provided Primavera and Ant Financial with the right to purchase the same number of shares of Yum China common stock under the first tranche of Warrants, at an initial exercise price of $39.25 per share. The Warrants were exercisable at any time through October 31, 2021 and contain customary anti-dilution protections, which were equity-classified and recorded in Additional paid in capital in the Consolidated balance sheet presented since December 2016, when the number of Warrants to be issued became fixed.

As of December 31, 2020, Primavera and Ant Financial had separately entered into pre-paid forward sale transactions with respect to all of their Warrants with several financial institutions, pursuant to which Primavera and Ant Financial would deliver their respective Warrants on the applicable settlement date.

In 2021, 7,534,316 shares of Yum China common stock were issued as a result of the cashless exercise of all Warrants, representing approximately 1.8% of Yum China common stock issued and outstanding as of December 31, 2021.

## Note 12 — Leases

As of December 31, 2021, we leased approximately 10,000 properties in China for our Company-owned restaurants. We generally enter into lease agreements for our restaurants with initial terms of 10 to 20 years. Most of our lease agreements contain termination options that permit us to terminate the lease agreement early if the restaurant's unit contribution is negative for a specified period of time. We generally do not have renewal options for our leases. Such options are accounted for only when it is reasonably certain that we will exercise the options. The rent under the majority of our current restaurant lease agreements is generally payable in one of three ways: (i) fixed rent; (ii) the higher of a fixed base rent or a percentage of the restaurant's sales; or (iii) a percentage of the restaurant's sales. Most leases require us to pay common area maintenance fees for the leased property. In addition to restaurants leases, we also lease office spaces, logistics centers and equipment. Our lease agreements do not contain any material residual value guarantees or material restrictive covenants.

In limited cases, we sub-lease certain restaurants to franchisees in connection with refranchising transactions or lease our properties to other third parties. The lease payments under these leases are generally based on the higher of a fixed base rent or a percentage of the restaurant's annual sales. Income from sub-lease agreements with franchisees or lease agreements with other third parties are included in Franchise fees and income and Other revenue, respectively, within our Consolidated Statements of Income. The impact of ASC 842 on our accounting as a lessor was not significant.

| Supplemental Balance Sheet | 2021/12/31 | 2020/12/31 | Account Classification |
|---|---|---|---|
| **Assets** | | | |
| Operating lease right-of-use assets[(a)] | $ 2,612 | $ 2,164 | Operating lease right-of-use assets |
| Finance lease right-of-use assets | 33 | 20 | Property, plant and equipment, net |
| **Total leased assets** | $ 2,645 | $ 2,184 | |
| **Liabilities** | | | |
| Current | | | |
| Operating lease liabilities[(a)] | $ 508 | $ 448 | Accounts payable and other current liabilities |
| Finance lease liabilities | 3 | 2 | Accounts payable and other current liabilities |
| Non-current | | | |
| Operating lease liabilities[(a)] | 2,286 | 1,915 | Non-current operating lease liabilities |
| Finance lease liabilities | 40 | 28 | Non-current finance lease liabilities |
| **Total lease liabilities** | $ 2,837 | $ 2,393 | |

(a) Changes in balances of operating lease right-of-use assets and liabilities include impact from the acquisition of Hangzhou KFC.

| Summary of Lease Cost | 2021 | 2020 | Account Classification |
|---|---|---|---|
| Operating lease cost | $ 564 | $ 496 | Occupancy and other operating expenses, G&A or Franchise expenses |
| Finance lease cost | | | |
| Amortization of leased assets | 3 | 2 | Occupancy and other operating expenses |
| Interest on lease liabilities | 2 | 2 | Interest expense, net |
| Variable lease cost[(b)] | 346 | 262 | Occupancy and other operating expenses or Franchise expenses |
| Short-term lease cost | 9 | 10 | Occupancy and other operating expenses or G&A |
| Sublease income | (26) | (24) | Franchise fees and income or Other revenues |
| **Total lease cost** | $ 898 | $ 748 | |

(b) The Company was granted $12 million and $36 million in lease concessions from landlords related to the effects of the COVID-19 pandemic for the years ended December 31, 2021 and 2020, respectively. The lease concessions were primarily in the form of rent reduction over the period of time when the Company's restaurant business was adversely impacted. The Company applied the interpretive guidance in a FASB staff Q&A document issued in April 2020 and elected: (1) not to evaluate whether a concession received in response to the COVID-19 pandemic is a lease modification and (2) to assume such concession was contemplated as part of the existing lease contract with no contract modification. Such concession was recognized as negative variable lease cost in the period the concession was granted.

| Supplemental Cash Flow Information | 2021 | 2020 |
|---|---|---|
| Cash paid for amounts included in the measurement of lease liabilities: | | |
| Operating cash flows from operating leases | $ 573 | $ 493 |
| Operating cash flows from finance leases | 2 | 2 |
| Financing cash flows from finance leases | 2 | 2 |
| Right-of-use assets obtained in exchange for new lease liabilities[(c)]: | | |
| Operating leases | $ 541 | $ 337 |
| Finance leases | 11 | 2 |

(c) This supplemental non-cash disclosure for ROU obtained in exchange for new lease liabilities also includes noncash transactions resulting in adjustments to the lease liability or ROU asset due to modification or other reassessment events.

| Lease Term and Discount Rate | 2021 | 2020 |
|---|---|---|
| Weighted-average remaining lease term (years) | | |
| Operating leases | 7.2 | 7.0 |
| Finance leases | 11.3 | 10.9 |
| Weighted-average discount rate | | |
| Operating leases | 5.5% | 5.8% |
| Finance leases | 5.5% | 5.8% |

### Summary of Future Lease Payments and Lease Liabilities

Maturities of lease liabilities as of December 31, 2021 were as follows:

| | Amount of Operating Leases | Amount of Finance Leases | Total |
|---|---|---|---|
| 2022 | $ 644 | $ 6 | $ 650 |
| 2023 | 547 | 6 | 553 |
| 2024 | 477 | 5 | 482 |
| 2025 | 400 | 5 | 405 |
| 2026 | 338 | 5 | 343 |
| Thereafter | 983 | 31 | 1,014 |
| Total undiscounted lease payment | 3,389 | 58 | 3,447 |
| Less: imputed interest[(d)] | 595 | 15 | 610 |
| Present value of lease liabilities | $ 2,794 | $ 43 | $ 2,837 |

(d) As the rate implicit in the lease cannot be readily determined, we use our incremental borrowing rate based on the information available at the lease commencement date in determining the imputed interest and present value of lease payments. We used the incremental borrowing rate on January 1, 2019 for operating leases that commenced prior to that date.

As of December 31, 2021, we have additional lease agreements that have been signed but not yet commenced, with total undiscounted minimum lease payments of $161 million. These leases will commence between 2022 and 2026 with lease terms of 1 year to 20 years.

## Note 13 — Fair Value Measurements and Disclosures

The Company's financial assets and liabilities primarily consist of cash and cash equivalents, short-term investments, long-term time deposits, accounts receivable, accounts payable, and lease liabilities, and the carrying values of these assets and liabilities approximate their fair value in general.

The Company accounts for its investment in the equity securities of Meituan at fair value, which is determined based on the closing market price for the shares at the end of each reporting period, with subsequent fair value changes recorded in our Consolidated Statements of Income.

The following table is a summary of our financial assets measured on a recurring basis or disclosed at fair value and the level within the fair value hierarchy in which the measurement falls. The Company classifies its cash equivalents, short-term investments, long-term time deposits, and investment in equity securities within Level 1 or Level 2 in the fair value hierarchy because it uses quoted market prices or alternative pricing sources and models utilizing market observable inputs to determine their fair value, respectively. No transfers among the levels within the fair value hierarchy occurred in 2021 and 2020.

| | Balance at December 31, 2021 | Fair Value Measurement or Disclosure at December 31, 2021 | | |
|---|---|---|---|---|
| | | Level 1 | Level 2 | Level 3 |
| Cash equivalents: | | | | |
| Time deposits | $ 321 | | $ 321 | |
| Money market funds | 45 | 45 | | |
| Fixed income debt securities[(a)] | 163 | 63 | 100 | |
| Total cash equivalents | 529 | 108 | 421 | — |
| Short-term investments: | | | | |
| Time deposits | 1,726 | | 1,726 | |
| Fixed income debt securities[(a)] | 1,055 | | 1,055 | |
| Variable return investments | 79 | 79 | | |
| Total short-term investments | 2,860 | 79 | 2,781 | — |
| Other assets: | | | | |
| Investment in equity securities | 122 | 122 | | |
| Long-term time deposits | 90 | | 90 | |
| Total | $ 3,601 | $ 309 | $ 3,292 | $ — |

| | Balance at December 31, 2020 | Fair Value Measurement or Disclosure at December 31, 2020 | | |
|---|---|---|---|---|
| | | Level 1 | Level 2 | Level 3 |
| Cash equivalents: | | | | |
| Time deposits | $ 601 | | $ 601 | |
| Fixed income debt securities[(a)] | 207 | 207 | | |
| Total cash equivalents | 808 | 207 | 601 | — |
| Short-term investments: | | | | |
| Time deposits | 2,165 | | 2,165 | |
| Fixed income debt securities[(a)] | 784 | 104 | 680 | |
| Variable return investments | 156 | 156 | | |
| Total short-term investments | 3,105 | 260 | 2,845 | — |
| Other assets: | | | | |
| Investment in equity securities | 160 | 160 | | |
| Long-term time deposits | 61 | | 61 | |
| Total | $ 4,134 | $ 627 | $ 3,507 | $ — |

(a) Classified as held-to-maturity investments and measured at amortized cost.

### *Non-recurring fair value measurements*

In addition, certain of the Company's restaurant-level assets (including operating lease ROU assets, property, plant and equipment), goodwill and intangible assets, are measured at fair value based on unobservable inputs (Level 3) on a non-recurring basis, if determined to be impaired. As of December 31, 2021, the fair value of restaurant-level assets, if determined to be impaired, are primarily represented by the price market participant would pay to sub-lease the operating lease ROU assets and acquire remaining restaurants assets, which reflects the highest and best use of the assets. Significant unobservable inputs used in the fair value measurement include market rental prices, which were determined with the assistance of an independent valuation specialist. The direct comparison approach is used as the valuation technique by assuming sub-lease of each of these properties in its existing state with vacant possession. By making reference to lease transactions as available in the relevant market, comparable properties in close proximity have been selected and adjustments have been made to account for the difference in factors such as location and property size.

The following table presents amounts recognized from all non-recurring fair value measurements based on unobservable inputs (Level 3) during the years ended December 31, 2021, 2020 and 2019. These amounts exclude fair value measurements made for restaurants that were subsequently closed or refranchised prior to those respective year-end dates.

| | 2021 | 2020 | 2019 | Account Classification |
|---|---|---|---|---|
| Restaurant-level impairment[a] | 32 | 52 | 28 | Closure and impairment expenses, net |
| ROU impairment prior to the adoption of ASC 842[b] | — | — | 82 | Retained Earnings |
| Daojia impairment[c] | — | — | 11 | Closure and impairment expenses, net |
| Total | $ 32 | $ 52 | $ 121 | |

(a) Restaurant-level impairment charges are recorded in Closures and impairment expenses, net and resulted primarily from our semi-annual impairment evaluation of long-lived assets of individual restaurants that were being operated at the time of impairment and had not been offered for refranchising. We performed an additional impairment evaluation in the first quarter of 2020, considering the adverse effects of the COVID-19 pandemic as an impairment indicator. A trend of continuing operating losses for certain restaurants due to the COVID-19 pandemic resulted in higher impairment during 2020 and 2021. We also performed an additional impairment evaluation upon adoption of ASC 842 in the first quarter of 2019. After considering the impairment charges recorded during the corresponding years, the fair value of assets as of the relevant measurement date was $112 million, $157 million and insignificant during the years ended December 31, 2021, 2020 and 2019, respectively.

(b) ROU impairment prior to the adoption of ASC 842 represents an impairment charge on operating lease ROU assets arising from existing operating leases as of January 1, 2019. After netting with the related impact on deferred taxes of $19 million and the impact on noncontrolling interests of $3 million, we recorded a cumulative adjustment of $60 million to retained earnings in accordance with the transition guidance for the new lease standard. For those restaurants under operating leases with full impairment on their long-lived assets (primarily property, plant and equipment) before January 1, 2019, an additional impairment charge would have been recorded before January 1, 2019 had the operating lease ROU assets been recognized at the time of impairment.

(c) See Note 6 for further discussion.

## Note 14 — Retirement Plans

For executives who were hired or re-hired after September 30, 2001, YUM has implemented the YUM LRP. This is an unfunded, unsecured account-based retirement plan which allocates a percentage of pay to an account payable to the executive following the executive's separation of employment from YUM or attainment of age 55. The Company adopted the YCHLRP upon separation while the assets and liabilities associated with these employees under YUM LRP were transferred to YCHLRP. YCHLRP will continue to be in effect until terminated by the Company's board of directors. The terms of the YCHLRP are substantially similar to the terms of the YUM LRP. Under the YCHLRP, certain executives who are at least age 21, who are classified as salary level 12, who are not eligible to participate in a tax-qualified defined benefit plan, and who satisfy certain additional requirements as to work location and assignment, are eligible to participate in the YCHLRP if selected for participation by the Company. The YCHLRP is an unfunded, unsecured account-based retirement plan that allocates a percentage of pay to an account payable to an executive following the later to occur of the executive's separation of employment from the Company or attainment of age 55. Under the YCHLRP, participants aged 55 or older are entitled to a lump sum distribution of their account balance on the last day of the calendar quarter that occurs on or follows their separation of employment. The liabilities attributable to our employees under the YCHLRP were insignificant as of December 31, 2021 and 2020.

YUM offers certain of the Company's executives working in China retirement benefits under the Bai Sheng Restaurants China Holdings Limited Retirement Scheme (previously known as the Bai Sheng Restaurants (Hong Kong) Ltd. Retirement Scheme). Under this defined contribution plan, YUM provides a Company-funded contribution ranging from 5% to 10% of an executive's base salary. Upon termination, participants will receive a lump sum equal to a percentage of the Company's contributions inclusive of investment return. This percentage is based on a vesting schedule that provides participants with a vested 30% interest upon completion of a minimum of 3 years of service, and an additional 10% vested interest for each additional completed year, up to a maximum of 100%. The Company adopted the same plan after the separation and the contribution amount to the plan for the years ended December 31, 2021, 2020 and 2019 was insignificant.

As stipulated by Chinese state regulations, the Company participates in a government-sponsored defined contribution retirement plan. Substantially all employees are entitled to an annual pension equal to a fixed proportion of the average basic salary amount of the geographical area of their last employment at their retirement date. We are required to make contributions to the local social security bureau between 13% and 20% of the previous year's average basic salary amount of the geographical area where the employees are under our employment. Contributions are recorded in the Consolidated Statements of Income as they become payable. We have no obligation for the payment of pension benefits beyond the annual contributions as set out above. In 2020, the Company also received one-time government subsidy related to COVID-19 in the form of a reduction in social security contributions, which was recognized as reduction to the related expenses when it was granted. The Company contributed $183 million, $167 million and $160 million to the government-sponsored plan for 2021, 2020 and 2019, respectively.

## Note 15 — Share-Based Compensation

### *Overview*

Upon the separation, holders of outstanding YUM equity awards generally received both adjusted YUM awards and Yum China awards, or adjusted awards of either YUM or Yum China in their entirety, to maintain the pre-separation intrinsic value of the awards. Depending on the tax laws of the country of employment, awards were modified using either the shareholder method or the employer method. Share issuances for Yum China awards held by YUM's employees will be satisfied by Yum China. Share issuances for YUM awards held by the Company's employees will be satisfied by YUM. The shareholder method was based on the premise that employees holding YUM awards prior to the separation should receive an equal number of awards of both YUM and Yum China. Under the employer method, employees holding YUM awards prior to the separation had their awards converted into awards of the Company that they worked for subsequent to the separation. As a result, Yum China may issue shares of common stock to YUM's employees upon exercise or vesting of various types of awards, including stock options, SARs, RSUs, and awards from the executive income deferral plan.

The modified equity awards have the same terms and conditions as the awards held immediately before the separation, except that the number of shares and the price were adjusted. In accordance with ASC 718, the Company compared the fair value of the awards immediately prior to the separation to the fair value immediately after the separation to measure the incremental compensation cost, using the Black-Scholes option-pricing model (the "BS model"). The incremental compensation cost was insignificant, and YUM and the Company continue to recognize the unamortized original grant-date fair value of the modified awards over the remaining requisite service period as their respective employees continue to provide services. Share-based compensation for the Company's employees is based on both YUM awards and Yum China awards held by those employees.

Effective October 31, 2016, the Company adopted the Yum China Holdings, Inc. Long Term Incentive Plan (the "2016 Plan"). The Company has reserved for issuance under the 2016 Plan of 45,000,000 shares of our common stock. Under this plan, the exercise price of stock options and SARs granted must be equal to or greater than the fair market value of the Company's stock on the date of grant.

Potential awards to employees and non-employee directors under the 2016 Plan include stock options, incentive options, SARs, restricted stock, stock units, RSUs, performance shares, performance units, and cash incentive awards. We have issued only stock options, SARs, RSUs and PSUs under the 2016 Plan. While awards under the 2016 Plan can have varying vesting provisions and exercise periods, outstanding awards under the 2016 Plan vest in periods ranging from three to five years. Stock options and SARs expire ten years after grant.

The Company recognizes all share-based payments to employees and non-employee directors in the Consolidated Financial Statements as compensation cost on a straight-line basis over the service period based on their fair value on the date of grant, for awards that actually vest and when performance conditions are probable of being achieved, if applicable. If no substantive service condition exists, the grant-date fair value is fully recognized as expense upon grant. Certain awards are subject to specific retirement conditions, which allow the awards to fully vest as long as the employee is actively employed for at least one year following the grant date, provides at least six months notification of intention to retire, and signs non-solicitation and non-compete agreements. Under such circumstances, the grant-date fair value of the award is recognized as expense on a straight-line basis over the one-year service period from the grant date.

### *Award Valuation*

## Stock Options and SARs

The Company estimated the fair value of each stock option and SAR award granted to the Company's employees as of the date of grant, using the BS model with the following assumptions:

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| Risk-free interest rate | 0.4% | 1.5% | 2.5% |
| Expected term (years) | 6.25 | 6.50 | 6.50 |
| Expected volatility | 33.9% | 33.2% | 32.0% |
| Expected dividend yield | 0.8% | 1.1% | 1.2% |

Share option and SAR awards granted to employees typically have a graded vesting schedule of 25% per year over four years and expire 10 years after grant. The Company uses a single weighted-average term for awards that have a graded vesting schedule and determined average terms of exercise based on analysis of the historical exercise and post-vesting termination behavior. Forfeitures were estimated based on historical experience. Historical data used to estimate the expected term and forfeiture rate were based on data associated with the Company's employees who were granted share-based awards by YUM prior to the separation.

For those awards granted by the Company after the separation, the Company considered the volatility of common shares of comparable companies in the same business as the Company, as well as the historical volatility of the Company stock. The dividend yield was estimated based on the Company's dividend policy at the time of the grant.

## RSUs and PSUs

RSU awards generally vest over a three-year period with a majority of the awards cliff vesting at 100% on the third grant anniversary. The fair values of RSU awards are based on the closing price of the Company's stock on the date of grant.

During 2019, the Company granted PSUs that are subject to market conditions and service conditions, cliff vesting at the end of the performance period. The number of shares to be distributed is based on the Company's performance on its total shareholder return relative to its peer group in the MSCI International China Index, measured over a three-year performance period. The fair value of PSU awards was valued based on the outcome of the Monte-Carlo Simulation model (the "MCS model") and amortized on a straight-line basis over the three-year period. The total amount of fair value for the PSUs granted in 2019 is immaterial.

In February 2020, the Company's board of directors approved new grants of a special award of PSUs ("Partner PSU Awards") to select employees who were deemed critical to the Company's execution of its strategic operating plan under the 2016 Plan. These Partner PSU Awards are subject to market and performance conditions, and will cliff vest only if threshold performance goals are achieved over a four-year performance period, with the payout ranging from 0% to 200% of the target number of shares. The fair value of Partner PSU Awards was determined based on the outcome of the MCS model and closing price of the Company's stock on the date of the grant. The assumptions used in determining the grant date fair value of Partner PSU Awards include the risk-free interest rate of 1.4%, expected dividend yield of 1.1%, and expected volatility of 33.4%.

The annual PSU awards granted in 2020 and 2021 are based on the Company's achievement of performance goals including relative total shareholder return against the MSCI China Index, and will cliff vest only if threshold performance goals are achieved over a three-year performance period. The fair value of annual PSU awards was determined based on the outcome of the MCS model and closing price of the Company's stock on the date of the grant. The assumptions used in determining the grant date fair value of annual PSU awards include the risk-free interest rate of 0.2% and expected volatility of 35.7% in 2021, and risk-free interest rate of 1.4% and expected volatility of 33.4% in 2020.

Compensation costs associated with annual and Partner PSU Awards are recognized on a straight-line basis over the performance period when performance conditions are probable of being achieved, adjusted for estimated forfeiture rate.

## Others

Commencing from November 11, 2016, Yum China also granted annual awards of common stock to non-employee directors for their service on Yum China's board of directors. The fair value of these awards is based on the closing price per share of the Company's common stock on the date of grant. The shares were issued outright to the directors on the date of grant, with no conditions attached. Therefore, the fair value of the awards was fully recognized as expenses upon grant. For the years ended December 31, 2021, 2020 and 2019, a total of 31,182, 54,757 and 60,419 shares of Yum China common stock, respectively, were granted to non-employee directors and the grant-date fair value of $2.1 million, $2.6 million and $2.4 million, respectively, was immediately recognized in full in the Consolidated Statements of Income.

### *Award Activity*

## Stock Options and SARs

| | Shares (in thousands) | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (years) | Aggregate Intrinsic Value (in millions) |
|---|---|---|---|---|
| Outstanding at the beginning of 2021 | 11,850 | 27.49 | | |
| Granted | 1,171 | 57.39 | | |
| Exercised | (2,074) | 21.56 | | |
| Forfeited or expired | (124) | 46.56 | | |
| Outstanding at the end of 2021 | 10,823[(a)] | 31.65 | 5.09 | 205 |
| Exercisable at the end of 2021 | 8,007 | 25.82 | 4.01 | 192 |

(a) Outstanding awards include 182,083 stock options and 10,640,450 SARs with weighted-average exercise prices of $20.30 and $31.84, respectively. Outstanding awards represent Yum China awards held by employees of both the Company and YUM.

The weighted-average grant-date fair value of SARs granted in 2021, 2020 and 2019 was $17.44, $13.36 and $13.43, respectively. The total intrinsic value of stock options and SARs exercised by the Company's employees during the years ended December 31, 2021, 2020 and 2019 was $22 million, $75 million and $39 million, respectively.

As of December 31, 2021, $29 million of unrecognized compensation cost related to unvested SARs, which will be reduced by any forfeitures that occur, is expected to be recognized over a remaining weighted-average vesting period of approximately 1.69 years. This reflects unrecognized cost for both Yum China awards and YUM awards held by the Company's employees. The total fair value at grant date or modification date of awards held by the Company's employees that vested during 2021, 2020 and 2019 was $15 million, $15 million and $14 million, respectively.

## RSUs

| | Shares (in thousands) | Weighted-Average Grant Date Fair Value |
|---|---|---|
| Unvested at the beginning of 2021 | 552 | 40.57 |
| Granted | 461 | 58.77 |
| Vested | (291) | 37.04 |
| Forfeited or expired | (38) | 50.93 |
| Unvested at the end of 2021 | 684 | 53.77 |

The weighted-average grant-date fair value of RSUs granted in 2021, 2020 and 2019 was $58.77, $48.01 and $42.62, respectively. As of December 31, 2021, $23 million of unrecognized compensation cost related to 683,672 unvested RSUs, which will be reduced by any forfeiture that occurs, is expected to be recognized over a remaining weighted-average vesting period of approximately 1.98 years. The total fair value at grant date of awards that vested during 2021, 2020 and 2019 was $11 million, $11 million and $4 million, respectively.

## PSUs

| | Shares (in thousands) | Weighted-Average Grant Date Fair Value |
|---|---|---|
| Unvested at the beginning of 2021 | 1,148 | 40.49 |
| Granted | 135 | 68.04 |
| Vested | (42) | 59.56 |
| Forfeited or expired | (8) | 40.81 |
| Unvested at the end of 2021 | 1,233 | 42.86 |

The weighted-average grant-date fair value of PSUs granted in 2021, 2020 and 2019 was $68.04, $39.78 and $57.41, respectively. As of December 31, 2021, $24 million of unrecognized compensation cost related to 1,232,599 unvested PSUs, which will be reduced by any forfeiture that occurs and adjusted based on the Company's achievement of performance goals, is expected to be recognized over a remaining weighted-average vesting period of approximately 1.94 years. The total fair value at grant date of awards that vested during 2021, 2020 and 2019 was $3 million, $3 million and nil respectively.

### *Impact on Net Income*

Share-based compensation expense was $41 million, $36 million and $26 million for 2021, 2020 and 2019, respectively. Deferred tax benefits of $1 million was recognized in each of 2021, 2020 and 2019.

## Note 16 — Equity

Immediately after the separation on October 31, 2016, Yum China authorized capital stock consisted of 1,000 million shares of common stock, par value $0.01 per share, and 364 million shares of Yum China common stock were issued and outstanding. As of December 31, 2021, 449 million shares of Yum China common stock were issued and 428 million shares were outstanding.

### *Share Repurchase Program*

The Company repurchased 1.3 million, 0.2 million and 6.2 million shares of common stock at a total cost of $75 million, $7 million and $261 million for the years ended December 31, 2021, 2020 and 2019, respectively. As of December 31, 2021, $617 million remained available for repurchase under the current authorization.

### *Cash Dividend*

On October 4, 2017, the board of directors approved a regular quarterly cash dividend program, and declared an initial cash dividend of $0.10 per share on Yum China's common stock in the fourth quarter of 2017. Beginning in the fourth quarter of 2018, we have paid a cash dividend of $0.12 per share. However, due to the unprecedented effects of the COVID-19 pandemic, the Company suspended its dividend payments in the second and third quarter of 2020. Cash dividends totaling $203 million, $95 million and $181 million were paid to stockholders in 2021, 2020 and 2019, respectively.

### *Accumulated Other Comprehensive Income ("AOCI")*

The Company's other comprehensive income (loss) for the years ended December 31, 2021, 2020, and 2019 and AOCI balances as of December 31, 2021 and 2020 were comprised solely of foreign currency translation adjustments. Other comprehensive income was $108 million and $230 million for the years ended December 31, 2021 and 2020, respectively, and other comprehensive loss was $32 million for the years ended December 31, 2019. The accumulated balances reported in AOCI in the Consolidated Balance Sheets for currency translation adjustments were net gain of $268 million and $167 million as of December 31, 2021 and 2020, respectively. There was no tax effect related to the components of other comprehensive income for all years presented.

### *Restricted net assets*

The Company's ability to pay dividends is primarily dependent on the Company receiving distributions of funds from its subsidiaries. Relevant PRC statutory laws and regulations permit payments of dividends by the Company's PRC subsidiaries only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. The results of operations reflected in the Consolidated Financial Statements prepared in accordance with U.S. GAAP differ from those reflected in the statutory financial statements of the Company's subsidiaries.

In accordance with the PRC Regulations on Enterprises with Foreign Investment and the articles of association of the Company's PRC subsidiaries, a foreign-invested enterprise established in the PRC is required to provide certain statutory reserves, namely general reserve fund, the enterprise expansion fund and staff welfare and bonus fund which are appropriated from net profit as reported in the enterprise's PRC statutory accounts. A foreign-invested enterprise is required to allocate at least 10% of its annual after-tax profit to the general reserve until such reserve has reached 50% of its respective registered capital based on the enterprise's PRC statutory accounts. Appropriations to the enterprise expansion fund and staff welfare and bonus fund are at the discretion of the board of directors for all foreign-invested enterprises. The aforementioned reserves can only be used for specific purposes and are not distributable as cash dividends.

As a result of these PRC laws and regulations subject to the limit discussed above that require annual appropriations of 10% of after-tax income to be set aside, prior to payment of dividends as general reserve fund, the Company's PRC subsidiaries are restricted in their ability to transfer a portion of their net assets to the Company in the form of dividend payments, loans or advances. The restricted net assets of the PRC subsidiaries is approximately $1 billion as of December 31, 2021.

Furthermore, cash transfers from the Company's PRC subsidiaries to its subsidiaries outside of China are subject to PRC government control of currency conversion. Shortages in the availability of foreign currency may restrict the ability of the PRC subsidiaries to remit sufficient foreign currency to pay dividends or other payments to the Company, or otherwise satisfy their foreign currency-denominated obligations.

## Note 17 — Income Taxes

In December 2017, the U.S. enacted the Tax Act, which included a broad range of tax reforms, including, but not limited to, the establishment of a flat corporate income tax rate of 21%, the elimination or reduction of certain business deductions, and the imposition of tax on deemed repatriation of accumulated undistributed foreign earnings. The Tax Act has impacted Yum China in two material aspects: (1) in general, all of the foreign-source dividends received by Yum China from its foreign subsidiaries will be exempted from taxation starting from its tax year beginning after December 31, 2017 and (2) Yum China recorded additional income tax expense in the fourth quarter of 2017, including an estimated one-time transition tax on its deemed repatriation of accumulated undistributed foreign earnings and additional tax related to the revaluation of certain deferred tax assets.

We completed the evaluation of the impact on our transition tax computation based on the final regulations released in the first quarter of 2019 and recorded an additional income tax expense of $8 million for the transition tax accordingly.

The Tax Act requires a U.S. shareholder to be subject to tax on Global Intangible Low Taxed Income ("GILTI") earned by certain foreign subsidiaries. We have elected the option to account for current year GILTI tax as a period cost as incurred.

U.S. and foreign income (loss) before taxes are set forth below:

| | 2021 | 2020 | 2019 |
|---|---|---|---|
| U.S. | $ (1) | $ (10) | $ (7) |
| Mainland China | 1,424 | 1,014 | 941 |
| Other Foreign | $ (31) | 104 | 69 |
| | $ 1,392 | $ 1,108 | $ 1,003 |

The details of our income tax provision are set forth below:

| | | 2021 | 2020 | 2019 |
|---|---|---|---|---|
| Current: | Federal | $ — | $ 1 | $ 16 |
| | Foreign | 209 | 183 | 228 |
| | | $ 209 | $ 184 | $ 244 |
| Deferred: | Federal | $ (8) | $ 26 | $ (1) |
| | Foreign | 168 | 85 | 17 |
| | | $ 160 | $ 111 | $ 16 |
| | | $ 369 | $ 295 | $ 260 |

The reconciliation of income taxes calculated at the U.S. federal statutory rate to our effective tax rate is set forth below:

| | 2021 | | 2020 | | 2019 | |
|---|---|---|---|---|---|---|
| U.S. federal statutory rate | $ 292 | 21.0% | $ 233 | 21.0% | $ 211 | 21.0% |
| Impact from the Tax Act | — | — | — | — | 8 | 0.8 |
| Statutory rate differential attributable to foreign operations | 73 | 5.2 | 63 | 5.7 | 53 | 5.3 |
| Adjustments to reserves and prior years | (4) | (0.3) | (6) | (0.6) | (2) | (0.2) |
| Change in valuation allowances | 9 | 0.7 | 1 | 0.1 | 2 | 0.2 |
| Impact from investment (gain) loss | (1) | (0.1) | 7 | 0.7 | (10) | (1.0) |
| Other, net | — | — | (3) | (0.3) | (2) | (0.2) |
| Effective income tax rate | $ 369 | 26.5% | $ 295 | 26.6% | $ 260 | 25.9% |

*Statutory rate differential attributable to foreign operations.* This item includes local taxes, withholding taxes, and shareholder-level taxes, net of foreign tax credits. A majority of our income is earned in China, which is generally subject to a 25% tax rate. The negative impact in 2021, 2020 and 2019 is primarily due to the U.S. federal statutory rate of 21%, which is lower than China's statutory income tax rate.

*Adjustments to reserves and prior years.* This item includes: (1) changes in tax reserves, including interest thereon, established for potential exposure we may incur if a taxing authority takes a position on a matter contrary to our position; and (2) the effects of reconciling income tax amounts recorded in our Consolidated Statements of Income to amounts reflected on our tax returns, including any adjustments to the Consolidated Balance Sheets. The impact of certain effects or changes may affect items reflected in *'Statutory rate differential attributable to foreign operations'*.

*Change in valuation allowances.* This item relates to changes for deferred tax assets generated or utilized during the current year and changes in our judgment regarding the likelihood of using deferred tax assets that existed at the beginning of the year. The impact of certain changes may affect items reflected in *'Statutory rate differential attributable to foreign operations'*.

*Impact from investment (gain) loss.* This item primarily relates to impact of gain or loss on investment in equity securities of Meituan. The Company recorded $29 million of U.S. tax in 2020, including $22 million and $7 million related to gains on investment in equity securities of Meituan recognized during the year of 2020 and prior year, respectively.

*Others.* This item primarily includes the impact of permanent differences related to current year earnings, as well as U.S. tax credits and deductions.

The details of 2021 and 2020 deferred tax assets (liabilities) are set forth below:

| | 2021 | 2020 |
|---|---|---|
| Operating losses and tax credit carryforwards | $ 43 | $ 24 |
| Tax benefit from Little Sheep restructuring | 17 | 17 |
| Employee benefits | 3 | 3 |
| Share-based compensation | 5 | 5 |
| Lease | 64 | 62 |
| Other liabilities | 15 | 13 |
| Deferred income and other | 89 | 75 |
| Gross deferred tax assets | 236 | 199 |
| Deferred tax asset valuation allowances | (53) | (42) |
| Net deferred tax assets | $ 183 | $ 157 |
| Intangible assets | (69) | (61) |
| Property, plant and equipment | (138) | (85) |
| Gain from re-measurement of equity interest upon acquisition | (245) | (87) |
| Unrealized gains from equity securities | (18) | (26) |
| Withholding tax on distributable earnings | (32) | (27) |
| Gross deferred tax liabilities | $ (502) | $ (286) |
| Net deferred tax (liabilities) | $ (319) | $ (129) |
| Reported in Consolidated Balance Sheets as: | | |
| Deferred income taxes | 106 | 98 |
| Deferred income tax liabilities | (425) | (227) |
| | $ (319) | $ (129) |

We have investments in our foreign subsidiaries where the carrying values for financial reporting exceed the tax basis. Except for the planned but yet to be distributed earnings, we have not provided deferred tax on the portion of the excess that we believe is indefinitely reinvested, as we have the ability and intent to indefinitely postpone the basis differences from reversing with a tax consequence. The Company's separation from YUM was intended to qualify as a tax-free reorganization for U.S. income tax purposes resulting in the excess of financial reporting basis over tax basis in our investment in the China business continuing to be indefinitely reinvested. The excess of financial reporting basis over tax basis as of December 31, 2017 was subject to the one-time transition tax under the Tax Act as a deemed repatriation of accumulated undistributed earnings from the foreign subsidiaries. However, we continue to believe that the portion of the excess of financial reporting basis over tax basis (including earnings and profits subject to the one-time transition tax) is indefinitely reinvested in our foreign subsidiaries for foreign withholding tax purposes. We estimate that our total temporary difference for which we have not provided foreign withholding taxes is approximately $3 billion at December 31, 2021. The foreign withholding tax rate on this amount is 5% or 10% depending on the manner of repatriation and the applicable tax treaties or tax arrangements.

At December 31, 2021, the Company had operating loss carryforwards of $186 million, primarily related to our Little Sheep and Daojia business as well as certain underperforming entities, most of which will expire by 2026. These losses are being carried forward in jurisdictions where we are permitted to use tax losses from prior periods to reduce future taxable income.

Cash payments for tax liabilities on income tax returns filed were $255 million, $170 million and $255 million in 2021, 2020 and 2019, respectively.

We recognize the benefit of positions taken or expected to be taken in tax returns in the financial statements when it is more likely than not that the position would be sustained upon examination by tax authorities. A recognized tax position is measured at the largest amount of benefit that is greater than 50% likely of being realized upon settlement.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| | 2021 | 2020 |
|---|---|---|
| Beginning of Year | $ 21 | $ 19 |
| Additions on tax positions | 5 | 8 |
| Reductions due to statute expiration | (6) | (6) |
| End of Year | $ 20 | $ 21 |

In 2021 and 2020, our unrecognized tax benefits were increased by $5 million and $8 million, respectively. The unrecognized tax benefits balance of $20 million as of December 31, 2021 related to the uncertainty with regard to the deductibility of certain business expenses incurred, all of which, if recognized upon audit settlement or statute expiration, would affect the effective tax rate. The Company believes it is reasonably possible its unrecognized tax benefits of $20 million as of December 31, 2021, which is included in Other liabilities on the Consolidated Balance Sheet, may decrease by approximately $5 million in the next 12 months, which if recognized, would affect the 2022 effective tax rate. The accrued interest and penalties related to income taxes at December 31, 2021 and 2020 are set forth below:

| | 2021 | 2020 |
|---|---|---|
| Accrued interest and penalties | $ 5 | $ 5 |

During 2021, 2020 and 2019, a net benefit of nil, nil and $1 million for interest and penalties was recognized in our Consolidated Statements of Income as components of our income tax provision, respectively.

The Company's results are subject to examination in the U.S. federal jurisdiction as well as various U.S. state jurisdictions as part of YUM's and our own income tax filings, and separately in foreign jurisdictions. Any liability arising from these examinations related to periods prior to the separation is expected to be settled among the Company, YCCL and YUM in accordance with the tax matters agreement we entered into in connection with the separation.

We are subject to reviews, examinations and audits by Chinese tax authorities, the IRS and other tax authorities with respect to income and non-income based taxes. Since 2016, we have been under a national audit on transfer pricing by the STA in China regarding our related party transactions for the period from 2006 to 2015. The information and views currently exchanged with the tax authorities focuses on our franchise arrangement with YUM. We continue to provide information requested by the tax authorities to the extent it is available to the Company. It is reasonably possible that there could be significant developments, including expert review and assessment by the STA, within the next 12 months. The ultimate assessment and decision of the STA will depend upon further review of the information provided, as well as ongoing technical and other discussions with the STA and in-charge local tax authorities, and therefore, it is not possible to reasonably estimate the potential impact at this time. We will continue to defend our transfer pricing position. However, if the STA prevails in the assessment of additional tax due based on its ruling, the assessed tax, interest and penalties, if any, could have a material adverse impact on our financial position, results of operations and cash flows.

## Note 18 — Segment Reporting

The Company has two reportable segments: KFC and Pizza Hut. Our remaining operating segments, including the operations of Little Sheep, Huang Ji Huang, Lavazza, COFFii & JOY, Taco Bell, East Dawning, Daojia and our e-commerce business, are combined and referred to as All Other Segments, as these operating segments are insignificant both individually and in the aggregate.

| 2021 | KFC | Pizza Hut | All Other Segments | Corporate and Unallocated[a] | Combined | Elimination | Consolidated |
|---|---|---|---|---|---|---|---|
| **Revenues** | | | | | | | |
| Revenue from external customers | $ 7,003 | $ 2,109 | $ 227 | $ 514 | $ 9,853 | $ — | $ 9,853 |
| Inter-segment revenue | — | — | 246 | 6 | 252 | (252) | — |
| Total | $ 7,003 | $ 2,109 | $ 473 | $ 520 | $ 10,105 | $ (252) | $ 9,853 |

| 2020 | KFC | Pizza Hut | All Other Segments | Corporate and Unallocated[a] | Combined | Elimination | Consolidated |
|---|---|---|---|---|---|---|---|
| **Revenues** | | | | | | | |
| Revenue from external customers | $ 5,821 | $ 1,730 | $ 184 | $ 528 | $ 8,263 | $ — | $ 8,263 |
| Inter-segment revenue | — | — | 58 | — | 58 | (58) | — |
| Total | $ 5,821 | $ 1,730 | $ 242 | $ 528 | $ 8,321 | $ (58) | $ 8,263 |

| 2019 | KFC | Pizza Hut | All Other Segments | Corporate and Unallocated[a] | Combined | Elimination | Consolidated |
|---|---|---|---|---|---|---|---|
| **Revenues** | | | | | | | |
| Revenue from external customers | $ 6,039 | $ 2,054 | $ 121 | $ 562 | $ 8,776 | $ — | $ 8,776 |
| Inter-segment revenue | 1 | — | 37 | — | 38 | (38) | — |
| Total | $ 6,040 | $ 2,054 | $ 158 | $ 562 | $ 8,814 | $ (38) | $ 8,776 |

| Operating Profit | 2021 | 2020 | 2019 |
|---|---|---|---|
| KFC[b] | $ 827 | $ 801 | $ 949 |
| Pizza Hut | 111 | 62 | 114 |
| All Other Segments | (29) | (7) | (14) |
| Unallocated revenues from transactions with franchisees and unconsolidated affiliates[c] | 500 | 533 | 558 |
| Unallocated Other revenues | 20 | 32 | 4 |
| Unallocated expenses for transactions with franchisees and unconsolidated affiliates[c] | (497) | (531) | (554) |
| Unallocated Other operating costs and expenses | (17) | (30) | (4) |
| Unallocated and corporate G&A expenses | (171) | (144) | (145) |
| Unallocated Closures and impairment expense[d] | — | — | (11) |
| Unallocated Other income[e] | 642 | 245 | 4 |
| Operating Profit | 1,386 | 961 | 901 |
| Interest income, net[a] | 60 | 43 | 39 |
| Investment (loss) gain[a] | (54) | 104 | 63 |
| Income Before Income Taxes | $ 1,392 | $ 1,108 | $ 1,003 |

| | Depreciation and Amortization | | |
|---|---|---|---|
| | 2021 | 2020 | 2019 |
| KFC | $ 378 | $ 315 | $ 290 |
| Pizza Hut | 111 | 113 | 120 |
| All Other Segments | 9 | 8 | 5 |
| Corporate and Unallocated | 18 | 14 | 13 |
| | $ 516 | $ 450 | $ 428 |

| | Impairment Charges | | |
|---|---|---|---|
| | 2021 | 2020 | 2019 |
| KFC[f] | $ 30 | $ 32 | $ 16 |
| Pizza Hut[f] | 13 | 29 | 20 |
| All Other Segments[f] | 5 | 5 | 2 |
| Corporate and Unallocated[d] | — | — | 11 |
| | $ 48 | $ 66 | $ 49 |

| | Capital Spending | | |
|---|---|---|---|
| | 2021 | 2020 | 2019 |
| KFC | $ 398 | $ 257 | $ 264 |
| Pizza Hut | 98 | 61 | 71 |
| All Other Segments | 16 | 5 | 10 |
| Corporate and Unallocated | 177 | 96 | 90 |
| | $ 689 | $ 419 | $ 435 |

| | Total Assets | |
|---|---|---|
| | 2021 | 2020 |
| KFC[g] | $ 6,072 | $ 4,084 |
| Pizza Hut | 972 | 906 |
| All Other Segments | 454 | 378 |
| Corporate and Unallocated[h] | 5,725 | 5,507 |
| | $ 13,223 | $ 10,875 |

(a) Amounts have not been allocated to any segment for performance reporting purposes.

(b) Includes equity income from investments in unconsolidated affiliates of $50 million, $63 million and $69 million in 2021, 2020 and 2019, respectively.

(c) Primarily includes revenues and associated expenses of transactions with franchisees and unconsolidated affiliates derived from the Company's central procurement model whereby the Company centrally purchases substantially all food and paper products from suppliers then sells and delivers to KFC and Pizza Hut restaurants, including franchisees and unconsolidated affiliates. Amounts have not been allocated to any segment for purposes of making operating decisions or assessing financial performance as the transactions are deemed corporate revenues and expenses in nature.

(d) Includes impairment charges on intangible assets and goodwill attributable to the Daojia business in 2019. See Note 6.

(e) In 2021, unallocated other income primarily includes gain from re-measurement of previously held equity interest in connection with the acquisition of Hangzhou KFC and the Lavazza joint venture. In 2020, unallocated other income primarily includes gain from re-measurement of previously held equity interest in connection with the acquisition Suzhou KFC in 2020. See Note 3.

(f) Primarily includes store closure impairment charges, restaurant-level impairment charges resulting from our semi-annual impairment evaluation as well as our additional impairment evaluation performed in the first quarter of 2020 in response to adverse impact from the COVID-19 pandemic, and incremental restaurant-level impairment charges in the first quarter of 2019 as a result of adopting ASC 842. (See Note 13).

(g) Includes investments in unconsolidated affiliates.

(h) Primarily includes cash and cash equivalents, short-term investments, investment in equity securities, long-term time deposits and inventories that are centrally managed.

As substantially all of the Company's revenue is derived from the PRC and substantially all of the Company's long-lived assets are located in the PRC, no geographical information is presented. In addition, revenue derived from and long-lived assets located in the U.S., the Company's country of domicile, are immaterial.

## Note 19 — Contingencies

### *Indemnification of China Tax on Indirect Transfers of Assets*

In February 2015, the STA issued Bulletin 7 on Income arising from Indirect Transfers of Assets by Non-Resident Enterprises. Pursuant to Bulletin 7, an "indirect transfer" of Chinese taxable assets, including equity interests in a Chinese resident enterprise ("Chinese interests"), by a non-resident enterprise, may be recharacterized and treated as a direct transfer of Chinese taxable assets, if such arrangement does not have reasonable commercial purpose and the transferor has avoided payment of Chinese enterprise income tax. As a result, gains derived from such an indirect transfer may be subject to Chinese enterprise income tax at a rate of 10%.

YUM concluded and we concurred that it is more likely than not that YUM will not be subject to this tax with respect to the distribution. However, given how recently Bulletin 7 was promulgated, there are significant uncertainties regarding what constitutes a reasonable commercial purpose, how the safe harbor provisions for group restructurings are to be interpreted and how the taxing authorities will ultimately view the distribution. As a result, YUM's position could be challenged by Chinese tax authorities resulting in a 10% tax assessed on the difference between the fair market value and the tax basis of the separated China business. As YUM's tax basis in the China business is minimal, the amount of such a tax could be significant.

Any tax liability arising from the application of Bulletin 7 to the distribution is expected to be settled in accordance with the tax matters agreement between the Company and YUM. Pursuant to the tax matters agreement, to the extent any Chinese indirect transfer tax pursuant to Bulletin 7 is imposed, such tax and related losses will be allocated between YUM and the Company in proportion to their respective share of the combined market capitalization of YUM and the Company during the 30 trading days after the separation. Such a settlement could be significant and have a material adverse effect on our results of operations and our financial condition. At the inception of the tax indemnity being provided to YUM, the fair value of the non-contingent obligation to stand ready to perform was insignificant and the liability for the contingent obligation to make payment was not probable or estimable.

### *Guarantees for Franchisees and Unconsolidated Affiliates*

From time to time we have guaranteed certain lines of credit and loans of franchisees and unconsolidated affiliates. As of December 31, 2021, no guarantees were outstanding for franchisees and unconsolidated affiliates.

### *Indemnification of Officers and Directors*

The Company's amended and restated certificate of incorporation and amended and restated bylaws include provisions that require the Company to indemnify directors or officers for monetary damages for actions taken as a director or officer of the Company or while serving at the Company's request as a director or officer or another position at another corporation or enterprise, as the case may be. The Company purchases standard directors and officers insurance to cover claims or a portion of the claims made against its directors and officers. Since a maximum obligation is not explicitly stated in the Company's bylaws or in the indemnification agreements and will depend on the facts and circumstances that arise out of any future claims, the overall maximum amount of the obligations cannot be reasonably estimated. The Company has not been required to make payments related to these obligations, and the fair value for these obligations is zero as of December 31, 2021.

### *Legal Proceedings*

The Company is subject to various lawsuits covering a variety of allegations from time to time. 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. Matters faced by the Company from time to time include, but are not limited to, claims from landlords, employees, customers and others related to operational, contractual or employment issues.

## Note 20 — Subsequent Events

### *Cash Dividend*

On February 8, 2022, the Company announced that the board of directors declared a cash dividend of $0.12 per share on Yum China's common stock, payable as of the close of business on March 29, 2022, to stockholders of record as of the close of business on March 8, 2022. Total estimated cash dividend payable is approximately $51 million.

# Controls and Procedures

## Evaluation of Disclosure Controls and Procedures

The Company has evaluated the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 as of the end of the period covered by this report. Based on the evaluation, performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer (the "CEO") and the Chief Financial Officer (the "CFO"), the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

## Management's Report on Internal Controls Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) under the Securities Exchange Act of 1934. Under the supervision and with the participation of our management, including the CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. As permitted, our management excluded Hangzhou KFC, acquired during 2021, from the scope of its assessment of the effectiveness of internal control over financial reporting as of December 31, 2021. Hangzhou KFC's total assets, excluding goodwill and net intangible assets which were included within the scope of assessment, and total revenues represented 3.9% and less than 1% of the Company's total consolidated assets and total consolidated revenues, respectively, as of and for the year ended December 31, 2021.

Based on our evaluation under the framework in *Internal Control — Integrated Framework (2013),* our management concluded that our internal control over financial reporting was effective as of December 31, 2021.

KPMG Huazhen LLP, an independent registered public accounting firm, has audited the effectiveness of our internal control over financial reporting as of December 31, 2021 and has issued their report, included in the Company's annual report on Form 10-K filed with the SEC.

## Changes in Internal Control over Financial Reporting

There were no changes with respect to the Company's internal control over financial reporting or in other factors that materially affected, or are reasonably likely to materially affect, internal control over financial reporting during the quarter ended December 31, 2021.

# PART III

## Directors, Executive Officers and Corporate Governance

Information regarding Section 16(a) compliance, the Company's Audit Committee and the Audit Committee financial expert, the Company's code of conduct and background of the directors will be provided under the captions "Governance of the Company" and "Election of Directors" in the proxy statement for the Company's 2022 annual meeting of stockholders (the "2022 Proxy Statement"), to be filed not later than 120 days after the end of the Company's fiscal year.

For information regarding executive officers of the Company, please refer to "Information about our Executive Officers" in this annual report.

## Executive Compensation

Information regarding executive and director compensation and the Company's Compensation Committee will be provided under the captions "Executive Compensation", "2021 Director Compensation" and "Governance of the Company" in the 2022 Proxy Statement.

## Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information regarding equity compensation plans and security ownership of certain beneficial owners and management will be provided under the captions "Executive Compensation" and "Stock Ownership Information" in the 2022 Proxy Statement.

## Certain Relationships and Related Transactions, and Director Independence

Information regarding certain relationships and related transactions and information regarding director independence will be provided under the caption "Governance of the Company" in the 2022 Proxy Statement.

## Principal Accountant Fees and Services

Information regarding principal accountant fees and services and audit committee pre-approval policies and procedures will be provided under the caption "Ratification of Independent Auditor" in the 2022 Proxy Statement.

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YumChina