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Yum! Brands, Inc. (YUM) Q3 2024 Earnings Call Transcript

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Q3: 2024-11-05 Earnings Summary

Play Call



Press Release



10-Q

EPS of \$1.37 **misses by \$0.04** | Revenue of \$1.83B (6.91% Y/Y) **misses by \$68.58M**Yum! Brands, Inc. (NYSE:[YUM](#)) Q3 2024 Earnings Conference Call November 5, 2024 7:45 AM ET

Company Participants

Matt Morris - Head, Investor Relations

David Gibbs - CEO

Chris Turner - CFO

Conference Call Participants

Gregory Francfort - Guggenheim Securities

Brian Bittner - Oppenheimer

Jon Tower - Citi

Dennis Geiger - UBS

David Palmer - Evercore ISI

John Ivankoe - JPMorgan

David Tarantino - Baird

Operator

Welcome, everyone, to the Yum! Brands 2024 Third Quarter Earnings Call. My name is Lauren, and I will be coordinating your call today. There will be an opportunity for questions at the end of the presentation. [Operator Instructions] I will now hand you over to Matt Morris, Head of Investor Relations. Please go ahead.

Matt Morris

Thanks, operator. Good morning, everyone, and thank you for joining us. On our call today are David Gibbs, our CEO; Chris Turner, our CFO; and Dave Russell, our Senior Vice President and Corporate Controller. Following remarks from David and Chris, we'll open the call to questions.

Before we get started, please note that this call includes forward-looking statements that are subject to future events and uncertainties that could cause our actual results to differ materially from these statements. All forward-looking statements are made only as of the date of this call and should be considered in conjunction with the cautionary statements in our earnings release and the risk factors included in our filings with the SEC.

In addition, please refer to our earnings release in the relevant sections of our filings with the SEC to find disclosures, definitions and reconciliations of non-GAAP financial measures and other metrics used on today's call. Please note that during today's call, losses and sales growth and operating profit growth results exclude the impact of foreign currency.

As a reminder, several of Yum! Brands business units report on a period calendar basis, including all U.S. and Canada brands, KFC U.K. and KFC Australia. When forecasting 2024, please keep in mind this year will include an extra week in the fourth quarter for those entities. For more information on our reporting calendar for each market, please visit the Financial Reports section of the IR website. We are broadcasting this conference call via our website. This call is also being recorded and will be available for playback.

We would like to make you aware of upcoming investor events. Our in-person Taco Bell Consumer Day will be held Tuesday, January 28, in Downtown Los Angeles. Taco Bell Consumer Day will take place in the morning and will be preceded by Taco Bell's iconic Live Moss Live event. Due to limited capacity, attendance for both events will be by invitation only. However, direct requests can be made by contacting IR at yuminvestormailbox@yum.com. Our fourth quarter earnings will be released on February 5 with a conference call on the same day.

Now I'd like to turn the call over to David Gibbs.

David Gibbs

Thank you, Matt, and good morning, everyone. Despite the complex consumer environment around the globe, our team managed to grow profits 3% year-over-year with the quarter bringing to light the real strengths of our twin growth engines, Taco Bell U.S., which meaningfully outperformed the industry on comp sales and KFC International, which meaningfully outperformed on unit growth.

Although the U.S. QSR industry experienced negative traffic trends in Q3, Taco Bell U.S. posted an impressive 4% increase in same-store sales and led the industry in Q3 on value perception among all QSR users. Taco Bell delivered another quarter of significant market share gains driven by the execution of the brand's magic formula involving brand buzz, value, category entry points and digital engagement. Taco Bell's competitive advantages in innovation, value leadership at compelling price points and strong consumer connection are clear reasons why the brand remains a category of one when it comes to winning with consumers in any economic environment.

Our other twin growth engine, KFC International, delivered 9% year-over-year unit growth, an incredible result that led all major competitors and that reflects the underlying power of the brand and the confidence of our franchise partners in the future of our business. KFC International's development was diverse, spanning 64 countries. Furthermore, gross unit openings year-to-date are up nearly 150 units over last year.

Building on this momentum, KFC is enhancing its core capabilities to ensure growth over the long term by establishing 7 centers of excellence focused on restaurant design, customer insights, market planning, food innovation and more. These centers will drive operational and marketing excellence while leveraging the brand's scale, strengthening a competitive moat that has helped KFC grow successfully around the globe in 150 countries, an achievement that few global brands have ever accomplished.

It is no secret that the global macroeconomic environment remains complex. In many parts of the world, our brands are delivering outstanding growth and outperforming the competition.

We continue to see strong sales growth in KFC regions such as Africa, Latin America and the Caribbean and parts of both Europe and Asia. In South Africa, where our KFC sales are up strongly, our teams have improved our value proposition, limiting recent price increases to 1% in comparison to nearly high single digits in affected local competitors.

In some other geographies, our permits did not meet our expectations, and our teams are working with our franchise partners to reestablish strong value offerings, all while safeguarding franchisee profitability. The complex consumer environment that exists in many markets around the globe has contributed to pronounced regional sales variations, which has caused our system sales growth to fall short of our long-term algorithm this year.

The most pronounced regional headwinds continue to be in the Middle East, Indonesia and Malaysia, stemming from the impact of the Middle East conflict. In these markets, KFC same-store sales declines have generally ranged between 15% and 45% throughout the year, including Q3. We are fortunate that the vast majority of our restaurants are in the hands of highly scaled and well-capitalized franchisees around the globe, including Americana, our largest partner in the Middle East, who can weather temporary headwinds like this over extended periods.

However, in a few isolated cases, the scale and duration of these sales impacts are affecting the financial health of our less scaled or less well-capitalized partners, particularly those whose restaurants have been most heavily impacted by the Middle East conflict.

We are working closely with those specific partners to help them navigate the challenges and implement tactical and strategic changes, including pricing studies, introducing new value offerings and adjusting development schedules to improve profitability and position business for healthy growth in the future.

As we mentioned on the second quarter earnings call, the same geopolitical pressures have grown to meaningfully, but less severely impact certain markets beyond the Middle East, Malaysia and Indonesia. As an example, we have seen in the U.K., Australia and New Zealand that KFC same-store sales performance in certain individual stores has been significantly impacted.

Importantly, these specific pressures have been location specific and not indicative of broader global trends. Specifically, our KFC markets, excluding China that we believe were not materially impacted by the Middle East conflict, reported an encouraging low single-digit increase in same-store sales.

As we shift to the U.S., the overall QSR industry is navigating a complex consumer environment. Of course, our scale and digital capabilities are an even bigger advantage right now and our powerhouse Taco Bell business, which represents 75% of our U.S. profit, is thriving. While our Pizza Hut and KFC businesses are more challenged in this environment, we have fantastic leaders in place in these businesses who are working through revised strategies to create a step change in the results.

Overall, we achieved 5% unit growth year-over-year, an impressive outcome considering the obstacle faced by our teams. Closures have temporarily increased this year, primarily in markets dealing with impacts from the Middle East conflict and in China. Despite the strength in our gross unit openings in this tough environment, the risk of an increase in closures of lower volume units affected by the Middle East conflict could impact our Q4 net new unit growth and put at risk our ability to deliver our 5% unit growth target.

Given the lower volume nature of these units, we would not expect a material financial impact from their closure. While 2024 unit growth will reflect a temporary reset on unit closures, we're encouraged at the pace of our gross unit openings that Chris will discuss in more depth and as we look at our 2025 pipeline, see no change in pace behind our gross opening momentum, giving us confidence in the strong fundamentals of our brands.

Now let me highlight our relevant, easy and distinctive brands, or RED for short, in more detail followed by our unrivaled culture and talent and good growth strategy. I'll then turn it to Chris to provide further updates on our third quarter results, including our bold restaurant development, unmatched operating capabilities and balance sheet position and capital strategy.

Starting with the KFC division, which represents 50% of our divisional operating profit, system sales grew 1% as significant unit growth was offset by the aforementioned Middle East conflict impact and transaction softness in several regions navigating constrained consumer spending. Such challenges have led competitors to introduce incremental value offers, namely to capture low ticket transactions in markets such as the U.K., France and India.

The good news is that despite category headwinds, we are gaining or holding share in several of our largest international markets as well as seeing positive transaction growth in markets like Mexico, Poland and Korea. We're also sustaining high system sales growth in larger regions like Africa and Latin America and the Caribbean, where we benefited from product innovation and more stable consumer environment. Helping KFC to remain agile has been the focus of its robust digital strategy.

Digital mix, now over 55%, grew 3 percentage points over the previous quarter on expanding kiosk and click-and-collect channels. In the U.S., limited time offers underperformed expectations due to a more intense competitive environment, particularly within the chicken QSR category.

In Q4, the team will focus on strengthening its value proposition and has recently introduced boneless innovation like original recipe chicken tenders. Additionally, the team will capitalize on the success of the KFC Rewards membership growth, which has contributed to digital sales growth over 20% from last year.

Moving on to Taco Bell, which contributes 37% of our divisional operating profit. System sales grew 5%, driven by a 4% increase in same-store sales. This quarter, Taco Bell gained momentum with the launch of the Cheesy Street Chalupas, marking the brand's first innovation on the canteen chicken platform. Further momentum came from the reintroduction of the Cheez-It and investing behind the \$7 Lux cravings box.

The team tapped into cheesy Street Chalupa innovation to drive delivery sales by offering exclusive access to an aggregates premium members, which led to 7 daily sales records for the aggregator during the quarter. Toward the end of the quarter, the team made the strategic move to make breakfast optional for our franchise partners, providing greater flexibility to spend our marketing dollars more effectively on growth drivers such as Cantina Chicken and our cravings value venue.

These are platforms where our marketing spend has had significant success building new and very profitable sales layers. We expect the net impact from these changes to be less than a 1-point headwind to same-store sales growth. We intend to reintroduce breakfast in the future with a bolder, more distinctive Taco Bell approach.

In another strategic priority involving growth through its loyalty program, Taco Bell drove impressive advancements with 90-day active loyalty users increasing by 50% year-over-year. On the digital front, where Taco Bell U. S. has implemented the majority of Yum!'s digital and technology platforms, digital sales grew an amazing 30% year-over-year.

Internationally, Taco Bell focused on executing its 3 core pillars, brand, food and value, leading to positive same-store sales growth for the quarter. Very encouragingly, that momentum has continued into Q4. To strengthen brand relevance, the team is connecting more with local cultures, including most recently in the U.K. with the launch of encore hours, allowing stores to stay open late near music venues to serve fans after shows.

We were also pleased to see our first equity store opened in the U.K. in late October with a very encouraging consumer response, giving us confidence in our accelerated investment in the brand internationally. Clearly, Taco Bell International has the potential to be a third growth engine for Yum! for many years to come.

At Pizza Hut, which represents 13% of our divisional operating profit, system sales declined 1% as the same-store sales decline of 4% was partially offset by 2% unit growth. The third quarter started strong in the U.S. with momentum from my hot box and a robust marketing plan for the Chicago Tavern Style Pizza, which translated to positive traffic growth for the full quarter and ahead of the QSR industry.

However, product news and bounce-back offers were not sufficient to compete against deep value offers in the market. Throughout the quarter, several markets became more intentional in pursuing value, including China, India and countries within the Middle East. As an example, in some of our pressured markets, we shifted towards a lower price point value over abundant value.

At the same time, we are making progress in repositioning the brand over the long term, most recently hiring a new Chief Brand Officer, and have plans to improve and expand our consumer relationship management and loyalty platforms next year.

Lastly, at Habit Burger Grill, while overall sales remained under pressure during the third quarter, there were encouraging signs of momentum as the quarter progressed. Same-store sales trends improved each period in the quarter as the team leveraged recent accolades, including being recognized as having the #1 grilled chicken sandwich by daily meal and the #1 fast food burger inside by USA TODAY. These accolades were impressive, given many of the other contenders have a broader national presence with larger store footprints.

Clever marketing efforts, combined with refinements to have its media mix using Yum!'s proprietary marketing analytics platform, successfully ignited consumer excitement driving visits to the brand to experience the award-winning Double Char and tempura green beans. I'm pleased to see this positive momentum continue into the fourth quarter.

Now I'll turn to our good growth strategy, starting with our people pillar. A hallmark of Yum! and a key driver of our performance is the strength of our talent base, including our deep bench of amazing leaders always ready to take on bigger roles. I'd like to start by congratulating Erica Burkhardt, who was recently promoted to Chief Legal Officer and Corporate Secretary for Yum!. Erica is a seasoned and respected leader throughout Yum!, who has been with the company for over 20 years. She leads by example and has earned the trust of her peers and teams alike, providing invaluable insight and counsel on key initiatives across Yum! and our brands.

I would also like to recognize her predecessor, Scott Catlett, for his years of service and the tremendous impact he made at Yum! and our brands as he starts a new chapter outside of the company.

Additionally, as we progress on our journey to becoming the leading global digital restaurant company, I'm pleased to announce Joe Park has been named President of Yum!'s Digital and Restaurant Technology Ecosystem in addition to his overall Chief Digital and Technology Officer role. He's doing a fantastic job bringing our vision to life for a fully collaborative digital and technology team across Yum! and is reinventing how the team works to drive increased consistency and efficiency in tools and processes as well as greater deployment of AI-driven capabilities, leveraging our global data assets and scaling our proprietary technology.

Also during the quarter, for the first time in over 2 years, we brought nearly 200 of our most senior leaders from around the world together for our Global Leadership Summit. Our technology leaders at the Summit made up the largest functional group, demonstrating our focus on leaning into our digital leadership and our investments in AI. We showcased the progress we're making on our good growth journey and what we're doing behind the scenes to reinvent how we run the business by better exploiting our scale to drive future growth.

Moving on to the planet pillar of our good growth strategy. Just last month, we published our annual global citizenship and sustainability report. This report highlights Yum!'s long-standing dedication and continued progress and investments in our 3 priority pillars of people, food and planet. We are on track to reduce our greenhouse gas emissions by nearly 50% by 2030 and continue to make progress around sustainable packaging building upon our harmonized cross-brand packaging policy.

In closing, in a difficult operating environment, we are encouraged by the underlying strength of the fundamentals of our business. Stepping back, our twin growth engines are demonstrating what makes them special through share gains at Taco Bell U.S. and strong franchisee investment in unit expansion in KFC International.

Despite the numerous headwinds, we are proud of the resilience of our overall business model and our ability to deliver 6% core operating profit growth year-to-date. Importantly, our teams are making great progress in ushering our brands into the [indiscernible], leveraging Yum! scale and digital and technology capabilities to improve sales and operations, leading to improved franchisee profitability and value creation for our shareholders.

With that, Chris, over to you.

Chris Turner

Thank you, David, and good morning, everyone. Today, I'll discuss our financial results, our bold restaurant development and unmatched operating capability growth drivers, our balance sheet and capital strategy, and provide an update on our outlook for the remainder of the year.

Turning to our third quarter financial results. System sales grew 1%, driven by 5% unit growth. As the third quarter progressed, sales trended below our expectations due to a more challenged U.S. environment, soft trends in China and continued pressures from the Middle East conflict. Ex special G&A was \$252 million for the quarter, less than anticipated due to lower performance-based compensation. Reported G&A was \$263 million, including \$11 million of special expense related to our ongoing resource optimization program.

Restaurant-level margins were 15.8%, modestly below levels from last year, partially due to KFC U.K. and Ireland equity restaurants acquired in the second quarter. Core operating profit grew 3%. Third quarter ex special EPS was \$1.37.

Our ex special tax rate was higher year-over-year at 24%, translating to a \$0.09 year-over-year EPS headwind. Now on to development.

In the third quarter, we achieved a significant development milestone, surpassing 60,000 restaurants worldwide. Overall, we increased our unit count by 547 units, reflecting 1,029 gross openings and 482 closures. KFC drove Yum!'s unit growth with the team opening 685 gross units led by China, India, Thailand and Japan.

Notably, we've seen an acceleration this past year in net new unit expansion in markets like Italy, the Philippines and South Africa. Most of our key KFC markets report paybacks less than 5 years, and as a result, we continue to see a strong appetite by franchisees for unit growth.

In Saudi Arabia, for example, we expect our store count this year to grow by nearly 30 restaurants with paybacks still under 3 years despite conflict-related sales pressures.

Turning to Pizza Hut. We added 63 units this quarter, driven by 292 gross unit openings offset by 229 closures. New unit openings were led by China, India and the United States. Taco Bell added nearly 50 gross units, led by the U.S., while 14 other countries contributed to growth. Recall, Yum! China went through a portfolio restructuring earlier this year, resulting in 60 closures in the first half of the year.

Excluding China, Taco Bell International's unit count increased 7% year-over-year. Last month, we also opened our first store in Bosnia and our first equity store in the U.K. We expect to open several equity Taco Bell U.K. stores by year-end, providing a fantastic test bed to generate insights to guide the business model, including an innovation, pricing, technology and restaurant experience.

Moving to our digital and technology initiatives. We continue to make great progress on both of the parallel phases of our journey. Recall, the first phase is focused on acquiring, building and scaling a comprehensive suite of platforms to enable ownership of our data, control of the digital ecosystem speed of innovation and cost advantages. These foundational platforms include aside, our young, cloud-first point-of-sale system, our e-commerce engine, our delivery optimization platform, Dragon Tail, Super App, an integrated restaurant management platform for team members, restaurant general managers and area coaches, and a scalable global data platform that houses over 80% of our transaction data.

In the second phase, we are focused on maximizing the value creation potential of our platforms through AI and by leveraging our extensive data assets. We believe we are still only scratching the surface of the full value creation potential of our capabilities with exciting innovations, including One Touch labor scheduling and inventory management, consumer feedback dashboards, quality control monitoring and personalized AI-driven marketing, to name a few. Let me now discuss additional digital and technology accomplishments for Q3 across our easy experiences, easy operations and easy insights pillars. I'll begin with our easy experiences pillar, focused on providing frictionless experiences to our consumers.

Taco Bell is currently working on 2 significant digital initiatives in the drive-through, voice AI and loyalty program enhancements. Drive-through voice AI continue to scale across our network with many franchisees eager to test this new innovation. To date, we have processed over 2 million successful orders with the system now in place in over 300 Taco Bell U.S. stores, making Taco Bell the largest QSR voice AI brand in the world.

For loyalty, Taco Bell is using its connected ecosystem to allow loyalty consumers to identify themselves at the drive-through and kiosk, enabling personalization of their ordering experience and earning and redeeming of loyalty rewards. This was rolled to 160 stores in Q3, and we're encouraged with early results, which clearly show an increase in sign-ups and in daily loyalty transactions all without an impact to speed of service.

As required enablers of these technologies, we have accelerated deployment of digital menu boards to now over 6,000 restaurants. Digital menu boards will be a Taco Bell brand standard in 2025, along with Yum!'s proprietary point-of-sale system side. Our other key initiative under this pillar is the rollout of Yum!'s e-commerce engine. We completed migration of a substantial portion of Pizza Hut's U.S. traffic in the quarter and are on track to complete migration by year-end.

We also recently launched the Yum! e-commerce engine in Pizza Hut U.K., our second international Pizza Hut market, and will target 2 new Pizza Hut international markets before year-end. Next, I'll discuss our easy operations pillar, where we continue to deploy our world-class technology to provide our franchisees and team members with the capabilities to operate their stores more effectively and efficiently.

This quarter, we started to expand Super App to KFC U.S. now having reached 50 countries and nearly 5,000 KFC and 8,000 Pizza Hut stores with the technology. We are planning to nearly double the KFC penetration by year-end. Recall, Super App is our modular restaurant management platform that offers a suite of products to managers and team members to simplify their jobs and improve operations.

This quarter, we also reached significant scale for our AI-powered labor scheduler, now in use in over 5,000 Taco Bell U.S. stores, driving significant improvements in labor planning accuracy and labor efficiency. At Taco Bell, we now have AI-powered forecasts, driving both our labor scaling and inventory management processes. We expect to scale these solutions to our other brands throughout 2025.

Lastly, I'll discuss our easy insights pillar. This quarter, we successfully launched personalized AI-driven marketing campaigns that relative to traditional digital marketing campaigns generated significant increases in consumer engagement, leading to increased purchases and a reduction in consumer churn. This innovation has the potential to greatly improve our marketing return on investment and allow us to extract the unique benefits of our proprietary global data hub, and we expect it to be broadly and easily scalable across brands. Next, I'll provide an update on our balance sheet and liquidity position.

Net capital expenditures for the quarter were \$34 million, reflecting \$52 million in gross CapEx and \$18 million in refranchising proceeds. We repurchased 2.1 million shares totaling \$277 million. Our net leverage ratio ended the quarter at 4.1x. As a reminder, we have no debt maturities until 2026. Our capital priorities remain unchanged: investing in the business, maintaining a resilient balance sheet, offering a competitive dividend and returning excess cash to our shareholders.

Before I close, let me touch on the outlook for the balance of 2024. We expect Q4 core operating profit growth to be mid- to high single digits, excluding contributions from the 53rd week, which we expect will add approximately \$35 million. Of course, precise forecasting is difficult in this environment.

To finish with guidance, we expect Taco Bell fourth quarter company-operated store margins to be in the range of 23% to 24% and lastly, our Q4 net interest expense to be just under \$140 million.

Taking into consideration the challenging environment, I am incredibly proud of our team's perseverance to open approximately 4,500 gross new restaurants or roughly 1 store every 2 hours, an envy at restaurant industry. Into next year, we'll continue our focus on capturing the global white space opportunity that offers significant runway for our iconic brands. I'm excited by our continued progress in transforming Yum! into a digital multi-brand powerhouse. We look forward to seeing many of you at our upcoming Taco Bell Consumer Day in January, where we'll further unpack many of these exciting digital and technology initiatives.

With that, operator, we are ready to take any questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from Gregory Francfort from Guggenheim Securities.

Gregory Francfort

My question is going to be on operating profit growth, but thanks for the thoughts on the fourth quarter. I think that leaves you a little bit below the 8% growth for this year. I guess, as you look out to next year, how confident are you in getting that back up to 8%? And what's the bridge maybe from what the outlook looks like this year to what might be the contributors next year?

Chris Turner

Yes, Greg. Hey, this year, year-to-date, we've got 6% core operating profit growth in a really challenging environment. So when we step back and look at that, we think that demonstrates the strength and resilience of our business model. The main change from the last time we updated you on the last call is that our sales didn't meet expectations in a few key markets, including China and the Middle East, where we have outsized exposure. And as a result, we tempered our expectations in Q4. Of course, that on a full year basis, if you flow through, [indiscernible] about Q4, we likely will end the year below our operating profit algorithm for 2024. But of course, the main driver of that was this conflict situation.

Without that, we would have had a very strong year and been on or above the algorithm. And of course, we delivered that while still investing in things that drive the long-term health of the business. Big investments in digital and AI. We talked about voice AI progressing rapidly, marketing-driven AI, 40 other AI-driven projects that are happening in the business. So that resilient business model and investing in the long-term growth of the business.

We're still working through the plans for 2025. We'll share an update, as we always do, on the next call. But there's no major things that are unusual right now as we look at that 2025 plan. But when we think about the long-term trajectory of the business, our dual growth engines continue to perform and our digital capabilities continue to power the business.

Operator

Our next question comes from Brian Bittner from Oppenheimer.

Brian Bittner

Just a confirmation question and then a follow-up on Taco Bell, just on the guidance for the fourth quarter as it relate to mid- to high single-digit core operating profit growth. Are you able to talk about the base case for global same-store sales that does underpin that outlook by any chance?

And just on Taco Bell, very strong relative performance, obviously, with your 4% same-store sales. And you mentioned that you were the best ranked by consumers in value within QSR during the quarter and it obviously happens at a time where the industry got way more aggressive. So just curious how you protected or even expanded your value positioning in this environment? And is there any new value ideas in the hopper as we move into 2025, particularly as a few large QSRs are eager to put more permanent value on their menu?

David Gibbs

Yes. Thanks, Brian. I'm glad you pointed out the Taco Bell's strength, it's obviously something we're incredibly proud of. And you can see that strength is evident in the U.S. with the plus 4. We were also positive in international.

And the other thing I'll share is that, that momentum has continued into Q4. A lot of it is what you said. It has to do with the unique way that Taco Bell can provide value with products that nobody else has. Really, if you think about it, Taco Bell can provide a product that is a value product, that's an innovative product and that can help our franchisees margins. That's an incredibly powerful set of tools that we have in our toolbox that our competitors don't.

As we move forward, of course, Taco Bell has always got ways to bring in new value. Right now, you're seeing us launching the decades menu and then you can get some of those products within the \$7 Lux Box, for example, which is a unique way to bring innovation and value to consumers. So I think we're very confident in Taco Bell's ability to win in this environment relative to our peers.

As far as sales guidance and everything for the quarter, it's obviously a difficult environment to forecast sales globally. But as I said, the trends that we saw in Q3 are continuing into Q4.

Operator

Our next question comes from Jon Tower from Citi.

Jon Tower

Great. I appreciate all the color you provided in the gross unit openings for the brands across the globe. I was hoping maybe you could drill a little bit more into the net unit number. David, I think you mentioned that there's a potential risk of not hitting the 5% this year. And then maybe specifically drilling into, you do have pockets of weakness across the globe. And I think you had mentioned some of the smaller operators having a hard time keeping the lights on. How should that inform the thinking regarding '25? Is there an opportunity to perhaps consolidate some of those closures into '24, such '25 is a cleaner year? And/or are there opportunities to consolidate some of those stores into larger operators within markets such that your net unit number is not under too much pressure?

David Gibbs

Yes. I have a couple of things on development, and then I'll let Chris give them a little more detail. If you think about it, 2024 is obviously a very challenged year in terms of the impact to our sales in certain parts of the world and some of the consumer pull back.

So for us, we're incredibly proud that this year does showcase how resilient business model is and the capabilities of the vast majority of our franchisees to continue to grow and invest in the business in this challenged environment, like American, our franchisee in the Middle East, you would think that this business would have disrupted -- this situation would have disrupted them more than it has, but they just reported. They're positive operating profit in this environment, continuing to develop. That is a unique strength of Yum! in terms of the capability of our franchisees around the world.

And 2024, as difficult as it is, really is allowing us to showcase that and let that part of our business model really shine. Americana has got about 2/3 of the stores of the Middle East, so most of our stores are in very good hands.

As far as the risk that we signaled on net new units, just to clarify and give you a little more detail, that was risk to the 5%. Right now, the numbers that we're looking at roll up in the 4.5% to 5.0% range. So we would still round to 5% on algorithm. But closures are obviously a little elevated this year. If you're going to have a little bit of a shortfall, you'd rather have see this strong gross development mostly continuing and then closure of some lower volume stores.

If you think about the closure rate, it's probably about another 0.5% of our store base. So this is not some widespread issue to your points about struggling -- other struggling franchisees. It really isn't a widespread issue. It's just a few stores, lower volume that might have closed in the future where those closures were pulled up. I'll let Chris give you a little more color on it.

Chris Turner

Yes, John, let me give you a little more color on the change in net new unit trajectory first through a couple of lenses.

First, if we just look at the deceleration in net new unit growth from last year to this year on a geographic perspective, we see that about 40% of the change in trajectory comes from countries and markets in our business that are directly impacted by this conflict situation. There's another 25% that are markets that have some impact from the conflict, not as much as those core markets, but that gives you about 2/3 of the change in net new unit trajectory that is in some way tied to the conflict situation. So that gives you a little bit of bound on it.

And of course, history would say we typically work through these situations over the long term. Another way to look at it, David mentioned a little bit higher closures this year. As we said before, when units closed in our system, they tend to be lower volume units. And we see that again this year. The average unit volume of the units that are closing this year is about 60% of our global average unit volume. And so when you actually look at the system sales contribution of our net new unit growth this year, it's going to be basically the same as the system sales growth contribution from our higher net new unit rate last year. So the economic implications of this aren't that big on our business. So that gives you a couple of additional ways to just think about this change in net new unit trajectory.

The other thing I'll add, you asked about specific franchisee situations. As David said, our global franchise base is strong. Americana in the Middle East region has – the majority of our stores is navigating this very well. In fact, in the 22 countries in the specific Middle East geography, we only have 2 countries right now where we're working with franchisees to transition the business into better hands. One of those processes is pretty far along.

Another one, we're working with the franchisee to either address some challenges in the business or to get it into the hands of another owner. There's some complexity always in the beginning of those situations, we might have some unit closures might have some onetime accounting adjustments that come with it. But our history would say that we typically end up getting the business into 3C franchisee hands, and that sets the business up for long-term growth and health.

Operator

The next question comes from Dennis Geiger from UBS.

Dennis Geiger

Great. Recognizing it's too early to talk about '25 specifically. Wondering if you could just comment high level about how you think about managing profitability as well as the team has in '24 if macro pressures continue? Maybe specifically, can you talk a little bit about G&A growth and how you think about that generally looking ahead and perhaps the ability of the divisions to continue managing cost and profitability?

Chris Turner

Yes. As I said earlier, we'll give more of an update on the 2025 plan when we get to the next call. As I mentioned, there's nothing that's significantly unusual right now as we're tumbling that plan. As we think about the puts and takes, our twin growth engines continue to perform in a strong way. We've shared that our gross unit outlook for next year is similar to this year.

On the G&A front, we've made productivity moves this year. We'll continue to get some benefit from those. Of course, we will have a reset of our incentive comp. So those are a couple of factors that we'll look at there. But if I think about the long-term trajectory of our business, there's a lot to be excited about, in particular, with those 2 primary growth engines. Taco Bell continues to outperform in any sort of economic environment in the U.S. KFC International 9% unit growth in Q3 continues to build units outpacing its competitors, and our digital story continues to strengthen. So if you look over the long term, there's a lot of reasons to be excited and confident in our business model.

Operator

The next question comes from David Palmer from Evercore ISI.

David Palmer

I wanted to maybe double-click on a couple of the digital initiatives. You highlighted the AI-enabled digital marketing that you talked about, Chris, and David mentioned the AI-enabled drive-throughs in the release.

On the digital AI marketing, is that hyper personalized push marketing in the app and other? You mentioned it was a nice lift where you're rolling that out. Could you maybe give some more color about what that lift was and where the rollout is across your brands? And on the AI voice drive-thrus in the U.S. I'm wondering if that could be a nice profit driver for Yum! Brands. Any reason that would not scale quickly in 2025 and any offsets to the fees that you'll collect there?

Chris Turner

Yes. Great. These are 2 initiatives that we're very excited about. I'll provide a little more color on the AI-driven marketing. This is something we're doing in a coordinated way across our 3 large brands in the U.S. We've run pilots in each of the brands. I'm not going to share any specific numbers on it.

But I can tell you what enables it is our digital ecosystem. And it's really what we call the AI factory within that ecosystem that leverages our massive data assets that we've built, which enable us to know our consumers. If you think about in the Taco Bell environment, it leverages the fact that we have the POS in the store, the digital menu boards and the ability to actually bring these to life at the store and through our loyalty programs and through our connections with customers in the app. So we've got many ways to bring it to life, but it essentially allows us to do more personalized tailoring of offers and to learn and refine much more rapidly than we could before.

So we're excited about the potential of this. We'll continue to bring it to life across the brands and across markets as we progress.

On the voice AI side, really, we're driven by how do we enhance the consumer and customer experience in our restaurants and how do we enhance the team member experience. And so far, the results in Taco Bell with voice AI have been outstanding on both fronts. The customer response has been very positive, and our team members really enjoy having what they call an extra pair of hands in the restaurant to help them operate the store. Our rollout pace this year has been much faster than we originally envisioned going into the year, and I think that speaks to how our operators are seeing the capability and how our franchisees are seeing the capability.

Operator

The next question comes from John Ivankoe from JPMorgan.

John Ivankoe

In your prepared remarks, you really did touch on many digital initiatives, many of which have yet to get to the hands of franchisees fully, especially on a global basis. So the question is on the previous Yum! language bending the curve on G&A.

If there's not further opportunity in '25, you talked about it there is, longer term, how much of an opportunity do we have to use fee collection from franchisees that will significantly drive their own profitability and ease of running their own businesses to kind of think about fee recapture, if you will, on a basis points of franchisee sales basis. I mean your sales base is so big, collecting even 50 or 100 basis points of franchise sales would obviously be very significant in terms of your total G&A spend. So I wanted to see if we could have an opportunity today to kind of think about the longer-term potential of that?

David Gibbs

Yes. Thanks, John. Just a couple of high-level comments on that. I know you and David asked a similar question in that regard. Our goal with technology is to give our franchisees the absolute best technology in the industry, better than any of our peers at the lowest possible cost, better than they can get anywhere else. That is our north star when it comes to tech. We know that if they get that tech in their restaurants and it drives sales and drives improvement in their business models, like voice AI is doing improving their margins by cutting labor, they'll build more stores, top line will grow more. And that's the best way for us to leverage technology to drive profitability in the business.

Of course, we're making investments. We will recover those investments. But voice AI is a great example. We're providing that to our franchisees at what we believe is a much lower cost than our competitors in the industry are having to pay for other third-party solutions. And we will continue to do that, and that is our mission.

Operator

The next question comes from David Tarantino from Baird.

David Tarantino

My question, David, I think you mentioned that as part of your response to a question, that the comp trend you saw in the third quarter carried over into Q4. I just wanted to make sure that, that comment was directly related to Taco Bell and not the global business. And I guess, secondly, I was wondering if you could comment on the KFC segment, and the comparison does get quite a bit better or easier in the fourth quarter, but I know you still have some macro pressures you're dealing with. So any sort of directional commentary on the KFC business and how we should think about that for the fourth quarter would be great.

David Gibbs

Yes. On Taco, if the comment was on Taco Bell in terms of sales trends where we sit in the quarter, we feel good about being able to continue the momentum from Q3, but in the U.S. and internationally.

Now of course, Taco Bell is a little bit easier to forecast because Taco Bell's global store footprint is really unaffected by the conflict. It's a lot harder to forecast KFC.

What I will say is we haven't really gotten to the point where even though we're past the 1-year anniversary of the conflict, we haven't gotten to the point where it really started to impact sales. So we don't know how sales will behave once we get to that lap.

But certainly, the lap will get better, and that should lead to a change in the trajectory of the KFC sales.

Operator

That is the end of the Q&A session. So I'll now hand over to David Gibbs for closing remarks.

David Gibbs

Great. I appreciate everybody's time today. We're excited about the upcoming January 28 Taco Bell Investor Day. So if you don't have that circled on your calendar, please do, and we're looking forward to seeing you out in Irvine, in California and L.A. then for that meeting. We've got a lot of exciting stuff to share about Taco Bell. Thanks for everybody's time today.

Operator

This concludes today's conference call. Thank you for joining, everybody. You may now disconnect your lines.

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