YUM BRANDS INC
Form 10-Q
November 07, 2018

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

[ ] **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934** for the quarterly period ended September 30, 2018

OR

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

For the transition period from ____________ to ________________

Commission file number 1-13163

YUM! BRANDS, INC.

(Exact name of registrant as specified in its charter)

North Carolina	13-3951308
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1441 Gardiner Lane, Louisville, Kentucky	40213
(Address of principal executive offices)	(Zip Code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [ü] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer:	[ü]	Accelerated filer:	[ ]
Non-accelerated filer:	[ ] (Do not check if a smaller reporting company)	Smaller reporting company:	[ ]

Emerging growth company: [ ]

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

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

The number of shares outstanding of the Registrant's Common Stock as of October 31, 2018 was312,301,824 shares.

YUM! BRANDS, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions, except per share data)

	Quarter ended		Year to date	
Revenues	9/30/2018	9/30/2017	9/30/2018	9/30/2017
Company sales	$499	$ 871	$1,523	$ 2,682
Franchise and property revenues	605	565	1,773	1,619
Franchise contributions for advertising and other services	287	—	834	—
Total revenues	1,391	1,436	4,130	4,301
Costs and Expenses, Net				
Company restaurant expenses	399	717	1,258	2,223
General and administrative expenses	204	215	631	699
Franchise and property expenses	40	61	127	161
Franchise advertising and other services expense	288	—	834	—
Refranchising (gain) loss	(100)	(201)	(285)	(331)
Other (income) expense	7	1	10	3
Total costs and expenses, net	838	793	2,575	2,755
Operating Profit	553	643	1,555	1,546
Investment (income) expense, net	(96)	(1)	(185)	(3)
Other pension (income) expense	4	10	10	42
Interest expense, net	111	110	330	325
Income before income taxes	534	524	1,400	1,182
Income tax provision	80	106	192	278
Net Income	$454	$ 418	$1,208	$ 904
Basic Earnings Per Common Share	$1.43	$ 1.21	$3.72	$ 2.58
Diluted Earnings Per Common Share	$1.40	$ 1.18	$3.64	$ 2.52
Dividends Declared Per Common Share	$0.36	$ —	$1.08	$ 0.60

See accompanying Notes to Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions)

	Quarter ended		Year to date	
	9/30/2018	9/30/2017	9/30/2018	9/30/2017
Net Income	$454	$ 418	$1,208	$ 904
Other comprehensive income (loss), net of tax				
Translation adjustments and gains (losses) from intra-entity transactions of a long-term investment nature				
Adjustments and gains (losses) arising during the period	(47)	38	(77)	95
Reclassification of adjustments and (gains) losses into Net Income	(4)	42	(4)	37
	(51)	80	(81)	132
Tax (expense) benefit	5	(1)	5	(5)
	(46)	79	(76)	127
Changes in pension and post-retirement benefits				
Unrealized gains (losses) arising during the period	1	8	1	(5)
Reclassification of (gains) losses into Net Income	5	10	16	46
	6	18	17	41
Tax (expense) benefit	(1)	(7)	(4)	(15)
	5	11	13	26
Changes in derivative instruments				
Unrealized gains (losses) arising during the period	16	(17)	43	(57)
Reclassification of (gains) losses into Net Income	(8)	15	(23)	52
	8	(2)	20	(5)
Tax (expense) benefit	(2)	—	(5)	2
	6	(2)	15	(3)
Other comprehensive income (loss), net of tax	(35)	88	(48)	150
Comprehensive Income	$419	$ 506	$1,160	$ 1,054

See accompanying Notes to Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions)

	Year to date	
	9/30/2018	9/30/2017
Cash Flows – Operating Activities		
Net Income	$ 1,208	$ 904
Depreciation and amortization	103	195
Refranchising (gain) loss	(285)	(331)
Investment (income) expense, net	(185)	(3)
Contributions to defined benefit pension plans	(9)	(47)
Deferred income taxes	32	122
Share-based compensation expense	36	53
Changes in accounts and notes receivable	(35)	17
Changes in prepaid expenses and other current assets	10	(7)
Changes in accounts payable and other current liabilities	(81)	(168)
Changes in income taxes payable	(47)	(125)
Other, net	49	108
Net Cash Provided by Operating Activities	796	718
Cash Flows – Investing Activities		
Capital spending	(147)	(228)
Investment in Grubhub Inc. common stock	(200)	—
Proceeds from refranchising of restaurants	445	716
Other, net	(9)	1
Net Cash Provided by Investing Activities	89	489
Cash Flows – Financing Activities		
Proceeds from long-term debt	106	1,088
Repayments of long-term debt	(462)	(372)
Revolving credit facilities, three months or less, net	273	35
Short-term borrowings by original maturity		
More than three months - proceeds	59	—
More than three months - payments	(59)	—
Three months or less, net	—	—
Repurchase shares of Common Stock	(1,684)	(1,348)
Dividends paid on Common Stock	(349)	(315)
Debt issuance costs	—	(32)
Other, net	(45)	(85)
Net Cash Used in Financing Activities	(2,161)	(1,029)
Effect of Exchange Rates on Cash and Cash Equivalents	(55)	42
Net Increase (Decrease) in Cash and Cash Equivalents, Restricted Cash and Restricted Cash Equivalents	(1,331)	220
Cash, Cash Equivalents, Restricted Cash and Restricted Cash Equivalents - Beginning of Period	1,668	831
Cash, Cash Equivalents, Restricted Cash and Restricted Cash Equivalents - End of Period	$ 337	$ 1,051

See accompanying Notes to Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED BALANCE SHEETS
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions)

	(Unaudited) 9/30/2018	12/31/2017
ASSETS		
Current Assets		
Cash and cash equivalents	$ 198	$ 1,522
Accounts and notes receivable, net	528	400
Prepaid expenses and other current assets	443	384
Advertising cooperative assets, restricted	—	201
Total Current Assets	1,169	2,507
Property, plant and equipment, net	1,378	1,697
Goodwill	489	512
Intangible assets, net	84	110
Other assets	886	346
Deferred income taxes	149	139
Total Assets	$ 4,155	$ 5,311
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current Liabilities		
Accounts payable and other current liabilities	$ 885	$ 813
Income taxes payable	14	123
Short-term borrowings	295	375
Advertising cooperative liabilities	—	201
Total Current Liabilities	1,194	1,512
Long-term debt	9,405	9,429
Other liabilities and deferred credits	1,014	704
Total Liabilities	11,613	11,645
Shareholders' Deficit		
Common Stock, no par value, 750 shares authorized; 313 and 332 shares issued in 2018 and 2017, respectively	—	—
Accumulated deficit	(7,141)	(6,063)
Accumulated other comprehensive loss	(317)	(271)
Total Shareholders' Deficit	(7,458)	(6,334)
Total Liabilities and Shareholders' Deficit	$ 4,155	$ 5,311

See accompanying Notes to Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Tabular amounts in millions, except per share data)

Note 1 - Financial Statement Presentation

We have prepared our accompanying unaudited Condensed Consolidated Financial Statements ("Financial Statements") in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, they do not include all of the information and footnotes required by Generally Accepted Accounting Principles in the United States ("GAAP") for complete financial statements. Therefore, we suggest that the accompanying Financial Statements be read in conjunction with the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 ("2017 Form 10-K").

YUM! Brands, Inc. and its Subsidiaries (collectively referred to herein as "YUM" or the "Company") comprise the worldwide operations of KFC, Pizza Hut and Taco Bell (collectively the "Concepts"). YUM has over 45,000 units in more than 140 countries and territories, of which 61% are located outside the U.S. YUM was created as an independent, publicly-owned company on October 6, 1997 via a tax-free distribution by our former parent, PepsiCo, Inc., of our Common Stock to its shareholders. References to YUM throughout these Financial Statements are made using the first person notations of "we," "us" or "our."

As of September 30, 2018, YUM consisted of three operating segments:

- The KFC Division which includes our worldwide operations of the KFC concept
- The Pizza Hut Division which includes our worldwide operations of the Pizza Hut concept
- The Taco Bell Division which includes our worldwide operations of the Taco Bell concept

YUM's fiscal year begins on January 1 and ends December 31 of each year, with each quarter comprised of three months. Our U.S. subsidiaries and certain international subsidiaries operate on a weekly periodic calendar where the first three quarters of each fiscal year consists of 12 weeks and the fourth quarter consists of 16 weeks in fiscal years with 52 weeks and 17 weeks in fiscal years with 53 weeks. Our remaining international subsidiaries operate on a monthly calendar similar to that on which YUM operates.

Our preparation of the accompanying Financial Statements in conformity with 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.

The accompanying Financial Statements include all normal and recurring adjustments considered necessary to present fairly, when read in conjunction with our 2017 Form 10-K, our financial position as of September 30, 2018, our cash flows for the years to date ended September 30, 2018 and 2017 and the results of our operations and comprehensive income for the quarters and years to date ended September 30, 2018 and 2017. Our results of operations, comprehensive income and cash flows for these interim periods are not necessarily indicative of the results to be expected for the full year.

Our significant interim accounting policies include the recognition of advertising and marketing costs, generally in proportion to revenue, and the recognition of income taxes using an estimated annual effective tax rate.

In January 2016, the Financial Accounting Standards Board ("FASB") issued a standard that updates certain aspects of recognition, measurement, presentation and disclosure of financial instruments. We adopted this standard beginning with the quarter ended March 31, 2018. While the adoption of this standard did not have a material impact on our

Financial Statements the standard requires our investment in Grubhub Inc. ("Grubhub") common stock, which was consummated in April 2018 (see Note 5), to be remeasured to fair value in each future reporting period with corresponding changes recorded in our Condensed Consolidated Statement of Income.

In October 2016, the FASB issued a standard that requires the recognition of the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. As required, we adopted this standard in the quarter ended March 31, 2018 and have recorded a cumulative adjustment to beginning retained earnings to write-off the unamortized tax consequences of certain historical intra-entity transfers of assets. As a result, we recognized a reduction in Other assets of $30 million with an offsetting increase to our Accumulated deficit.

In August 2017, the FASB issued a standard that refines and expands existing hedge accounting guidance. We adopted this standard beginning with the quarter ended March 31, 2018. The adoption of this standard did not have a material impact on the Financial Statements.

In February 2018, the FASB issued a standard that allows a reclassification to retained earnings for tax effects that were stranded within accumulated other comprehensive (income) loss ("AOCI") subsequent to the accounting in the fourth quarter of 2017 necessary as a result of the enactment of the Tax Cuts and Jobs Act of 2017. We adopted this standard during the quarter ended March 31, 2018 and reclassified stranded tax effects of $19 million from AOCI with a corresponding decrease to Accumulated deficit at the beginning of our first quarter 2018. These stranded tax effects primarily related to the remeasurement of deferred tax assets associated with pension losses within AOCI. The Company's policy is to follow the specific identification approach for releasing stranded tax effects from AOCI.

From 2014 through 2017 the FASB issued standards to provide principles within a single framework for revenue recognition of transactions involving contracts with customers across all industries ("Topic 606"). We adopted these standards beginning with the quarter ended March 31, 2018, using the modified retrospective method. See Notes 2 and 5.

We have reclassified certain other items in the Financial Statements for the prior periods to be comparable with the classification for the quarter and year to date ended September 30, 2018. These reclassifications had no effect on previously reported Net Income.

Note 2 - Revenue Recognition Accounting Policy

We adopted Topic 606 at the beginning of the quarter ended March 31, 2018. Below is a discussion of how our revenues are earned, our accounting policies pertaining to revenue recognition prior to the adoption of Topic 606 ("Legacy GAAP"), our accounting policies pertaining to revenue recognition subsequent to the adoption of Topic 606 and other required disclosures. Refer to Note 5 for information regarding the cumulative effect adjustment recorded to Accumulated deficit as of the beginning of the quarter ended March 31, 2018 to reflect the adoption of Topic 606. Also included in Note 5 is disclosure of the amount by which each balance sheet and income statement line item was impacted in the current reporting periods as compared to Legacy GAAP.

<u>Company Sales</u>

Revenues from the sale of food items by Company-owned restaurants are recognized as Company sales when a customer purchases the food, which is when our obligation to perform is satisfied. The timing and amount of revenue recognized related to Company sales was not impacted by the adoption of Topic 606.

<u>Franchise and Property Revenues</u>

Franchise Revenues

Our most significant source of revenues arises from the operation of our Concept stores by our franchisees. Franchise rights may be granted through a store-level franchise agreement or through a master franchise agreement. Our franchise agreements require that the franchisee remit continuing fees to us as a percentage of the applicable restaurant’s sales in exchange for the license of the intellectual property associated with our Concepts' brands (the “franchise right”). Our franchise agreements also typically require certain, less significant, upfront franchise fees such as initial fees paid upon opening of a store, fees paid to renew the term of the franchise right and fees paid in the event the franchise agreement is transferred to another franchisee.

Continuing fees represent the substantial majority of the consideration we receive under our franchise agreements. Continuing fees are typically billed and paid monthly and are usually 4%-6% for store-level franchise agreements. Master franchise agreements transfer exclusive master franchise rights and administrative obligations, including control of advertising contributions, to master franchisees in certain regions who in turn grant sub-franchising rights to sub-franchisees. As a result of transferring administrative obligations to a master franchisee the percentage of a master franchisee's restaurants' sales that we receive as a continuing fee (typically 3%) is less than the percentage we receive for restaurants operating under a store-level franchise agreement. Upfront franchise fees are typically billed and paid when a new franchise or sub-franchise agreement becomes effective or when an existing agreement is transferred to another franchisee or sub-franchisee.

Under Legacy GAAP, continuing fees were recognized as the related sales occurred. The timing and amount of revenue recognized related to continuing fees was not impacted by the adoption of Topic 606 based on the application of the sales-based royalty exception within Topic 606. Under Legacy GAAP, revenue related to initial fees was recognized upon store opening and renewal and transfer fees were recognized when the related agreement became effective. Upon the adoption of Topic 606, we have determined that the services we provide in exchange for these upfront franchise fees are highly interrelated with the franchise right and are not individually distinct from the ongoing services we provide to our franchisees. As a result, upon the adoption of Topic 606, upfront franchise fees are recognized as revenue over the term of each respective franchise or sub-franchise agreement. Revenues for these upfront franchise fees are recognized on a straight-line basis, which is consistent with the franchisee’s or sub-franchisee's right to use and benefit from the intellectual property. Revenues from continuing fees and upfront franchise fees is presented within Franchise and property revenues in our Condensed Consolidated Statements of Income.

Additionally, from time-to-time we provide non-refundable consideration to franchisees in the form of cash or other incentives (e.g. cash payments to incent new unit openings, free or subsidized equipment, etc.). The Company’s intent in providing such consideration is to drive new unit development or same-store sales growth that will result in higher future revenues for the Company. Under Legacy GAAP, these payments were recognized when we were obligated to make the payment and were presented as either a reduction to Franchise and property revenues, if cash was provided directly to the franchisee, or as Franchise and property expenses, if cash was not provided directly to the franchisee. Due to the adoption of Topic 606, such payments are capitalized and presented within Prepaid expense and other current assets or Other assets. These capitalized balances are being amortized as a reduction in Franchise and property revenues over the period of expected cash flows from the franchise agreements to which the payment relates.

Property Revenues

From time to time, we enter into rental agreements with franchisees for the lease or sublease of restaurant locations. These rental agreements typically originate from refranchising transactions and revenues related to the agreements are recognized as they are earned. Amounts owed under the rental agreements are typically billed and paid on a monthly basis. Revenues from rental agreements with franchisees are presented within Franchise and property revenues within our Condensed Consolidated Statements of Income. Related expenses are presented as Franchise and property expenses within our Condensed Consolidated Statements of Income and primarily include depreciation or, in the case of a sublease, rental expense. The timing and amount of revenue and expenses recognized related to the rental of restaurants we lease or sublease was not impacted by the adoption of Topic 606.

<u>Franchise Contributions for Advertising and Other Services</u>

Advertising Cooperatives

We participate in various advertising cooperatives with our franchisees, typically within a country where we have both Company-owned restaurants and franchise restaurants. These advertising cooperatives are established to collect and administer funds contributed for use in advertising and promotional programs designed to increase sales and enhance the reputation of the Company and its franchise owners. Contributions to the advertising cooperatives are required for both Company-owned and franchise restaurants and are generally based on a percentage of restaurant sales. Revenues for these services are typically billed and paid on a monthly basis. We are required to spend all funds collected by advertising cooperatives we consolidate on advertising and promotional programs. Under Legacy GAAP, receipts and expenditures related to advertising cooperatives we were required to consolidate were presented on a net basis in our Condensed Consolidated Statements of Income. In accordance with the provisions of Topic 606, we have determined we act as a principal in the transactions entered into by the advertising cooperatives we are required to consolidate based on our responsibility to define the nature of the goods or services provided and/or our responsibility to define which franchisees receive the benefit of the goods or services. Additionally, we have determined the advertising services provided to franchisees are highly interrelated with the franchise right and therefore not distinct. Franchisees remit to us a percentage of restaurant sales as consideration for providing the advertising services. As a result, revenues for advertising services are recognized when the related sales occur based on the application of the sales-based royalty exception within Topic 606. These revenues are presented as Franchise contributions for advertising and other services. Expenses incurred to provide these services are presented as Franchise advertising and other services expense.

Other Services

On a much more limited basis, we provide goods or services to certain franchisees that are individually distinct from the franchise right because they do not require integration with other goods or services we provide. Such arrangements typically relate to supply chain, quality assurance and information technology services. In instances where we rely on third parties to provide goods or services to franchisees at our direction, we have determined we act as a principal in these transactions. The extent to which we provide such goods or services varies by brand, geographic region and, in some instances, franchisee. Similar to advertising services, receipts and expenditures related to these other services were presented on a net basis under Legacy GAAP. Upon adoption of Topic 606, revenues from the goods or services described above are presented as Franchise contributions for advertising and other services within our Condensed Consolidated Statements of Income. Expenses related to the provisioning of these goods and services are recorded in Franchise advertising and other services expense. These revenues are recognized as the goods or services are transferred to the franchisee and related expenses are recognized as incurred.

Taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue transaction and collected from a customer are excluded from revenue under both Legacy GAAP and Topic 606.

Disaggregation of Total Revenues

The following table disaggregates revenue by Concept, for our two most significant markets based on Operating Profit and for all other markets. We believe this disaggregation best reflects the extent to which the nature, amount, timing and uncertainty of our revenues and cash flows are impacted by economic factors.

	Quarter ended 9/30/2018			
	KFC Division	Pizza Hut Division	Taco Bell Division	Total
U.S.				
Company sales	$ 17	$ 6	$ 265	$288
Franchise and property revenues	46	66	136	248
Franchise contributions for advertising and other services	3	62	105	170
China				
Franchise and property revenues	52	16	—	68
Other				
Company sales	204	7	—	211
Franchise and property revenues	222	61	6	289
Franchise contributions for advertising and other services	105	11	1	117
	$ 649	$ 229	$ 513	$1,391

	Year to date ended 9/30/2018			
	KFC Division	Pizza Hut Division	Taco Bell Division	Total
U.S.				
Company sales	$ 50	$ 31	$ 759	$840
Franchise and property revenues	135	200	387	722
Franchise contributions for advertising and other services	7	187	293	487
China				
Franchise and property revenues	155	47	—	202
Other				
Company sales	657	24	2	683
Franchise and property revenues	647	185	17	849
Franchise contributions for advertising and other services	307	39	1	347
	$ 1,958	$ 713	1,459	$4,130

Contract Liabilities

Our contract liabilities are comprised of unamortized upfront fees received from franchisees. A summary of significant changes to the contract liability balance during 2018 is presented below.

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	Deferred Franchise Fees
Balance at January 1, 2018	$ 392
Revenue recognized that was included in unamortized upfront fees received from franchisees at the beginning of the period	(47)
Increase for upfront fees associated with contracts that became effective during the period, net of amounts recognized as revenue during the period	61
Other[(a)]	(11)
Balance at September 30, 2018	$ 395

(a) Includes impact of foreign currency translation as well as the recognition of deferred franchise fees into Refranchising (gain) loss upon the modification of existing franchise agreements when entering into master franchise agreements.

We expect to recognize contract liabilities as revenue over the remaining term of the associated franchise agreement as follows:

Less than 1 year	$58
1 - 2 years	53
2 - 3 years	49
3 - 4 years	45
4 - 5 years	40
Thereafter	150
Total	$395

We have applied the optional exemption, as provided for under Topic 606, which allows us to not disclose the transaction price allocated to unsatisfied performance obligations when the transaction price is a sales-based royalty.

Note 3 - Earnings Per Common Share (“EPS”)

	Quarter ended		Year to date	
	2018	2017	2018	2017
Net Income	$454	$418	$1,208	$904
Weighted-average common shares outstanding (for basic calculation)	318	345	325	351
Effect of dilutive share-based employee compensation	7	8	7	7
Weighted-average common and dilutive potential common shares outstanding (for diluted calculation)	325	353	332	358
Basic EPS	$1.43	$1.21	$3.72	$2.58
Diluted EPS	$1.40	$1.18	$3.64	$2.52
Unexercised employee stock options and stock appreciation rights (in millions) excluded from the diluted EPS computation[(a)]	2.2	1.9	1.9	2.3

(a)

These unexercised employee stock options and stock appreciation rights were not included in the computation of diluted EPS because to do so would have been antidilutive for the periods presented.

Note 4 - Shareholders' Deficit

Under the authority of our Board of Directors, we repurchased shares of our Common Stock during the years to date ended September 30, 2018 and 2017 as indicated below. All amounts exclude applicable transaction fees.

	Shares Repurchased (thousands)		Dollar Value of Shares Repurchased		Remaining Dollar Value of Shares that may be Repurchased
	2018	2017	2018	2017	2018
November 2016 Authorization	—	19,110	$—	$1,327	$ —
November 2017 Authorization	18,240	—	1,500	—	—
August 2018 Authorization	2,244	—	198	—	1,802
Total	20,484 (a)	19,110 (b)	$1,698 (a)	$1,327 (b)	$ 1,802

(a) Includes the effect of $14 million in share repurchases (0.2 million shares) with trade dates prior to September 30, 2018, but cash settlement dates subsequent to September 30, 2018.

(b) Includes the effect of $24 million in share repurchases (0.3 million shares) with trade dates on, or prior to, September 30, 2017, but cash settlement dates subsequent to September 30, 2017 and excludes the effect of $45 million in share purchases (0.7 million shares) with trades dates prior to December 31, 2016, but cash settlement dates subsequent to December 31, 2016.

On August 10, 2018 our Board of Directors authorized share repurchases through December 2019 of up to $2 billion (excluding applicable transaction fees) of our outstanding Common Stock.

Changes in AOCI are presented below.

	Translation Adjustments and Gains (Losses) From Intra-Entity Transactions of a Long-Term Nature	Pension and Post-Retirement Benefits	Derivative Instruments	Total
Balance at December 31, 2017, net of tax	$ (174)	$ (106)	$ 9	$(271)
Adoption of accounting standards	21 (a)	(17) (b)	(2) (b)	2
OCI, net of tax				
Gains (losses) arising during the period classified into AOCI, net of tax	(72)	1	35	(36)
(Gains) losses reclassified from AOCI, net of tax	(4)	12	(20)	(12)
	(76)	13	15	(48)
Balance at September 30, 2018, net of tax	$ (229)	$ (110)	$ 22	$(317)

(a) Represents the impact of foreign currency translation from the adoption of Topic 606. See Notes 2 and 5.

(b) During the quarter ended March 31, 2018, we adopted a standard that allows for the reclassification from AOCI to Accumulated deficit for stranded tax effects resulting from the Tax Act. See Note 1.

Note 5 - Items Affecting Comparability of Net Income, Financial Position and Cash Flows

Refranchising (Gain) Loss

The Refranchising (gain) loss by reportable segment is presented below. Given the size and volatility of refranchising initiatives, our chief operating decision maker ("CODM") does not consider the impact of Refranchising (gain) loss when assessing segment performance. As such, we do not allocate such gains and losses to our segments for performance reporting purposes.

During the quarter and year to date ended September 30, 2018, we refranchised 134 restaurants and 329 restaurants, respectively, and received $193 million and $445 million, respectively, in pre-tax proceeds. During the quarter and year to date ended September 30, 2017, we refranchised 209 restaurants and 574 restaurants, respectively, and received $395 million and $716 million, respectively, in pre-tax proceeds.

A summary of Refranchising (gain) loss is as follows:

	Quarter ended		Year to date	
	2018	2017	2018	2017
KFC Division	$(29)	$(50)	$(128)	$(8)
Pizza Hut Division	3	27	14	40
Taco Bell Division	(74)	(178)	(171)	(363)
Worldwide	$(100)	$(201)	$(285)	$(331)

KFC U.S. Acceleration Agreement

During 2015, we reached an agreement with our KFC U.S. franchisees that gave us brand marketing control as well as an accelerated path to expanded menu offerings, improved assets and enhanced customer experience. In connection with this agreement we are investing approximately $130 million from 2015 through 2019 primarily to fund new back-of-house equipment for franchisees and to provide incentives to accelerate franchisee store remodels. Under Legacy GAAP these amounts were expensed as incurred including $4 million and $12 million during the quarter and year to date ended September 30, 2017, respectively. We recorded total pre-tax charges for such amounts of $115 million, primarily as Franchise and property expenses, during the three year period ended December 31, 2017. Due to their size and unique and long-term brand building nature, as well as their non-recurring impact on KFC Division's results when expensed upfront, our CODM did not consider the impact of these investments when assessing segment performance from 2015 through 2017. As such, prior to 2018 the investments were not allocated to the KFC Division segment operating results for performance reporting purposes.

Upon adoption of Topic 606 in 2018, approximately $100 million of these incentives paid to franchisees from 2015 through 2017 were capitalized, which was net of amortization of $19 million. These capitalized amounts are now being amortized as a reduction to Franchise and property revenues over the period of expected cash flows from the franchise agreements to which the payment relates. Amortization related to both franchise incentive payments that were capitalized upon the adoption of Topic 606 and franchise incentive payments that will be capitalized going forward will be allocated to KFC segment operating results as the expense is recurring and is not expected to significantly impact the comparability of results in any given period. During the quarter and year to date ended September 30, 2018, we recorded a reduction to KFC Division Franchise and property revenues related to the amortization of these franchise incentive payments of $2 million and $7 million, respectively.

In addition to the investments above, we agreed to fund $60 million of incremental system advertising from 2015 through 2018. During the quarters ended September 30, 2018 and 2017, we incurred $2 million and $5 million, respectively, in incremental system advertising expense. During the years to date ended September 30, 2018 and 2017, we incurred $7 million and $14 million, respectively, in incremental system advertising expense. We funded approximately $50 million of such advertising during the three year period ended December 31, 2017, which included $20 million during 2017. We currently expect to fund approximately $10 million in 2018. These advertising amounts were recorded primarily in Franchise and property expenses and have been and continue to be included in the KFC Division segment operating results.

YUM's Strategic Transformation Initiatives

In October 2016, we announced our strategic transformation plans to drive global expansion of the KFC, Pizza Hut and Taco Bell brands ("YUM's Strategic Transformation Initiatives") following the then anticipated separation of our China business on October 31, 2016. Major features of the Company’s strategic transformation plans involve being more focused on the development of our three brands, increasing our franchise ownership and creating a leaner, more efficient cost structure. During the quarters ended September 30, 2018 and 2017, we recognized pre-tax charges of $1 million and $4 million, respectively, primarily within G&A, related to these initiatives. During the years to date ended September 30, 2018 and 2017, we recognized pre-tax charges of $2 million and $15 million, respectively, primarily within G&A, related to these initiatives. These costs primarily related to severance and relocation costs. Due to the scope of the initiatives as well as the significance of YUM's Strategic Transformation Initiatives program, our CODM does not consider the impact of these initiatives when assessing segment performance. As such, costs associated with the initiatives are not being allocated to any segment for performance reporting purposes.

Pizza Hut U.S. Transformation Agreement

In May 2017, we reached an agreement with Pizza Hut U.S. franchisees that will improve brand marketing alignment, accelerate enhancements in operations and technology and that includes a permanent commitment to incremental advertising as well as digital and technology contributions by franchisees (the “Transformation Agreement”). In connection with the Transformation Agreement we anticipate investing approximately $90 million to upgrade restaurant equipment to improve operations, fund improvements in restaurant technology and enhance digital and e-commerce capabilities. We currently expect the majority of this investment, which will be a mix of both capital and operating investments, to be split between 2017 and 2018.

We invested $39 million related to the Transformation Agreement in 2017, which included $8 million of investments that we capitalized and $31 million that was expensed primarily as Franchise and property expenses or G&A. The $31 million expense amount included $5 million of franchisee incentive payments that under Legacy GAAP were expensed as incurred, but that upon adoption of Topic 606 in 2018 were capitalized. In 2018, both amounts capitalized upon adoption of Topic 606 and franchisee incentive payments capitalized thereafter are being amortized as a reduction to Franchise and property revenues over the period of expected cash flows from the franchise agreements to which the payments relate.

We have invested $5 million and $16 million in the quarter and year to date, respectively, related to the Transformation Agreement, primarily consisting of capital investments and franchisee incentive payments that were capitalized.

Due to their unique and long-term brand-building nature as well as their non-recurring impact on Pizza Hut’s Division results, the financial impact of operating investments that are part of the Transformation Agreement are not being considered by our CODM when assessing segment performance in 2017 or 2018. As such, these operating investments were not allocated to the Pizza Hut Division operating segment results for performance reporting purposes. Depreciation on capital investments made as part of the Transformation Agreement is being allocated to Pizza Hut segment results as the expense is recurring and is not expected to significantly impact the comparability of results in any given period. For the same reasons, the amortization related to franchisee incentive payments that were capitalized upon the adoption of Topic 606 and amortization related to franchisee incentive payments that are being capitalized going forward are being allocated to Pizza Hut Division operating segment results starting in 2018.

In addition to the investments above, we agreed to fund $37.5 million of incremental system advertising dollars from the second half of 2017 through 2018. During the quarter and year to date ended September 30, 2018, we incurred $4 million and $9 million, respectively, in related incremental system advertising expense. We funded approximately $25 million of such advertising during 2017, which was expensed in the third and fourth quarters of 2017. We currently expect to fund approximately $12.5 million in 2018. These advertising amounts have been and will continue to be recorded primarily in Franchise and property expenses and are included in Pizza Hut's segment operating results.

Modifications of Share-based Compensation Awards

In connection with the separation of our business in China, we modified certain share-based compensation awards held as part of our Executive Income Deferral ("EID") Plan in phantom shares of YUM Common Stock to provide one phantom Yum China share-based award for each outstanding phantom YUM share-based award. Through October 31, 2018, these Yum China awards could be settled in cash, as opposed to stock, which required recognition of the fair value of these awards within G&A in our Condensed Consolidated Income Statement. During the quarter and year to date ended September 30, 2018 we recorded pre-tax credits related to these awards of $2 million and $3 million, respectively, due to depreciation in the market price of Yum China's common stock. During the quarter and year to date ended September 30, 2017, we recorded pre-tax charges related to these awards of less than $1 million and $18 million, respectively, due to appreciation in the market price of Yum China common stock. Given these adjustments were a direct result of the separation, our CODM did not consider their impact when assessing segment performance. As such, these amounts were not allocated to any of our segment operating results.

Subsequent to the quarter end, on October 31, 2018, deferrals in phantom shares of Yum China common stock are no longer an investment option within our EID Plan and any balances relating to these shares were moved to another available EID Plan investment option as selected by the participants. Amounts directed into cash or phantom shares of a Stock Index Fund or a Bond Index Fund will remain classified as a liability and any appreciation or depreciation in these investments from the transfer date forward will be recognized as compensation expense and included in our segment operating results consistent with existing investments in these funds. Any balances directed into phantom shares of YUM Common Stock will be reclassified to Common Stock on our Consolidated Balance Sheet. We do not recognize compensation expense for the appreciation or depreciation, if any, of investments in phantom shares of our Common Stock.

Impact of Adopting New Revenue Recognition Standards

As discussed in Note 1, we adopted Topic 606 beginning with the quarter ended March 31, 2018, using the modified retrospective method. Topic 606 was applied to all contracts with customers as of January 1, 2018 and the cumulative effective of this transition was recorded as an adjustment to Accumulated deficit as of this date. As a result, the following adjustments were made to the Condensed Consolidated Balance Sheet as of January 1, 2018:

CONDENSED CONSOLIDATED BALANCE SHEET

	As Reported 12/31/2017	Adjustments	Balances with Adoption of Topic 606 1/1/2018
ASSETS			
Current Assets			
Cash and cash equivalents	$ 1,522	$ 11	$ 1,533
Accounts and notes receivable, net	400	112	512
Prepaid expenses and other current assets	384	76 [a]	460
Advertising cooperative assets, restricted	201	(201)	—
Total Current Assets	2,507	(2)	2,505
Property, plant and equipment, net	1,697	11	1,708
Goodwill	512	—	512
Intangible assets, net	110	—	110
Other assets	346	118	464
Deferred income taxes	139	26	165
Total Assets	$ 5,311	$ 153	$ 5,464
LIABILITIES AND SHAREHOLDERS' DEFICIT			
Current Liabilities			
Accounts payable and other current liabilities	$ 813	$ 220	$ 1,033
Income taxes payable	123	—	123
Short-term borrowings	375	—	375
Advertising cooperative liabilities	201	(201)	—
Total Current Liabilities	1,512	19	1,531
Long-term debt	9,429	—	9,429
Other liabilities and deferred credits	704	353	1,057
Total Liabilities	11,645	372	12,017
Shareholders' Deficit			
Accumulated deficit	(6,063)	(240)	(6,303)
Accumulated other comprehensive loss	(271)	21	(250)
Total Shareholders' Deficit	(6,334)	(219)	(6,553)
Total Liabilities and Shareholders' Deficit	$ 5,311	$ 153	$ 5,464

(a) Includes $58 million of restricted cash related to advertising cooperatives. These balances can only be used to settle obligations of the respective cooperatives.

We recorded an increase in Accounts payable and other current liabilities and Other liabilities and deferred credits of $57 million and $335 million, respectively, as part of our cumulative adjustment related to unamortized upfront franchise fees, with a corresponding $392 million increase in Accumulated deficit. We recorded increases in Prepaid expenses and other current assets and Other assets of $18 million and $118 million, respectively, as part of our cumulative adjustment related to unamortized franchise incentives, with a corresponding $136 million decrease in Accumulated deficit.

Deferred income taxes increased $26 million as a result of recording the tax effects of the two adjustments noted above, with a corresponding decrease to Accumulated deficit. Accumulated other comprehensive loss decreased $21 million as a result of recognizing the impact of foreign currency translation related to the three adjustments noted above, with a corresponding increase in Accumulated deficit.

The remaining adjustments to our December 31, 2017 Condensed Consolidated Balance Sheet are primarily a result of reclassifying the assets and liabilities of our consolidated advertising cooperates from Advertising cooperative assets, restricted and Advertising cooperative liabilities to the respective balance sheet caption to which the assets and liabilities relate.

The following tables reflect the impact of the adoption of Topic 606 on our Condensed Consolidated Statement of Income for the quarter and year to date ended September 30, 2018 and our Condensed Consolidated Balance Sheet as of September 30, 2018.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Quarter ended 9/30/2018		
Revenues	As Reported	Impact	Balances under Legacy GAAP
Company sales	$499	$—	$ 499
Franchise and property revenues	605	11	616
Franchise contributions for advertising and other services	287	(287)	—
Total revenues	1,391	(276)	1,115
Costs and Expenses, Net			
Company restaurant expenses	399	—	399
General and administrative expenses	204	—	204
Franchise and property expenses	40	10	50
Franchise advertising and other services expense	288	(288)	—
Refranchising (gain) loss	(100)	—	(100)
Other (income) expense	7	—	7
Total costs and expenses, net	838	(278)	560
Operating Profit	553	2 (a)	555
Investment (income) expense, net	(96)	—	(96)
Other pension (income) expense	4	—	4
Interest expense, net	111	—	111
Income before income taxes	534	2	536
Income tax provision (benefit)	80	(2)	78
Net Income	$454	$4	$ 458
Basic Earnings Per Common Share	$1.43	$0.01	$ 1.44
Diluted Earnings Per Common Share	$1.40	$0.01	$ 1.41

	Year to date ended 9/30/2018		
Revenues	As Reported	Impact	Balances under Legacy GAAP
Company sales	$1,523	$—	$1,523
Franchise and property revenues	1,773	23	1,796
Franchise contributions for advertising and other services	834	(834)	—
Total revenues	4,130	(811)	3,319
Costs and Expenses, Net			
Company restaurant expenses	1,258	—	1,258
General and administrative expenses	631	—	631
Franchise and property expenses	127	21	148
Franchise advertising and other services expense	834	(834)	—
Refranchising (gain) loss	(285)	4	(281)
Other (income) expense	10	—	10
Total costs and expenses, net	2,575	(809)	1,766
Operating Profit	1,555	(2) (a)	1,553
Investment (income) expense, net	(185)	—	(185)
Other pension (income) expense	10	—	10
Interest expense, net	330	—	330
Income before income taxes	1,400	(2)	1,398
Income tax provision (benefit)	192	(3)	189
Net Income	$1,208	$1	$1,209
Basic Earnings Per Common Share	$3.72	$0.01	$3.73
Diluted Earnings Per Common Share	$3.64	$—	$3.64

(a) Includes $2 million and $11 million of franchise incentive payments related to the KFC U.S. Acceleration Agreement or the Pizza Hut U.S. Transformation Agreement that would have been expensed immediately and that we would not have allocated to the KFC Division or the Pizza Hut Division under Legacy GAAP for the quarter and year to date ended September 30, 2018, respectively. Upon the adoption of Topic 606, these payments have been capitalized as assets.

Upon the adoption of Topic 606, the timing and amount of revenue recognized for upfront franchise fees and franchise incentives changed from upfront recognition under Legacy GAAP to recognition over the term of the franchise agreement to which the fees and incentives relate. Also, under Legacy GAAP, amounts reported as Franchise contributions for advertising and other services and Franchise advertising and other services expense were presented on a net basis. Upon the adoption of Topic 606, these amounts require gross presentation in our Condensed Consolidated Statements of Income. Lastly, Legacy GAAP required that certain value-added taxes withheld and remitted on our behalf by our franchisees be reported as revenue and corresponding expense in our Condensed Consolidated Statements of Income. Upon adoption of Topic 606, these taxes are reported on a net basis as a reduction in Franchise and property revenues.

CONDENSED CONSOLIDATED BALANCE SHEET

	As Reported 9/30/2018	Impact	Balances under Legacy GAAP 9/30/2018
ASSETS			
Current Assets			
Cash and cash equivalents	$ 198	$ (22)	$ 176
Accounts and notes receivable, net	528	(101)	427
Prepaid expenses and other current assets	443	(71)	372
Advertising cooperative assets, restricted	—	197	197
Total Current Assets	1,169	3	1,172
Property, plant and equipment, net	1,378	(19)	1,359
Goodwill	489	—	489
Intangible assets, net	84	—	84
Other assets	886	(117)	769
Deferred income taxes	149	(25)	124
Total Assets	$ 4,155	$ (158)	$ 3,997
LIABILITIES AND SHAREHOLDERS' DEFICIT			
Current Liabilities			
Accounts payable and other current liabilities	$ 885	$ (239)	$ 646
Income taxes payable	14	—	14
Short-term borrowings	295	—	295
Advertising cooperative liabilities	—	197	197
Total Current Liabilities	1,194	(42)	1,152
Long-term debt	9,405	—	9,405
Other liabilities and deferred credits	1,014	(337)	677
Total Liabilities	11,613	(379)	11,234
Shareholders' Deficit			
Accumulated deficit	(7,141)	241	(6,900)
Accumulated other comprehensive loss	(317)	(20)	(337)
Total Shareholders' Deficit	(7,458)	221	(7,237)
Total Liabilities and Shareholders' Deficit	$ 4,155	$ (158)	$ 3,997

The significant impacts resulting from the adoption of Topic 606 on our Condensed Consolidated Balance Sheet as of September 30, 2018, are consistent with those recorded as of January 1, 2018 as described previously.

Under Legacy GAAP, Cash, Cash Equivalents, Restricted Cash, and Restricted Cash Equivalents pertaining to advertising cooperatives that we were required to consolidate were classified within Advertising cooperative assets, restricted. Upon adoption of Topic 606, these amounts are reflected on our Condensed Consolidated Balance Sheet and changes in these balances are reported within our Condensed Consolidated Statement of Cash Flows.

<u>Investment in Grubhub</u>

On February 7, 2018, certain of our subsidiaries entered into a master services agreement with a subsidiary of Grubhub, the leading online and mobile takeout food-ordering company in the U.S., which is intended to provide dedicated support for the KFC and Taco Bell branded online delivery channels in the U.S. through Grubhub’s online ordering platform, logistics and last-mile support for delivery orders, as well as point-of-sale integration to streamline operations. Concurrently with the master services agreement, one of our subsidiaries entered into an investment agreement with Grubhub to invest $200 million in exchange for approximately 2.8 million shares of Grubhub common stock. In April 2018, all necessary regulatory approvals were obtained and the purchase of Grubhub shares was consummated. Shares acquired as part of this purchase are restricted from being transferred until the earlier of the two-year anniversary of closing the investment agreement or 30 days following the termination of our master services agreement with Grubhub. In the quarter and year to date ended September 30, 2018 we recognized pre-tax income of $94 million and $185 million, respectively, which includes the appreciation in the market price of Grubhub common stock less valuation adjustments related to the transfer restrictions. Changes in the fair value of our investment in Grubhub common stock are presented as Investment (income) expense, net within our Condensed Consolidated Statements of Income.

Non-cash Pension Adjustment

During the first quarter of 2017, as a result of the completion of a pension data review and reconciliation, we recorded a non-cash, out-of-year charge of $22 million to Other pension (income) expense to adjust our historical U.S. pension liability related to our deferred vested participants. Our CODM did not consider the impact of this charge when assessing segment performance given the number of years over which it accumulated. As such, this cost was not allocated to any of our segment operating results for performance reporting purposes.

Note 6 - Other (Income) Expense

Other (income) expense primarily includes net foreign exchange (gains) losses and store closure and impairment expenses.

Note 7 - Supplemental Balance Sheet Information

Accounts and Notes Receivable, net

The Company's receivables are primarily generated as a result of ongoing business relationships with our franchisees as a result of franchise and lease agreements. Trade receivables consisting of royalties from franchisees are generally due within 30 days of the period in which the corresponding sales occur and are classified as Accounts and notes receivable, net in our Condensed Consolidated Balance Sheets. Upon adoption of Topic 606, Accounts and notes receivable, net also includes receivables generated from advertising cooperatives that we consolidate which were previously recorded in Advertising cooperative assets, restricted.

	9/30/2018	12/31/2017
Accounts and notes receivable, gross	$ 560	$ 419
Allowance for doubtful accounts	(32)	(19)
Accounts and notes receivable, net	$ 528	$ 400

Property, Plant and Equipment, net

	9/30/2018	12/31/2017
Property, plant and equipment, gross	$ 2,669	$ 3,177
Accumulated depreciation and amortization	(1,291)	(1,480)
Property, plant and equipment, net	$ 1,378	$ 1,697

Assets held-for-sale at September 30, 2018 and December 31, 2017 total $129 million and $37 million, respectively, and are included in Prepaid expenses and other current assets in our Condensed Consolidated Balance Sheets. 2018 amounts include assets related to approximately 210 KFC restaurants in Russia, France and the UK and approximately 80 Taco Bell restaurants in the U.S.

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Reconciliation of Cash and cash equivalents for Condensed Consolidated Statements of Cash Flows

	9/30/2018	12/31/2017
Cash and cash equivalents as presented in Condensed Consolidated Balance Sheets	$ 198	$ 1,522
Restricted cash included in Prepaid expenses and other current assets[(a)]	108	60
Restricted cash and restricted cash equivalents included in Other assets[(b)]	31	17
Cash, Cash Equivalents and Restricted Cash as presented in Condensed Consolidated Statements of Cash Flows[(c)]	$ 337	$ 1,599

(a) Restricted cash within Prepaid expenses and other current assets primarily relates to the Taco Bell Securitization interest reserves and cash related to advertising cooperatives that we consolidate which can only be used to settle obligations of the respective cooperatives. As of September 30, 2018, Restricted cash within Prepaid expenses and other current assets also includes $9 million of cash held by an entity that will be refranchised whose assets are classified as held for sale.

(b) Primarily trust accounts related to our self-insurance program and cash balances required, to the extent necessary, to meet statutory minimum net worth requirements for legal entities which enter into U.S. franchise agreements.

(c) Upon adoption of Topic 606 we reclassified $11 million and $58 million, respectively, from Advertising cooperative assets, restricted to Cash and cash equivalents and Prepaid expenses and other current assets. These amounts are included in the Beginning of Period balance of Cash, Cash Equivalents, Restricted Cash and Restricted Cash equivalents in our Condensed Consolidated Statement of Cash Flows for the year to date ended September 30, 2018.

Note 8 - Income Taxes

	Quarter ended		Year to date	
	2018	2017	2018	2017
Income tax provision	$80	$106	$192	$278
Effective tax rate	15.1%	20.2 %	13.7 %	23.5 %

Our third quarter effective tax rate was lower than prior year primarily due to the favorable impact of the reduction in the U.S. federal statutory tax rate, as described below, the favorable impact of the $16 million benefit described below, and lapping the prior year cost of repatriating foreign earnings. This benefit was partially offset by the unfavorable impacts associated with lapping the benefit of loss carryovers recognized due to an international refranchising transaction in the prior year and less in excess tax benefits on share-based compensation recognized than in the prior year.

Our year to date effective tax rate was lower than prior year primarily due to the favorable impact of the reduction in the U.S. federal statutory tax rate, as described below, the favorable impact of the $32 million benefit described below and lapping the prior year cost of repatriating foreign earnings. This benefit was partially offset by less in excess tax benefits on share-based compensation recognized than in the prior year, lapping the benefit of loss carryovers recognized due to an international refranchising transaction in the prior year, and a current year charge related to the correction of an error associated with the tax recorded on a prior year divestiture.

On December 22, 2017, the U.S. government enacted comprehensive Federal tax legislation commonly referred to as the Tax Cuts and Jobs Act of 2017 (the "Tax Act"). The Tax Act significantly modified the U.S. corporate income tax system by, among other things, reducing the federal income tax rate from 35% to 21%, limiting certain deductions, including limiting the deductibility of interest expense to 30% of U.S. earnings before interest, taxes, depreciation and amortization, imposing a mandatory one-time deemed repatriation tax on accumulated foreign earnings and creating a territorial tax system that changes the manner in which future foreign earnings are subject to U.S. tax including the elimination of U.S. federal tax on dividends from foreign subsidiaries, a provision designed to tax global intangible low-taxed income ("GILTI") of foreign subsidiaries and a lower U.S. effective tax rate on certain revenues from sources outside the U.S. On December 22, 2017, the SEC staff issued Staff Accounting Bulletin 118 ("SAB 118") that allows us to record provisional amounts related to the impacts of the Tax Act during a measurement period not to extend beyond one year of the enactment date.

In the fourth quarter of 2017, we recorded a provisional discrete net tax expense associated with the Tax Act of $434 million. In the quarter and year to date ended September 30, 2018, we recorded a provisional benefit of $16 million and $32 million, respectively, as an adjustment to the amounts recorded at December 31, 2017.

As of September 30, 2018, the amounts recorded for the Tax Act remain provisional for the mandatory one-time deemed repatriation tax on accumulated foreign earnings, the remeasurement of deferred taxes, and our reassessment of permanently reinvested earnings, uncertain tax positions and valuation allowances. These estimates may be impacted by further analysis and future clarification and guidance regarding available tax accounting methods and elections, earnings and profits computations, state tax conformity to federal tax changes and the impact of the GILTI provisions. We expect to complete our analysis of the amounts recorded upon enactment of the Tax Act within SAB 118's measurement period of one year.

Companies subject to GILTI have the option to account for the GILTI tax as a period cost if and when incurred, or to recognize deferred taxes for temporary differences including outside basis differences expected to reverse as GILTI. The Company has elected to account for GILTI as a period cost, and therefore is including GILTI in the effective tax rate calculation.

Note 9 - Reportable Operating Segments

We identify our operating segments based on management responsibility. The following tables summarize Revenues and Operating Profit for each of our reportable operating segments:

	Quarter ended		Year to date	
Revenues	2018	2017	2018	2017
KFC Division	$649	$794	$1,958	$2,296
Pizza Hut Division	229	203	713	659
Taco Bell Division	513	442	1,459	1,349
Unallocated	—	(3)	—	(3)
	$1,391	$1,436	$4,130	$4,301

	Quarter ended		Year to date	
Operating Profit	2018	2017	2018	2017
KFC Division	$248	$260	$704	$710
Pizza Hut Division	88	82	257	250
Taco Bell Division	161	147	442	440
Corporate and unallocated G&A expenses[a]	(38)	(45)	(122)	(167)
Unallocated restaurant costs	1	5	2	5
Unallocated Franchise and property revenues[b]	—	(3)	—	(3)
Unallocated Franchise and property expenses[b]	(2)	(5)	(4)	(21)
Unallocated Refranchising gain (loss) (See Note 5)	100	201	285	331
Unallocated Other income (expense)	(5)	1	(9)	1
Operating Profit	$553	$643	$1,555	$1,546
Investment income (expense), net (See Note 5)	96	1	185	3
Other pension income (expense) (See Note 10)	(4)	(10)	(10)	(42)
Interest expense, net	(111)	(110)	(330)	(325)
Income before income taxes	$534	$524	$1,400	$1,182

(a) Includes non-cash adjustments associated with share-based compensation and charges associated with YUM's Strategic Transformation Initiatives. See Note 5.

(b) Represents costs associated with the KFC U.S. Acceleration Agreement and Pizza Hut U.S. Transformation Agreement. See Note 5.

Note 10 - Pension Benefits

We sponsor qualified and supplemental (non-qualified) noncontributory defined benefit pension plans covering certain full-time salaried and hourly U.S. employees. The most significant of these plans, the YUM Retirement Plan (the "Plan"), is funded. We fund our other U.S. plans as benefits are paid. The Plan and our most significant non-qualified plan in the U.S. are closed to new salaried participants.

The components of net periodic benefit cost associated with our significant U.S. pension plans are as follows:

	Quarter ended		Year to date	
	2018	2017	2018	2017
Service cost	$1	$ 2	$5	$8
Interest cost	9	9	27	29
Expected return on plan assets	(10)	(10)	(31)	(33)
Amortization of net loss	4	1	11	4
Amortization of prior service cost	1	2	4	4
Net periodic benefit cost	$5	$ 4	$16	$12
Additional loss recognized due to settlements[(a)]	$—	$ 8	$—	$16
Pension data adjustment[(b)]	$—	$ —	$—	$22
Special termination benefits	$1	$ 2	$1	$2

(a) Losses are a result of settlement transactions which exceeded the sum of annual service and interest costs for the applicable plan. These losses were recorded in Other pension (income) expense.

(b) Reflects a non-cash, out-of-year charge related to the adjustment of certain historical deferred vested liability balances in the Plan during the first quarter of 2017 recorded in Other pension (income) expense. See Note 5.

Note 11 - Short-term Borrowings and Long-term Debt

Short-term Borrowings	9/30/2018	12/31/2017
Current maturities of long-term debt	$ 301	$ 386
Less current portion of debt issuance costs and discounts	(6)	(11)
Short-term borrowings	$ 295	$ 375
Long-term Debt		
Securitization Notes	$ 2,265	$ 2,271
Subsidiary Senior Unsecured Notes	2,850	2,850
Revolving Facility	273	—
Term Loan A Facility	494	500
Term Loan B Facility	1,960	1,975
YUM Senior Unsecured Notes[(a)]	1,875	2,200
Capital lease obligations	80	105
	$ 9,797	$ 9,901
Less debt issuance costs and discounts	(91)	(86)
Less current maturities of long-term debt	(301)	(386)
Long-term debt	$ 9,405	$ 9,429

(a) During the first quarter of 2018, we repaid $325 million in YUM Senior Unsecured Notes that matured in March 2018.

Credit Agreement Repricing

On April 3, 2018, KFC Holding Co., Pizza Hut Holdings, LLC, a limited liability company, and Taco Bell of America, LLC, a limited liability company, as co-borrowers (collectively, the “Borrowers”), each of which is a wholly-owned subsidiary of the Company, completed the repricing of the then existing $1.97 billion under the Term Loan B Facility pursuant to an amendment to the Credit Agreement (as defined in our 2017 Form 10-K). The amendment reduces the interest rate applicable to the Term Loan

B Facility by 25 basis points to adjusted LIBOR plus 1.75% or Base Rate plus 0.75%, at the Borrowers' election, and extends the maturity date for the Term Loan B Facility by 2 years to April 3, 2025. All other material provisions under the Credit Agreement remained unchanged as a result of this amendment.

Details of our short-term borrowings and long-term debt as of December 31, 2017 can be found within our 2017 Form 10-K. Cash paid for interest during the years to date ended September 30, 2018 and 2017 was $300 million and $275 million, respectively.

Note 12 - Derivative Instruments

We use derivative instruments to manage certain of our market risks related to fluctuations in interest and foreign currency exchange rates.

Interest Rate Swaps

We enter into interest rate swaps with the objective of reducing our exposure to interest rate risk for a portion of our variable-rate debt interest payments. On July 25, 2016, we agreed with multiple counterparties to swap the variable LIBOR-based component of the interest payments related to $1.55 billion of borrowings under our Term Loan B Facility for a fixed rate. These interest rate swaps will expire in July 2021. Further, on May 14, 2018 we entered into forward-starting interest rate swaps to fix the interest rate on $1.5 billion of borrowings under our Term Loan B Facility from the date the July 2016 swaps expire through March 2025. The interest rate swaps executed in May 2018 will result in a fixed rate of 4.81% on the swapped portion of the Term Loan B Facility from July 2021 through March 2025. These interest rate swaps are designated cash flow hedges as the changes in the future cash flows of the swaps are expected to offset changes in expected future interest payments on the related variable-rate debt. There were no other interest rate swaps outstanding as of September 30, 2018.

Gains or losses on the interest rate swaps are reported as a component of AOCI and reclassified into Interest expense, net in our Condensed Consolidated Statements of Income in the same period or periods during which the related hedged interest payments affect earnings. Through September 30, 2018, the swaps were highly effective cash flow hedges.

Foreign Currency Contracts

We have entered into foreign currency forward and swap contracts with the objective of reducing our exposure to earnings volatility arising from foreign currency fluctuations associated with certain foreign currency denominated intercompany receivables and payables. The notional amount, maturity date, and currency of these contracts match those of the underlying intercompany receivables or payables. These foreign currency contracts are designated cash flow hedges as the future cash flows of the contracts are expected to offset changes in intercompany receivables and payables due to foreign currency exchange rate fluctuations.

Gains or losses on the foreign currency contracts are reported as a component of AOCI. Amounts are reclassified from AOCI each quarter to offset foreign currency transaction gains or losses recorded within Other (income) expense when the related intercompany receivables and payables affect earnings due to their functional currency remeasurements. Through September 30, 2018, all foreign currency forward and swap contracts related to intercompany receivables and payables were highly effective cash flow hedges.

As of both September 30, 2018 and December 31, 2017, foreign currency forward and swap contracts outstanding related to intercompany receivables and payables had total notional amounts of $456 million. As of September 30, 2018 these foreign currency forward and swap contracts have durations expiring as late as 2020.

As a result of the use of interest rate swaps and foreign currency contracts, the Company is exposed to risk that the counterparties will fail to meet their contractual obligations. To mitigate the counterparty credit risk, we only enter into contracts with major financial institutions carefully selected based upon their credit ratings and other factors, and continually assess the creditworthiness of counterparties. At September 30, 2018, all of the counterparties to our interest rate swaps and foreign currency contracts had investment grade ratings according to the three major ratings agencies. To date, all counterparties have performed in accordance with their contractual obligations.

Gains and losses on derivative instruments designated as cash flow hedges recognized in OCI and reclassifications from AOCI into Net Income:

	Quarter ended				Year to date			
	Gains/(Losses) Recognized in OCI		(Gains)/Losses Reclassified from AOCI into Net Income		Gains/(Losses) Recognized in OCI		(Gains)/Losses Reclassified from AOCI into Net Income	
	2018	2017	2018	2017	2018	2017	2018	2017
Interest rate swaps	$12	$ —	$ (4)	$ —	$28	$(8)	$ (7)	$ 2
Foreign currency contracts	4	(17)	(4)	15	15	(49)	(16)	50
Income tax benefit/(expense)	(3)	2	1	(2)	(8)	5	3	(3)

As of September 30, 2018, the estimated net gain included in AOCI related to our cash flow hedges that will be reclassified into earnings in the next 12 months is $22 million, based on current LIBOR interest rates.

See Note 13 for the fair value of our derivative assets and liabilities.

Note 13 - Fair Value Disclosures

As of September 30, 2018, the carrying values of cash and cash equivalents, restricted cash, short-term investments, accounts receivable, short-term borrowings, accounts payable and borrowings under our Revolving Facility approximated their fair values because of the short-term nature of these instruments. The fair value of notes receivable net of allowances and lease guarantees less subsequent amortization approximates their carrying value. The following table presents the carrying value and estimated fair value of the Company’s debt obligations:

	9/30/2018		12/31/2017	
	Carrying Value	Fair Value (Level 2)	Carrying Value	Fair Value (Level 2)
Securitization Notes[a]	$2,265	$2,289	$2,271	$2,367
Subsidiary Senior Unsecured Notes[b]	2,850	2,858	2,850	2,983
Term Loan A Facility[b]	494	495	500	503
Term Loan B Facility[b]	1,960	1,968	1,975	1,990
YUM Senior Unsecured Notes[b]	1,875	1,871	2,200	2,277

(a) We estimated the fair value of the Securitization Notes by obtaining broker quotes from two separate brokerage firms that are knowledgeable about the Company’s Securitization Notes and, at times, trade these notes. The markets in which the Securitization Notes trade are not considered active markets.

(b) We estimated the fair value of the YUM and Subsidiary Senior Unsecured Notes, Term Loan A Facility, and Term Loan B Facility using market quotes and calculations based on market rates.

<u>Recurring Fair Value Measurements</u>

The Company has interest rate swaps, foreign currency contracts, an investment in Grubhub common stock and other investments, all of which are required to be measured at fair value on a recurring basis (See Note 12 for discussion regarding derivative instruments). The following table presents fair values for those assets and liabilities measured at fair value on a recurring basis and the level within the fair value hierarchy in which the measurements fall.

		Fair Value		
	Level	9/30/2018	12/31/2017	Condensed Consolidated Balance Sheet
Interest Rate Swaps - Asset	2	21	9	Prepaid expenses and other current assets
Interest Rate Swaps - Asset	2	51	40	Other assets
Interest Rate Swaps - Liability	2	2	—	Other liabilities and deferred credits
Foreign Currency Contracts - Liability	2	28	46	Other liabilities and deferred credits
Foreign Currency Contracts - Asset	2			