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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Yum China Fourth Quarter and Fiscal Year 2019 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Debbie Ding. Thank you. Please go ahead.

Debbie Ding ***Yum China Holdings, Inc. - Senior IR manager***

Thank you, operator. Hello, everyone, and thank you for joining Yum China's Fourth Quarter 2019 Earnings Conference Call. Joining us on today's call are Ms. Joey Wat, CEO of Yum China; and Mr. Andy Yeung, CFO of the company.

Before we get started, I'd like to remind you that our earnings call and investor presentation contain forward-looking statements, which are subject to future events and uncertainties. Our actual results may differ materially from these forward-looking statements. All forward-looking statements should be considered in conjunction with the cautionary statement in our earnings release and the risk factors included in our filings with the SEC.

This call also includes certain non-GAAP financial measures. You should carefully consider the comparable GAAP measures and reconciliations thereto.

Today's call includes 3 sections. First, Joey will cover Yum China's 2019 and fourth quarter highlights and recent development of the coronavirus situation, then Andy will cover the financial results and 2020 outlook. We will then open the call to questions.

You can find the webcast of this call and a PowerPoint presentation, which contains operational and financial information for the quarter, on our IR website.

At this time, I would like to turn the call over to Ms. Joey Wat, CEO of Yum China.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Thank you, Debbie. Hello, everyone, and thank you for joining us today. Before we dig into the details of the quarter, I want to step back and offer some perspective on the past year and on our long-term strategy. We achieved solid performance in 2019. This was supported by our unique competitive advantages, including our leading development in supply chain expertise as well as our ability to innovate. Customers are drawn to us for 4 reasons: one, our delicious food; two, great value; three, a pleasant customer experience, which is enhanced by our digital efforts; and four, convenience through delivery and mobile ordering.

Let me very briefly review the progress we made in 2019 in each of these strategic areas. I will start with the fundamental core of our business, the food. Our customers expect delicious new menu alternatives, and we exceed those expectations last year, whether it was the shrimp or crayfish burgers we introduced at KFC in Q1 or the double chili chicken in Q3 or the Christmas snow pizza featured at Pizza Hut in Q4, we are continuously refreshing our menu. To support menu innovation, we opened our innovation center in Shanghai last February. That facility represents our full commitment to sustain our leadership in offering delicious, high-value menu alternatives.

Second, we are focused on offering great value to our customers. We offset higher food costs with greater efficiencies in order to keep price increases to a minimum. We kept customers engaged through various smart value promotions and digital offerings. Finally, we used the promotions in a more strategic and targeted manner. Crazy Thursday at KFC and Scream Wednesday at Pizza Hut remain effective, and we continued to spoil our members with exclusive or tailored offers.

Third, our digital engagement is key to creating a closer relationship with our customers, driving loyalty and traffic. In general, digital significantly improves our marketing efficiency. With digital membership programs, we can understand customer behavior, their likes and dislikes, price sensitivity, et cetera, you name it. We can then tailor promotions down to the individual. In our experience, this is far more powerful than any sort of marketing we can do. We introduced useful functions such as YUMC Pay. In addition, our exciting offers within the Privilege program drove frequency, value perception and customer loyalty. One example of the power of digital is coffee marketing, which is primarily driven by digital initiatives. In 2019, we sold 137 million cups of coffee at KFC, up 48%.

Fourth, and finally, we are committed to creating more convenient ways for customers to access our menu. Delivery continued to ramp significantly during the year and account for 21% of sales. Sales via our own channels grew faster than that via third-party aggregators. Our convenient mobile ordering and kiosk ordering are becoming more popular. They also free up our store staff for other in-store functions, making our restaurants more efficient.

Each of these strategic initiatives enable us to meet or exceed our goal in 2019. We've opened over 1,000 new stores. This was the highest annual store openings in our history. We also remodeled almost 1,000 stores, solidifying the appeal of our new designs. Over half of the remodels were the new design at Pizza Hut.

Same-store sales growth was 3%, reflecting strength at KFC and revitalization at Pizza Hut. KFC and Pizza Hut combined digital membership grew by over 1/3 to 240 million. Those members contribute half of our sales. Importantly, all of these result in solid profit growth. We also continued to develop our emerging brand portfolio. Little Sheep has 300 stores in 11 countries, including New Zealand and Myanmar, which are new markets we entered in 2019. We opened 40 COFFii & JOY, bringing us to 53 total in 10 cities. Taco Bell now has 7 stores in Shanghai.

In addition to the customer-facing digital and delivery initiatives, we are further leveraging technology across our entire business. We are using technology to enable our operations to be nimble and flexible. And that, coupled with our in-house and integrated supply chain, enable us to launch new products and promotions at national, regional or even store level with increasing speed and efficiencies.

Our IT investment is also enabling greater efficiency in staffing. We have utilized AI-based technology to implement store-based hourly sales forecasting, which supports labor scheduling and inventory management. We also started to roll out smartwatches, enabling RGMs, our managers, to closely monitor the ordering and serving status in our restaurants. We will step up investments in IT infrastructure and supply chain. This is money well spent as it helps us to create a tremendous amount of flexibility and agility in our daily operations.

Now let's drill down to the fourth quarter performance. We are pleased with our strong performance in the fourth quarter. We delivered our 13th consecutive quarter of system sales growth since the spin-off with positive same-store sales and expanding margins.

Let's start with menu innovation. Through this end, we launched several exciting limited time offers, LTOs, during the quarter. At KFC, we launched new products for our premium burger line, including the turkey and spicy chicken burger and the thick-cut Australian steak burger, both are proving quite popular.

Breakfast continue to be one of our key growth drivers and grew faster than other dayparts. We launched thinly sliced beef congee, (Sheng Gun Niu Rou Zhou), to enrich our Chinese menu offerings. We also drove strong sales growth in coffee with new products such as flat white and caramel macchiato. We also launched hot taro tea drinks as new additions to the oolong tea series, (Jiu Long Jin Yu), which is available in all 1,400 digital kiosks across the country.

At Pizza Hut, we launched various new products such as the snow cheese beef pizza, roasted turkey thigh and sea salt caramel milk tea to capture the festive spirit. Steak sustained its momentum as well. Sales grew mid-teens and accounted for 13% of our Pizza Hut sales now.

Our digital and delivery strategies are designed to ensure great customer experience on top of great food. Here is the progress we made this quarter. Our Privilege subscriptions continue to be very popular with over 3 million sold during the quarter. Since we launched our first Privilege program, we have sold 15 million subscriptions. Privilege sales continued to increase in the mix of total sales. In November, we used our partnership and our Super App to capitalize on the hype around Singles' Day on the 11th, the so-called Double 11 shopping holiday. We enabled consumers to indulge themselves across the Yum China family of brands. The results were outstanding.

Notably, KFC doubled GMV compared to last year and ranked #1 on Tmall in the restaurant category. Pizza Hut grew GMV by over 1/3 and ranked #1 on Meituan in the food category. Digital orders, which includes delivery, mobile orders and kiosk orders reached 61% of sales, and digital payment exceed 90%, both well ahead of last year.

Now let me cover some details of the performance of our 2 largest brands, starting with KFC. KFC reported another strong quarter, despite a tougher lap compared to the prior quarters in 2019. We maintained solid momentum with 10% system sales growth. This was driven by same-store sales growth of 3% and accelerated new store openings.

On a full year basis, KFC opened 742 new stores, which is equivalent to 2 stores per day and entered over 100 new cities in China. We offset elevated chicken prices with diligent cost control and creativity in our menu. One example of our creativity is the wing tip bucket, (Ji Chi Jian). We used alternative chicken parts to develop a tasty new product that also represent good value. We delivered operating profit growth of 20% in constant currency.

Next, Pizza Hut. Pizza Hut continues to cement the progress being made in its revitalization program. In Q4, we achieved traffic growth in both dining and delivery. Margin also improved. In addition to digital marketing campaigns, Pizza Hut also enhanced tableside mobile ordering. This better user experience resulted in an uptick in usage. Delivery grew to 28% of sales, mainly driven by our own channels, thanks to our digital platforms. We are enhancing our asset portfolio through accelerated remodels. We remodeled 281 stores in the fourth quarter, bringing the total to 513 for the full year. Over 1/3 of the Pizza Hut stores now feature the new design. Overall, we are seeing progress at Pizza Hut in operating metrics and consumer satisfaction, which tell us we are pursuing the correct long-term strategy for this brand. In 2020, we will continue to excite customers with good food and good value, including a menu revamp.

Before I hand the call to Andy to go through the financial results, I would like to update you the health situation in China and what we are doing. First of all, our top priority is the safety of our employees and customers. We are closely monitoring and implementing the requirements of local government and health authorities. Because the situation is fast changing, we are implementing all measures as rapidly as possible. Fortunately, we have outstanding operations and supply chain teams that we can mobilize. For example, our procurement team secured enough facemasks for all our staff. All restaurant staff and riders are required to wear facemasks and measure their body temperature. We have stepped up cleaning and disinfection of all areas and equipment in our restaurants, and we are complying with local authority health requirements. We also took the opportunity to improve our operation by launching contactless delivery. This arrangement helps to reduce the risk of human-to-human infection and protect our staff, riders and customers.

Having been in China for over 30 years, we are determined to overcome this challenge and do our part to assist the communities we serve. With the support of our staff in Wuhan, we are providing free KFC and Pizza Hut meals to the medical staff at 7 hospitals in the city. This represents over 1,000 meals per day. We also have donated RMB 3 million to assist medical workers involved in fighting the outbreak.

Chinese New Year is an important trading period for us usually driving first quarter performance. This year, the outbreak right before Chinese New Year is causing significant interruption to the business. We expect there will be material impact to our first quarter and full year sales and profitability. Nevertheless, we believe that our operating excellence and financial strength enable us to withstand challenges like this. We remain fully confident in the long-term opportunity of the China market.

With that, I will hand over the call to our CFO, Andy Yeung. Andy?

Ka Wai Yeung *Yum China Holdings, Inc. - CFO*

Thank you, Joey. Good morning, everyone. As we start a new year, we are going to make a small change to how I review the financials. And because you can find all the figures and comparisons you need in our press release and supplemental slides, we will not repeat all the numbers here. Instead, we will focus on the primary factors that influenced our results.

Unless I note otherwise, any figure I mention now refer to the fourth quarter 2019. All figures are before the effect of foreign exchange, and all comparisons are year-over-year.

Now fourth quarter financial results. Total revenues grew 8%. It was driven by both new stores and same-store sales growth. KFC same-store sales growth of 3% was driven by higher ticket average, which is a function of higher prices, fewer promotions and more delivery. Pizza Hut same-store sales growth was flattish as traffic growth was offset by promotions that we reduced ticket average. There was also 1 less long weekend compared to 2018. And then as Joey mentioned, new store openings were well ahead of our initial expectations.

We pulled some planned openings from 2020 into 2019 to capture more of the holiday selling season before the Chinese New Year. The strong performance of KFC also allowed us to open more stores than expected. The increase in restaurant margin was due to better margins at both KFC and Pizza Hut. At KFC, sales leverage and improved labor productivity more than offset wage and commodity inflation. At Pizza Hut, margin was improved, mainly due to more efficient restaurant operations and contribution from breakage revenues recognized.

The jump in G&A expense was in part due to the lapping of government's incentive that were received and reduced G&A in fourth quarter in 2018 but were receive in third quarter in 2019. We also have higher performance-related compensation in 2019. Our goal is to keep G&A increase in line or less than revenue growth.

We achieved operating profit growth of 16% due to sales leverage, net new unit growth and productivity improvements, which more than offset higher cost from inflation, promotion and G&A. Net income increased 23% to 90 million, driven by the operating profit growth just mentioned and the mark-to-market gain from our equity investment in Meituan. This is partially offset by the lapping of tax benefit in the fourth quarter 2018 that was related to the U.S. tax reform and higher tax accrual in 2019.

Similar to net income, diluted EPS and adjusted EPS growth was partially driven by the mark to market gains from Meituan investments. Excluding that, adjusted diluted EPS grew 5% in the fourth quarter and 13% in the full year.

Next, let me cover our capital allocation. In full year 2019, we generated over $1.1 billion net operating cash flow. About 1/3 of that cash flow was directed to CapEx. Of the balance, about 60% or over $440 million was returned to shareholders through dividends and share repurchases. Including what we returned in 2017 and 2018, we have now returned over $1 billion to shareholders since our spin off. The balance of our cash and short-term investments remained strong at $1.66 billion. We maintain our quarterly dividend at $0.12 per share. We also have approximately $700 million authorization remaining for the share buyback.

Now let me turn our turn to our outlook for 2020. The recent coronavirus outbreaks have caused significant interruptions to our business. The impact comes from temporary closure of our restaurants as well as substantial decline in sales to the restaurant that remained open. We started closing some of our restaurants right before the Chinese New Year. As recent days, more than 30% of our restaurants were closed. The traffic at the restaurant that remained open were impacted by travel restriction, suspended festivities and shortened operating hours as people avoid going out.

For the restaurant that remained open, same-store sales since the Chinese New Year declined by 40% to 50% year-over-year, after adjusting for the timing of the Chinese New Year holiday. While dine-in traffic was hard hit as people avoided public gatherings, delivery is holding up well. Now to better serve our customer and protect our employees, we rolled out contactless delivery, which is very well received by our customers. In addition, we also rolled out order online, pick up in store, contactless services and saw some encouraging early results as well. However, at this time, we cannot forecast when nor at what rate the closed restaurant will be reopened, and the traffic will be restored. Furthermore, we may be required or otherwise decide to close additional stores or modify our operations in response to the outbreak.

The situation is rapidly evolving. While we cannot yet fully ascertain the expected impact, we may experience operating losses for the first quarter of 2020 and if the sales trend continues for the full year of 2020. Future operations, cash flow and financial position may be materially and adversely influenced by the further development related to the outbreak, including potential additional announcements and action from the central and local authorities or other reasons.

However, despite the headwinds from the current situation, we are optimistic and committed to the long-term opportunity in China. So we will continue to roll out more new stores as some of our planned new stores in 2020 were accelerated to open in 2019. We expect to build 800 to 850 new stores this year. Obviously, this is subject to revision based on the impact from the coronavirus. We will evaluate throughout the year and revise the target as needed.

Seeing the clear power of our digital strategy, we intend to step up investments in digital technology and supply chain this year. We expect full year CapEx for 2020 to be in the $500 million to $550 million range, which include new store, store upgrades, digital, IT-related investments as well as operational infrastructure-related investments. We will continue to invest in our emerging brands, which we believe is the right thing to do for the long-term growth of our business.

The Huang Ji Huang acquisition is on track and is expected to close in early 2020. We expect wage inflation to stay at the mid- to high single digit this year as for commodity inflation is still a challenge. The pork shortage puts pressure not only on the price of chicken, but on all proteins. We do not yet have full visibility for the full year. Our best estimate of the commodity inflation now is for low to mid-single digits in the first half of 2020.

At the end of 2019, RMB have depreciated 4% during the course of the year. If the exchange rate continues at the current level, we expect there will be, again, foreign exchange translation pressure in 2020.

So all in all, we expect 2020 will be very challenging. During this difficult and challenging time, we will continue to focus our efforts to protect and to serve our customers, our employees and our communities that we're operating in. And we, Yum China, are here for the long run. So we will continue to invest in the future to ensure that we are well positioned for long-term growth opportunities in China.

With that, I will pass you back to Debbie to start the Q&A.

Debbie Ding ***Yum China Holdings, Inc. - Senior IR manager***

Thanks, Andy. We will now open the call for questions. (Operator Instructions) Operator, please start the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Michelle Cheng from Goldman Sachs.

Michelle Cheng ***Goldman Sachs Group Inc., Research Division - Executive Director***

Congrats on the good results, and I really appreciate the color on the recent development. And my question is about the cost. Can you share with us more details about how you can manage the cost in this situation? Mainly like related to how to -- possibility to renegotiate the rent with landlords or the staff cost. I understand, you use a lot of part-time. So is there like a potential that we have some arrangement on the part-time or the staffing management?

And also, is there any like insurance coverage in this kind of situation for business interruption?

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Let me take this question then. So I will address the question about cost. So if you look at -- in the short term, obviously, during the Chinese New Year, we have planned for the Chinese New Year selling season. So I think in the short term, those costs are likely fixed. Now like if we look at going forward, obviously, if you look at our cost structure, for example, we have some variable costs, right? As you mentioned, in the restaurant level, we have -- while we have some full-time staff and salary employees, we also have some temporary or part-time workers. So a portion of that restaurant labor cost will be variable. Now if you look at the cost of sales, obviously, that is very related to the sales of the restaurant. If you look at our operational occupancy and other expenses, as we have previously disclosed, a large number of our contracts have a variable component to it. And -- but however, there's also some fixed costs in that rental arrangement as well. So that would be a mix of variable and fixed.

And then in terms of our overall corporate G&A expenditure, we -- of course, given the very challenging time, we're going to implement significant cost control and programs going forward. So we're targeting, obviously, the controlling of the labor cost increase as well as some of the discretionary spending, like travel expenses as well as our professional service fees that we generally would incur.

So in terms of overall impact, I think, this year, we'll continue to monitor the situation and implement additional cost control if necessary.

In regard to your second question, which is about business interruption insurance for outbreak. I think since the SARS outbreak in 2003, our business insurance -- because of that, a lot insurers no longer provide that kind of insurance. So it does not cover outbreak.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Michelle, just a little bit extra color on the cost. The moment that we see the impact of the outbreak, which is the weekend of January 18, the management is experienced enough actually to pull their AMP immediately. The advertising cost for Chinese New Year is a big investment. So we are very quick to react to pull that because otherwise we will be in a situation of lost sales, but then sort of invest AMP, that will be very unfortunate. So we did that already.

And in terms of labor cost, you can be sure that management is doing everything we could to manage the labor cost. However, the timing this year is the challenge because Chinese New Year, the first 3 days has tripled, 3x labor cost according to the labor law and then extend holidays for the staff implied double labor cost for our staff as well. So -- and these become sort of fixed in a way because we are complying to our government requirements, but you can be sure that we are doing everything we could to manage the cost, while doing everything that is the right thing for our staff, for our customer, for our community as well. Thank you, Michelle.

Operator

And your next question comes from the line of Sara Senatore from Bernstein.

Sara Harkavy Senatore ***Sanford C. Bernstein & Co., LLC., Research Division - Senior Research Analyst***

I have a question actually about the unit growth. You pointed out that 1,000 stores is the highest number in history. And even before coronavirus, you were expecting a slightly lower number of gross adds in 2020. I was just wondering if 1,000, there's some sort of natural limit to how many stores you can open, again, setting aside what's going on now with the virus. But over time, as we think about the growth rate and your store base increases, I think you've been leaning more heavily on unit growth and a little bit less on comp. So as we think about the rate of growth, should we think about 1,000 units as being kind of the highest number you can open in a year because of either human capital or real estate or whatever the gating factor can be. So can you just talk long-term about what the unit growth might look like and what the limiting factors would be if you really can't open more than 1,000 stores a year?

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Thank you. In general, at a very high level, the number of new stores is a function of how well the business is operating. For example, last year, we opened 742 KFC stores and then 132 Pizza Hut stores. But back to 2013 and -- '14 and '15, actually, we opened more Pizza Hut stores than KFC stores. So as KFC business performance improved, we are able to open more stores because we are able to pay more rent and then also the quality of the store is better, so we can open more. So in general, it is a function of business performance.

When it comes to, is there a natural limit? We actually don't really chase after a particular figure. In general, we have a pipeline that's more bottom up. And then we try our best to open as many good store as possible because loss-making store is not a good thing to a business. So we don't chase after a number. Just like 2019, we set a target and then we exceed the target because the business is doing better and we find more pipeline. But for 2020, we set a target, but as we experience business interruption, we will expect we will revise the pipeline as we go through the rest of the year.

The third point I want to make is for a business like ours, although we emphasize a lot on new store openings, but also, at the same time, management team has balanced 2 more factors. One is the impact on the same-store sales. Of course, the new store opening has impact on same-store sales. And we want a bit of both. We want the new store. Also, we want the same-store sales. Technically, in an emerging market, we probably want to focus on system sales growth more than just same-store sales. However, our learning is that our investors want to focus on same-store sales. So we kind of have to deliver both, new store and same-store sales.

But again, other than the same-store sales, the management also has to balance the third piece, which is remodeling because right now, you can see we are reaching the number on 9,200 stores by year-end. And in China, particularly in China, we are targeting to maintain the age of our store at 3 years. That means every 3 years, we're going to reset or remodel or do something about the store to look -- to make the store look lovely and appealing to the customer. So while we have opened more than 1,000 stores last year, we also have opened -- have remodeled 1,000 stores at the same time. Because if we just keep opening new stores but not remodeling the stores, the quality of asset will go down. So you can see, we not only try to open store, good new store, we want to maintain the same-store sales, we also want to maintain the speed and the pace of remodeling. If we don't maintain that pace, we will get to the situation in 2016, we actually refit almost 1,800 stores during 2018 as a catch-up. And right now, Pizza Hut, we are also doing the catch-up. Therefore, Pizza Hut, after last year's catch-up, we have 1/3 of our new stores have been design. So I hope that gives you a holistic view of the way that we look at the new store opening. It's just not only about new store opening, it's about the same-store sales, it's about remodeling, it's about keeping the business going, and it's about having good number, a good profitable number for the new store as well. Thank you.

Operator

And your next question comes from the line of Chen Luo from Bank of America.

Chen Luo ***BofA Merrill Lynch, Research Division - MD***

I've got a question on our outlook guidance in the result release. So we are actually not ruling out the scenario of a full year loss if the current situation continues. So what is the underlying revenue assumption? Or what kind of -- what level of revenue decline are we looking at to achieve that scenario? And also related to that is more color on our cost structure. Just now, Michelle also asked about the question. So the food and labor costs -- food and people cost is largely variable, but for the labor costs and occupancy and others, how much is variable and how much is fixed in nature?

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Let me sort of give you some color about the current store opening situation, and then I'll pass on to Andy. The overall situation, the situation is very fluid. It's still early days to predict and to have a sort of more concrete number, but we are closely monitoring the situation and following the guidelines from the relevant authorities.

Let me talk about the store close situation first. So roughly, we are -- 30% of our stores are closed. And that's the sort of the current number, and we don't know what is next. Let me talk about the key components of the 30%, then you would have a better understanding of our current situation. We, from the very beginning, decided -- on the condition that our staff are safe, we have done everything we could to protect the safety of our staff, our customers. We would like to continue to serve our community. And that means we would like to continue to open the store while we operationally could because I think in this crisis, it's very important to try our very best to keep life going as normal as we could.

So we start to close the store in Wuhan first because that's the center of the outbreak, and that was 3% or 4% of our sales -- or actually

2%. And then as situation become evolved, then we closed the store in Hubei, which is the province Wuhan is, right? And then as the situation evolves, we closed a significant number of stores in the surrounding provinces, such as Henan, such as Hunan. So that's a group of the stores that we have closed. And then as the situation evolved, the stores -- most of the stores in our tourist location and transportation hubs, and that's roughly about 5% to 6% of our portfolio, were closed.

And then the situation continued to evolve, then some stores in the lower tier cities, in particular, around the country, were closed because there are a lot of travel restrictions, festive activities were canceled and, operationally, it became too challenging to open the stores. So there is -- so you can see the progression of our store closing as the situation evolved, so what is next is a bit too early to tell.

So as the stores closed, what are we doing? What are the impacts on the -- on our business? And what are we doing to mitigate the situation? Obviously, you can imagine the dine-in traffic was severely impacted. However, as we mentioned earlier, the delivery business held up relatively well. Also thanks to the quick reaction of our operation team, we launched the contactless delivery service to our customer, and that was well received. And the little budding opportunity right now we can see is the catering opportunity that we can see. And part of the catering opportunity comes from the fact that due to our commitment to serve the community, we opened 6 restaurants in Wuhan not to do business but just to serve free meals to the doctors and the medical staff as our contribution to the community. And therefore, for the rest of the country, in other markets, we also follow similar practice. And as a result, we received a lot of requests in terms of catering services because we are trusted, and we are truly grateful to the trust that our customers and our community give us.

So that's sort of the overall picture of our sales side, and obviously, you can imagine, despite the fact that the delivery sales hold up, catering business is growing, the same-store sales for our business was also impacted due to the travel restriction, less traffic and also shortened operating hours, particularly in shopping malls, et cetera.

So with that, I'm going to pass the question to Andy to talk about the revenue and cost side.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Okay, Joey. So as we mentioned earlier, if you look at the interruptions caused by the outbreak, it's quite significant to our business. We have basically 2 impacts, 1 is the store closure. As Joey mentioned, it's 30% right now. So about 30% of our stores are closed right now. And of course, this is a very fast and evolving situation, so it's very hard for us to know what's coming next.

The second part is that for the store that we remain open, the impact on the traffic was also quite significant, especially for dine-in business, as Joey mentioned, so -- although our delivery business is actually holding up pretty well. So the same-store growth for those restaurants are down about 40%, 50%, right? So overall, if you look at the impact on the total system sales growth, it's actually -- systems, it's actually sort of, that. So as we mentioned, if the trend continues at the current level, we expect to go into operating losses.

So to address your questions, no, we don't actually have a target for the revenue losses -- or revenue that would drive into losses. I think there's a lot of variable factors right now for us to address these issues: obviously, store closings as well as the ongoing trading trend is another one. And so we'll talk a little bit about -- there was a driver for the cost, so maybe it can help you in your modeling. So Chinese New Year is a very critical trading period for us during the first quarter. So as I mentioned, the consumable portion of our cost are fixed and are already incurred before the Chinese New Year trading period. And then that, including food ingredients, right, that's all in the restaurant themselves. And then also the discussion of labor, I would just say at 3x. And then also, as Joey mentioned, during extended trading holiday period, now it's also in overtime pay. So I think that led to a decline in the profitability, for sure, in the first quarter.

Portion of the fixed cost [is caused by this], okay? Cost of sales, as I mentioned, variable at the restaurant level. And labor, at the restaurant level, are partially fixed. The management salary, employee -- management team and staff, we do have some flexibility there. So a portion of -- a big portion of our front-line workers are part-time workers that we can have more flexibility.

A portion of the fixed cost are in the occupancy, right? So as we mentioned, a portion of our brand is in fixed, and then a portion of that is in variable cost. As we mentioned, a fast-growing number of our contracts actually have an element of the variable cost. Obviously, that element varies quite significantly from location to location. We -- for when -- we also -- obviously, you probably have noticed on the news, there is a time, there is call for sacrifice in the country right now. So if you look at some of the real estate companies, they have also participated and then also have provided some rent relief. And I think if you look at other activities, we'll continue to seek opportunity to minimize our costs during this kind of crisis.

In terms of other store costs, for example, that means it's largely fixed. If the store is open. But if it is not opened, then you know it's almost 0, right, so for utility and all that.

So in terms of G&A, as we mentioned, right now, in the short term, it's going to be rapidly fixed under the current census. But we -- going forward, for the rest of the year, we're going to implement additional cost control to lower that overall corporate G&A. So we may also incur some write-off for our cash flow items, right? So some of the inventory that we have stacked up may be written off. So we don't know. It depends on, going forward, what's the trading condition there.

So yes. And then if you look at -- we have mentioned before, we have spent a lot of good work in terms of reducing wastage and improve labor productivity. But during this time of lower trading volumes, it's possible that the wastage and also labor productivity for our staff and also the riders may also reduce as well.

So as we mentioned, we expect a very challenging first quarter, for sure, and then maybe for the rest of the year. And so it may take some time for business to recover. And so -- and then a lot of these, as we mentioned before, these fast-changing condition is very hard for us to predict what else is going to happen in the next few weeks or a few months. So a lot of our results in operation will be influenced by future development of the corona situation -- coronavirus situation. So it may improve additional stockholding or a lot of action that is required out of both sides, the central government and local authorities or our own operational need. So hopefully, that can help you address your questions. I know you know, still, there's a lot of uncertainty. I think under the current situation, I think we are under -- operating under some uncertainty right now.

Chen Luo ***BofA Merrill Lynch, Research Division - MD***

That's very helpful. So I firmly believe that our company can overcome the situation and that the whole restaurant industry is facing even bigger challenges. Good luck.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Thank you also.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Thank you.

Operator

And our next question comes from the line of Lillian Lou from Morgan Stanley.

Lillian Lou ***Morgan Stanley, Research Division - Executive Director***

Andy, very quickly, before I ask my question, just to verify, in terms of your guidance of loss-making first Q. You're kind of under the similar assumption that 30% or more is still going to be -- remain closed, and the remaining stores are seeing kind of 40% to 50% same-store sales decline. That's just -- very quickly verify. And the question is more on the raw material trend because you mentioned -- I think Joey and Andy mentioned in the presentation that we're still seeing some challenges in the raw material trend. And most recently, I think that there are some disruption in the logistics of -- for the supply. And also, we are seeing, not necessarily just in China but in other countries as well, there's avian flu coming up. So do you see there's additional cost pressure going forward, not necessarily just in the various time but also it could linger around for a longer period of time to depress our margin. That's my question.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Okay. Yes. So Lillian, thank you for your questions. So I'll just confirm, like our assumption regarding the 2020 possibility of incurring losses, yes, so as we mentioned, if we assume the current sales trend continue, we would expect potentially full year 2020 market. But -- and then that's based on the 30%-plus stores closed right now and then, obviously, our 40% to 50% decline in the same-store sales growth of the stores that remain open. So that's the current situation. And -- but again, like this is a fast-evolving situation, so it's quite difficult to predict what's going to happen.

Now in terms of commodity inflation, I think if you look at -- in the fourth quarter, it actually come down a little bit for chicken prices for us. But however, if you look at the market itself, actually, we saw a spike in the chicken prices just in November. As we mentioned in the prepared remarks, for this year, we don't have full disclosure yet. But for the first half, we do expect the commodity inflation for us will be at the low to mid-single-digit in the first half of this year. The reason why we have a little bit visibility is because a lot of this are commodity -- especially for chicken, we have contract a lot, probably a quarter at least, ahead of the time, and then also we have some inventory in our platform. So that's how we get some visibility there.

So as you mentioned, there's a number of things that is a moving part in the marketplace for the commodity price and chicken prices. Obviously, one is the U.S. and China trade deal. That's why there are some pocket, right? But a lot of the details are yet to come. So it's very hard to see. The U.S. chicken import here in China, traditionally, have been relatively small. So the impact may not be as fixed. And then also, you mentioned that there's potentially avian flu in other regions. I think you're probably addressing the Hunan situation. Yes. But -- and we don't actually source from Hunan. So at the current rate, we don't see any material impact for us, but we'll continue to monitor the situation for sure.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

I just want to add to kind of the -- I think 2019, we have proven ourselves to be pretty good at innovating, not only with chicken but with different parts of chicken and different proteins. So even with the very big pressure on chicken price, we managed to control our cost of sales at a very reasonable level, and we did not disappoint our customers. Anything, as turkey is the chicken wingtip, which is turkey for the national customer, is very well received for those customers who love chicken wingtips. Of course, the cost is very desirable. To the alternative proteins, such as crayfish burger for KFC for the Chinese New Year and also (Xian Dan Huang Xue Yu) pizza, the salty egg yolk codfish pizza, these are protein. So we are pretty good at innovating the protein. And the mentality that our team -- our R&D team is, if we are good chefs, we are good at looking at whatever ingredient we can get and prepare a very good food for a customer. And the goal is we don't disappoint our customers while managing our cost of sales. Thank you, Lillian.

Operator

And your next question comes from the line of Xiaopo Wei from Citigroup.

Xiaopo Wei ***Citigroup Inc, Research Division - Director & Head of Asia-Pacific Consumer Research***

I know that is -- thank you for giving us a color on the development of the coronavirus. I know nobody has a crystal ball on what could happen. So I do have a question for a more look beyond the midterm and long term. In my understanding, the company has developed a very comprehensive business model with a lot of toolbox. I just want to know, in the midterm, have you thought of adjusting your strategy operationally and financially to absorb the short-term shocks? For example, will you put the Pizza Hut revitalization as less priority and you give more priority to restore the sales of KFC? And also will you be more aggressive in pushing digital and delivery to make up for the sales loss in dine-in? And then thirdly, I think in this situation, reserving the cash is very important. Are you thinking of reducing the dividend or share repurchase to preserve more cash for any unfortunate negative outlook?

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Thank you, Xiaopo. We have established our strategy for Yum China, for KFC, for Pizza Hut. Will we do some tweaking based on the current challenges? Yes. Will we dramatically change our strategy? No. So let me just share with you my thoughts about some of your question, and then I'll pass on to Andy about the cash bit. In terms of priority, both Pizza Hut and KFC are important. We have 2 big kids now, 2 kids, but all the kids are important. And for Pizza Hut, the revitalization strategy will continue. Pizza Hut has its own dedicated brand team to make that happen. And KFC, of course, is the most important business for Yum China, but it also has its own very strong dedicated brand team to pursue the strategy as well. So both businesses are important.

In terms of the question about our focus on digital and delivery, will we make it even more important, it has been in our strategy to accelerate the investment of digital technology. As Andy mentioned earlier, we are going to invest heavily in our digital and technology to pursue our end-to-end digitization strategy. And will we continue? If we could accelerate, we would, but we will not push for it just for the sake of pushing. So the ongoing strategy will continue, but we will certainly tweak and react very quickly. As the situation is fluid, I can share with you, the management team, we have daily meeting to respond, react, to adjust, not only strategy but operationally, what we need to do in a store, in supply chain, in human resources, arrangement, et cetera, et cetera.

One example is we pulled the health program for our restaurant management team forward. Originally, we are going to announce this program in March. But given in March, we are not going to have our RGM convention, we pulled it forward because we believe that this is something that our restaurant management team will appreciate. What it is, the program is about -- we're going to enhance and upgrade the health coverage for our restaurant management teams, families that include the spouse, the kids and their parents up to 75 years age. So that we pulled forward. So things like that, you can see, we'll continue to manage on a daily basis. So with that, I'll pass on to Andy.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Okay. Thank you. So regarding the -- our cash and dividend policy, I think I'm very lucky that we inherit a very prudent and conservative financial management program here. We have about $1.66 billion in cash and short-term cash. So in time of crisis or situation that we are in right now, this is a very good strong financial position. Our #1 priority, obviously, is to ensure that we have enough liquidity for our operational needs as well as for the investments that we plan for our future. So if you look at our press release today, we have just declared a dividend payout for March, reflecting our current strong liquidity position. In terms of the current trading environment or the current situation here, operationally, it's very challenging. So as we mentioned, preservation of cash, ensuring liquidity is paramount as a financial function for us. So we'll consider all options, and we'll continue to review our dividend and share buyback program periodically, and we'll report as well. So but -- so if we look at our current position, we're very strong at $1.66 billion cash and cash balance. So as we mentioned, we also would -- for the year, as we mentioned, often open, including cost control, right, and then also a review significant capital allocation going forward as needed.

Operator

And your next question comes from the line of Lina Yan from HSBC.

Hau-Yee Yan ***HSBC, Research Division - Hong Kong and China Consumer Analyst***

So I just want to clarify, Andy mentioned, for existing opening stores, your same-store sales declined by 40% to 50%. So does that include the delivery service? So I want to ask, is there any bottlenecks for you to further grow your delivery service? And if you allow, I want to ask another question. It's regarding your licensee fee paid to Yum! Brands. You normally pay 3%, but under current critical situation, is there a possibility you can like have some concession from Yum! Brands on that? And if you can share with us if there's any risks to potential disruption to your supply chain, that will be like a highly appreciated as well.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

So I think, let me clarify a little bit. For the stores that remain open, our operations improved both dine-in and/or delivery. So the same-store sales growth for those restaurants at are about 40% to 50%. That's including both dine-in and also delivery. As we've mentioned before, dine-in has been impacted more significantly, and then the delivery service actually held up very well. So we will continue to -- as we mentioned, we rolled out contactless delivery. We also rolled out the online order, pick up in store, contactless services we have at our restaurant as well. So we continue to utilize our digital assets, right, to continue to serve our customer. I think our investment in the digital side will help us quite this year in the current situation to serve our customers.

In terms of bottlenecks to our delivery. I think, obviously, there's a couple of things, right? In China right now, in some of the cities, there are some restrictions on travel or traffic. And so that would probably have some impact on the delivery side. And also, if you look at, both in terms of some of the labor cost for delivery, it's also probably impacted by some of these travel restriction as well. So that could potentially be one of the items there.

In terms of Yum! Brands licensing fees concessions due to the situation, at this time, a very difficult and challenging situation. Obviously, we seek help from our business partners. So -- but I think contractually, there's no obligation for Yum! Brands to make a concession. But we welcome any help that we can get. Obviously, if that happens, it will be great real gesture, and we will appreciate that very much.

In terms of risk to supply chain disruptions, and actually we have our Chief Logistics and Supply Head here, Danny, and maybe Danny can help us address that a little bit.

Danny Tan ***Yum China Holdings, Inc. - Chief Supply Chain Officer***

Sure, Andy. Thank you. Yes, Lina, this is Danny. On supply chain, first, let's talk about logistics impact. Obviously, the biggest impact is in the city of Wuhan and the province of Hubei where the government has imposed travel restrictions that is banning nonessential civilian traffic in and out of the city. But as you know, we have a wide network of logistics centers. We have opened 24 logistic centers across the country. So for example, the stores that was served by Wuhan logistic centers in the neighboring province, such as [Jiangxi] is now being served by our logistic centers from Changsha of Hunan province. So really, we -- a key element of the supply chain is really contingency planning. So that network of our logistic centers will allow us to continue to support our stores' operations. Obviously, as you know, nationwide, there's an increasing number of provinces and cities imposing travel and traffic restrictions. As we mentioned multiple times, the situation is fluid. We're monitoring on a daily basis. But for now, we manage. We are able to deliver to all stores that remains open as of today.

Now moving on to suppliers. We obviously have some -- we have more than 300 plants supplying food and beverage material to Yum China. A very small number of the suppliers are in Hubei province. But again, because of contingency planning, we're able to allocate the volume to other suppliers. And so for now, as of now, we do not foresee any disruptions to our supply chain at all. Again, like I said, I want to stress that the situation continues to evolve. So we'll continue to monitor, and we'll manage from there. Thank you.

Hau-Yee Yan ***HSBC, Research Division - Hong Kong and China Consumer Analyst***

I'd just like to follow up, like Andy, can I say you have reached your peak delivery capacity during this difficult period? Or do you still have room to further grow? That's end of my question.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Well, I don't think we have a limit right now. Obviously, as you would probably know, this is the Chinese New Year period. And a lot of times, people at this time would be returning to work. And -- but the situation is very fast evolving. So it's very hard to say what's the situation there. But in terms of our online capabilities, you have probably seen some of the news we've got. Have done a very good job in rolling out this contactless delivery, and which is very well received by consumer and also are recognized as a good service during a situation like we are in right now. We -- and so in terms of the labor force, as we mentioned, we continue to look at little ways to alleviate that. And then, the labor force right now is a big fluctuation, a big unknown right now because people return from work next week. And so we'll see how that's going to happen.

In addition to that, as we mentioned, we also rolled out our contactless order online and pick up in store services, right, which is also pretty well received by customer. I think right now, we do have the capability to serve our customers at the location that we can continue to remain open.

Operator

The question comes from the line of Christine Peng from UBS.

Yan Peng ***UBS Investment Bank, Research Division - Executive Director & China Consumer Staples Sector Analyst***

I think your previous comments pretty much addressed most of my questions. Just a very quick question on Pizza Hut. So obviously, Pizza Hut has achieved a turnaround in terms of sales growth, although there's a bit of fluctuations in terms of the same-store sales growth in Q4 of last year. So looking ahead, if we disregard the virus, what is the outlook for management for Pizza Hut brand in the next 12 to 18 months?

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Christine, you're asking the outlook for Pizza Hut in the next 12 to 18 months, right? For 2019, we are pleased with the progress actually, 1% of same-store sales growth. Most importantly, the underlying driver of the growth is from the improved traffic from both dine-in and delivery. The improvement of the dine-in traffic is critical because that shows that we are doing the right thing to improve the fundamentals of the business. And not only the sales has improved but also the profit has improved as well, and all the other consumer metrics like customer satisfaction, like how young the brand is, et cetera, et cetera. We do see Pizza Hut does need more time to cement the revitalization both in the areas of the fundamental, such as the product, digital, delivery and assets, the 4 fundamental areas that we have talked about many, many times.

We are particularly pleased with the fundamental improvements such as the product introduction. The product that I talked about earlier, the (Xian Dan Huang Xue Yu) pizza, the salty egg yolk codfish pizza, that's from National Banquet. And that's the aspiration of our food innovation right now, really good, appealing food that's sold at Pizza Hut price level and has amazing promotion mechanics such as Scream Wednesday. So both the product is good, the value proposition, value for money is very good. And then the delivery platform, the infrastructure is improving very, very well. And then the digital experience is improving by -- through seeing the increase of the Privilege members program and also the rollout of the Super, et cetera. And then the asset, 1/3 of our store has the new design. Like 1/3, there's no scientific number to prove that 1/3 is important, but just based on my experience, 1/3 of the entire asset is a new design. Customer perception towards the brand, towards the overall brand asset starts to move. It's just based on my experience. So all good.

However, the current coronavirus is hitting us hard, particularly Pizza Hut. Actually, it's hitting harder in Pizza Hut than KFC because KFC has the advantage of very high delivery percentage but also a well-established model of takeaway. So if we look at KFC's business, 20% delivery -- 20%-plus delivery and then actually 30% takeaway. So customers are very, very familiar with the model. So we're not -- when we launched the contactless delivery, not only contactless delivery but contactless pickup, so there are some stores that we opened just to provide a delivery service and pickup. So the customer just picked it up from the door, and it's okay. So that helps us hold up the business better. However, when it comes to Pizza Hut, while we have very high delivery service, the pickup service is yet to be well established. So the dine-in business still drives the bulk of the business. And therefore, the impact on Pizza Hut, unfortunately, is harder than KFC.

However, we do believe it's short term. I mean how long it will last? We don't know yet. We cannot tell. But as Andy mentioned from the very beginning, we do still very much believe in the long-term potential of this market, and we do believe in the business model of Pizza Hut. We need a bit more time. We'll probably need a bit more time to cement all the good stuff that we are doing through Pizza Hut right now. Thank you, Christine.

Debbie Ding ***Yum China Holdings, Inc. - Senior IR manager***

Thank you for joining the call today. We look forward to speaking with you on the next earnings call. That concludes today's call. Have a great day.

Joey Wat ***Yum China Holdings, Inc. - CEO & Director***

Thank you.

Ka Wai Yeung ***Yum China Holdings, Inc. - CFO***

Thank you.

Operator

And that does conclude our conference for today. Thank you for participating. You may all now disconnect.
