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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to Yum China's Second Quarter 2021 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions) I would now like to hand the conference over to our first speaker today, Ms. Michelle Shen. Thank you. Please go ahead.

Michelle Shen ***Yum China Holdings, Inc. - Director of IR***

Thank you, Divina. Hello, everyone, and thank you for joining Yum China's Second Quarter 2021 Earnings Conference Call. Joining us on today's call are our CEO, Ms. Joey Wat; and our CFO, Mr. Andy Yeung.

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. Reconciliation of non-GAAP and GAAP measures is included in our earnings release.

Today's call includes 3 sections. Joey will provide an update regarding recent developments and our second quarter 2021 results. Andy will then cover the financial performance in greater detail. Finally, we will open the call to questions. You can find the webcast of this call and the PowerPoint presentation, which contains operational and financial information for the quarter, on our IR website.

Now I would like to turn the call over to Ms. Joey Wat, CEO of Yum China. Joey?

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

Thank you, Michelle. Hello, everyone, and thank you for joining us today. Our business has recovered remarkably well, although the pandemic is still impacting our business and will continue to do so. We have learned to live with it, and we are focusing on the future. We focus on our core: good food, great value and customer experience. We penetrated further into lower-tier cities. We increased our store network density to suit the shift to off-premise dining post pandemic.

KFC remains resilient and continues to grow at a very fast pace. Pizza Hut achieved stellar performance and is expected to become another growth engine of Yum China. COFFii & JOY and Lavazza are making good progress.

We delivered a solid second quarter. System sales grew 14%. Operating profit grew 83%. We expanded the store footprint at an accelerated pace opening 404 new stores in the quarter. In less than 1 year, we added more than 1,000 net new stores and increased total store count to over 11,000.

Our team is laser-focused on driving sales. Our powerful digital platform enabled us to swiftly adjust our marketing campaigns. We can reach members directly with targeted offers. In the quarter, we recruited over 10 million new members, ending the quarter with over 330 million members.

Notably, off-premise and home consumption are becoming more popular in the post-pandemic era. Our delivery sales grew over 60% compared to 2019. We also launched retail products across our brands, leveraging our online and off-line assets, we intend to learn and innovate to address evolving consumer needs.

Let me update you on our core brands. First, let's start with KFC. KFC led our new store openings. We increased store density in existing cities and entered over 100 new cities in the last 12 months. With 280 new stores opened in the quarter, we now have over 7,600 stores across China. More impressively, new store cash payback and profitability remains very healthy across city tiers.

System sales grew 14%, led by same-store sales growth and accelerated new store openings. KFC successfully navigated this tough operating environment with reduced volume at transportation and tourist locations. Our operating profit grew by 50% to $240 million. It goes without saying the crucial role good food plays in our business.

In the second quarter, KFC added the wagyu and angus beef burgers to the permanent menu. KFC also launched Double Down a meaty chicken sandwich as a limited time offer. These innovations generated strong social buzz and are well received by consumers.

We know our consumers well and cater to local taste buds. KFC has introduced regional menu items such as hot and dry noodles, Wuhan Re Gan Mian and steamed dumplings, Xiao Long Bao in Hangzhou. We also launched a Sichuan spicy plant-based beef wrap and an oatmilk latte to provide choices to consumers.

With our good food, we also offer great value. Throughout the quarter, we launched attractive promotions to drive traffic. Our May Labor Day holiday bucket are the first ever mix and match buckets for dine-in locations.

On the digital front, we focused on growing our member base and driving their spending. We launched a new Privilege subscription plan, giving our members the choice of perks from a range of offerings. This provides flexibility for our members and drives incremental sales. We sold 8 million Privilege membership in the quarter. The average spending of our Privilege members doubled that of regular members.

Now let's move on to Pizza Hut. Our transformative initiatives in the last 4 years have yielded great results. Compared to pre-COVID levels in the back to 2019, same-store sales continued to recover, system sales growth turned positive. Operating profit more than doubled from the same period last year. We accelerated our new openings and add 70 net new builds in the first half of this year. This is the highest total net new units we added in the first half since 2016. It shows our confidence in the business model now.

Hub and spoke and other small store formats have proven to be successful and now account for most of our new stores. Store economics continue to improve. New store payback remains healthy and particularly for the hub and spoke and small stores. We will continue to increase density and penetrate into more new cities.

In the March new menu, we changed 40% of the menu items compared to the previous year. In the second quarter, we continued to improve our product offerings for better customer experience. In June, we upgraded our hand-tossed dough with more premium flavor and low-temperature long fermentation. This makes the pizza dough crispy outside and soft inside. It tastes particularly good and very, very suitable for delivery.

We also launched sirloin steak with parmesan cheese and knife-sliced noodle, not a very proper translation, but the Chinese name is called Dao Xiao Mian, it's a traditional specialty noodle of Shanxi province. This is a great fusion product combining elements of East and West.

To enable value proposition and enhance our value proposition, Pizza Hut has expanded the price range of its pizza offerings. In June, we launched 13 new pizza flavors at more affordable price points, mainly for the new upgraded hand-tossed dough. We also launched another successful All You Can Eat campaign offering abundant value. The Pizza Hut membership reached a significant milestone of 100 million members. Member sales now account for over half of system sales.

Digital and technology continue to play an important role in driving sales. Digital ordering increased to 84% of sales from just 29% 2 years ago. Delivery and table-side mobile ordering became more popular.

Coffee. Our coffee business making good progress. Lavazza tripled its store count, although the base is a bit small, in the second quarter. Initial results of our new store openings are encouraging. We now have 14 Lavazza stores in Shanghai, and we are opening our first beautiful store in Hangzhou, which is the first store outside China in about 1 hour, today.

We are confident in the potential of this 126-years-old Italian coffee brand.

COFFii & JOY doubled its per unit sales compared to 2019 and had a meaningful number of stores breaking even at the end of the quarter. We are reinforcing a specialty coffee brand positioning, expanding dayparts with more food choices, broadening the customer base and have better value for money.

To conclude my session, we are well positioned to capture the market opportunities in China. Our store network is growing at an unprecedented pace. We are investing ahead to fortify and future-proof our infrastructure and digitization. At Yum China, we are committed and confident to achieving sustainable growth in many years to come.

With that, I will turn the call over to Andy. Andy?

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

Thank you, Joey, and hello, everyone. Let me now provide additional details on our second quarter financials and then share our perspective on this year's outlook. Unless noted otherwise, all percentage changes are before the effects of foreign exchange.

Let me first cover our second quarter financial results. Total revenue grew 17% year-over-year and reached $2.45 billion. System sales increased 14% led by same-store sales growth of 5% and accelerated new unit development. Similar to last quarter, we are providing pro forma measures here for convenient comparison with 2019.

Same-store sales recovered to approximately 94% of the second quarter 2019. System sales grew roughly 9%, benefiting from new units and the consolidation of Huang Ji Huang.

Sales were recovering in April and May, but the trajectory was disrupted by the delta variant outbreak in Guangdong province at the end of May. Guangdong province is the largest economy in China and one of the largest markets. Housing 2 of the 4 Tier 1 cities, the outbreak led to temporary closures in the region and affected consumer behavior across China. Same-store dine-in volume is still well below 2019 levels. While off-premise occasions continue to grow rapidly.

KFC remains resilient and delivered robust growth. On a year-over-year basis, system sales of KFC grew 14%, led by strong unit growth and same-store sales growth. On a 2-year basis, system sales grew an impressive 7%, it is 2% faster than the Chinese restaurant industry growth of 5%. Despite subdued traffic at transportation and tourist locations, same-store sales recovered to approximately 93% with the same-store traffic at approximately 86%. Average ticket grew roughly 8% versus 2019, mainly due to the increase in delivery mix.

Pizza Hut delivered exceptional performance. On a year-over-year basis, system sales grew 16%, same-store sales grew 11%. On a 2-year basis, system sales growth in the quarter returned to positive. Same-store sales recovered to approximately 97%, a 2-point sequential improvement from the first quarter 2021. It was led by a 9% increase in traffic, driven mainly by more delivery and breakfast sales.

Restaurant margin was 15.8%, up 210 basis points compared to last year. This was mainly driven by sales leverage, favorable commodity prices and operational excellence. Cost of sales was 30.7%, 220 basis points lower than last year. Commodity prices declined by 7% year-over-year, mainly helped by lower poultry prices.

Cost of labor was 24.2%, 150 basis points higher than last year. This was mostly due to lapping of COVID-related government subsidies received in 2020, and cost and wage inflation of 3%. Labor productivity and labor shortage partially offset the increase.

Occupancy and other was 29.3%, 140 basis points lower than last year, mainly attributable to sales leverage, savings in operating costs. G&A expenditure increased 10% year-over-year, mainly due to higher compensation costs, consolidation of Suzhou KFC and the resumption of some business travel.

Operating profit grew to $233 million, a 65% increase year-over-year or a 6% increase compared to 2019. The increase was mainly driven by system sales growth and restaurant margin improvement. Our effective tax rate of 24.8% is similar to last year. We expect full year effective tax rate to be 27% to 29%.

Net income was $181 million. Adjusted net income was $185 million. Excluding $5 million net investment gain, it was $180 million, up 55% year-over-year. Diluted EPS increased to $0.42 from $0.34 a year ago despite enlarging our share base by roughly 11% as part of our secondary listing in Hong Kong last year.

Now let's turn our attention to the outlook. As we continue to drive sales growth and accelerate store network expansion, we need to be mindful of the near-term challenges. It may sound like a cliche, but we continue to expect the impact of COVID-19 to linger and that there would be periodic regional outbreak.

So full recovery of same-store sales to pre-COVID level will take time. Sales recovery will continue to be uneven and not linear, impacted by a few factors. One, subdued traffic at transportation and tourist locations; two, some health measures and restrictions on mobility to remain in place that will continue to impact dine-in traffic; three, shortened school holidays.

Operating profits and margins have improved year-on-year. In the first half, benefiting from sales leverage, favorable commodity prices, moderate wage increase and labor productivity improvement. We expect certain tailwinds to turn into perhaps headwinds in the second half.

First, cost of sales, which will be pressured by our focus on value campaigns and increasing commodity prices. We have already seen an uptick in poultry prices and will lap the low prices in the prior year. Therefore, the commodity prices will potentially come into inflationary pressure later this year.

Second, cost of labor. Cost of labor will increase in the second half of 2021 for 2 reasons. First, most of our stores have increased restaurant staff wages in June and July. Therefore, wage increase will be higher in the second half compared to 3% in the first half. Second, we are also increasing staffing levels to ensure customer services. As a reminder, the speedy recovery last year creates a tough comparison in the second half of this year.

Now despite these challenges, we remain confident in the long-term potential of China. We're accelerating store network expansion with increased store density to capture market opportunity and to better serve the shifting demand to on premise. We now expect to open around 1,300 new stores in 2021. We also will incubate our emerging brands for future growth.

To support this growth, we will continue to invest ahead in technology and infrastructure to further solidify our competitive position. We now expect full year capital expenditure of approximately $700 million to $800 million. As we step up investments, restaurant margins as well as G&A will reflect higher depreciation costs. Finally, following an assessment of the COVID situation, our financial position, the Board has approved the resumption of share repurchases. There's over $690 million remaining under the current authorization. We are committed to drive long-term returns for our shareholders.

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

Michelle Shen ***Yum China Holdings, Inc. - Director of IR***

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

QUESTIONS AND ANSWERS

Operator

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

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

Congrats for the very good results, again, during this environment. My question is about the labor cost and also the new guidelines from government to protect delivery rider's entries. So we all understand that YUMC has been taking care of the employees, but I still want to hear management's thought on the future labor cost management. And more specifically, given we have high revenue contribution from delivery business, so how should we think about the delivery cost increase due to government's requirements. And also, since we are also talking about the delivery 3.0 to enhance the efficiency, so like can we expect some efficiency upside to offset this potential cost increase?

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

Okay.

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

Michelle, this is Andy. Let me first give you some color on the cost of labor. As we have mentioned in prior quarters, we were facing labor shortage in some of our restaurants. And then we also have some moderate -- our wage increase over the past year because of the pandemic situations. Now we have decided early on in the second quarter to increase wages at our market in the -- for the restaurant staff. And so as I mentioned on my prepared remarks, we have increased wages in June and July in China. So obviously, we roll it out, as I mentioned, over the 2-month period across China.

And so -- and as a result, we do expect that the wage increase will be higher. And so we're approximately 7%, which is going to be roughly normal to returning to the pre-COVID level of rate increase. And so as a result, as I mentioned, we should expect higher COL in the second half because of the wage increase.

Now of course, we -- as a company, we always want to pay our staff more, higher salary and higher wages. We always promised that, we're focused on also maintaining profitability and delivering value for our shareholders. Therefore, we have invested over the years and then we'll continue to invest in technologies, improve our efficiencies in operations, investment in automation so that can continue to drive that labor productivity improvement. So hopefully, in the long run, we can continue to pay our staff more. At the same time, maintain a reasonable profit margin for our business.

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

Thank you, Andy. Michelle, I have just one comment about the labor cost, and then I'll address your question on rider labor law and delivery 3.0. We increased our delivery sales mix from 11% to right now over 30% since 2016. And I think you can see from our P&L statement that we managed to manage the overall delivery rider cost and also to find a savings to fund it and also to continue to deliver the profit margin for our shareholders. So we have done it in the last 5 years as proven in the numbers, and I believe that Andy also gave you some view and we'll continue to do that in the near future as well.

So let me address the rider labor law question and delivery 3.0. For the rider labor law question, I would like to make 3 comments. One is we are compliant to applicable laws and regulations, and we also require our service provider to sign a Yum China supplier code of conduct to ensure they are legally compliant with all applicable laws and regulations.

Second is regarding the rider safety, we have a very comprehensive delivery management system, clear guidelines. And we conduct regular audits to ensure food safety and rider safety. Of course, we also provide our riders training and equipment with safety measures.

Third, very important, we actually work with our service provider to manage rider's work intensity. Our riders, unlike other riders in the market, they are dedicated to serve only Yum China brands, so KFC, Pizza Hut. And we focus on service quality. And one thing rather different, which we have been criticized in the past but now I think we can see the beauty of it, is our order density for riders is roughly 30% lower than the platforms.

So you asked the question, so how do we make sure we pay the rider well so that we can keep them. Well, we pay our riders more per transaction. They get paid a bit more money. So net-net, the pay, the take-home pay for the rider is competitive. On top of that, our riders enjoy stable income with less stressful work intensity.

In the short term, it may sound like a disadvantage to our cost. But remember, as I mentioned earlier, we managed the cost okay. But that's absolutely the right thing to do for the long term with happier riders, better service quality and protect our brand in the long term.

So let me move on to your question about delivery 3.0. We upgraded our rider platform in 2020 to optimize our delivery trade zone and rider routine. As of right now, this platform covers 75% of KFC stores. And by the end of 2021, we will complete the rollout for all the KFC stores. At the same time, we are -- on top of -- we shared the rider within a few stores or few KFC stores within the same trade zone. We are also trying and going through the testing phase to share the rider with Pizza Hut as well.

So all this work will continue in 2021. We do expect the improvement in the trade zone optimization, the routine will result in improving in rider cost. Of course, there are more to be done as delivery business continues to grow, but the progress is good. Thank you, Michelle.

Operator

Our next question comes from the line of Xiaopo Wei from Citi.

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

Can you hear me?

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

Yes.

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

Yes, Xiaopo, go ahead.

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

My question's on Pizza Hut. And we are glad to see the strong recovery both in sales and margins in Pizza Hut as we know that casual dining has been very difficult segment for years for everybody. According to the public information, one of a few of your competitors actually did a very weak performance in the casual dining sector, but you guys really surprised the market with upside.

I know that Joey and team had done a lot for the Pizza Hut in the past 4 years: Products, delivery, innovation, et cetera, what do you think is the most important factors that contributing to the surprise on the upside. And why it suddenly take off? And how long this kind of recovery -- strong recovery can be sustainable.

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

Thank you, Xiaopo. Well, I would say there's no sudden recovery. It's really the hard work of the last 4 years, but it's hard to translate, but I think the Chinese way called Houjibofa is a good way to describe it. You work on it for over 4 years, day by day on all the key areas. And then finally, we get to the inflection point that the results start to speak for itself.

Let me comment on the path so far, we have taken, but also what is next. Well, I think it's fair to say that our 4-year revitalization program have yield great results almost in all the key dimensions from same-store sales traffic, same-store sales, system sales, margin, operating profit and right now, new store opening. They're all trending to the right direction. I'm not going to repeat the numbers which you all have it.

We -- if you remember, when we started the journey, we had a very bold goal to turn the same-store sales positive within 24 months. And we did. We delivered that. We turned the same-store traffic positive first then same-store sales. And in terms of which particular -- analytically, we like to say there are a few focuses. In reality, when we come to turnaround business, I have to be honest that we have to work on all areas. There's no such luxury of just focusing on 1 or 2 factors. And we roughly categorize them into 4 pillars, the fundamental, delivery, digital and store format, which you guys should be more than familiar, if not bored with the repeat focus. So all of them, all of them have delivered. But if I really am pressed to single out 1 or 2, I will have to say is the great food with great value. As simple as that. Food right now is fantastic with great value for money. My recent favorite, chicken curry, well, curry vegetables, it's hard to imagine that that's the national dish of British people. And then the pizza has improved a lot, not only topping but the dough. Right now, as of now, we are having pizza topping that's with Baozhi and Heniu, that's abalone sauce with Wagyu beef and that's a Michelin-star recipe. But the price is very, very good. So that has to be a key attraction and turnaround.

On top of that, we have really worked hard to improve the technology, the digital ordering and then the delivery, et cetera. So I'm not going to go through all the details about the 4 pillars.

What I would like to comment is what's next? Well, we now have confidence in the Pizza Hut business, and we are very clear that we want to make it another solid growth engine. What is next? Well, you guys are familiar with that, too. The next is resilience and high growth. We want the Pizza Hut business as resilient as KFC business so that it makes money during good times, but it also make money during bad time. That's the best way to protect the jobs of our staff in this big market.

And also now we have good food, good value for money. But we also have found a way with the new store opening has industry-leading cash payback and in-store profitability that's even comparable to that of KFC. What a fantastic thing to have, particularly for the satellite store and new store -- and small store Therefore, you can expect we are going to pursue high growth for these very profitable stores to pursue profitable growth now and in the future.

So focus on 4 pillars in the last 4 years. Going forward, we're going to focus on resilience and growth, in particularly, profitable growth. Thank you, Xiaopo.

Operator

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

Chen Luo ***BofA Securities, Research Division - MD***

Again, congratulations on another strong set of results. I also have some follow-up questions on Pizza Hut. I noticed in the announcement, Joey described Pizza Hut as another growth engine. We have not seen this level of confidence on Pizza Hut in the past few years. And just now, Joey, you also elaborate on a lot of initiatives regarding Pizza Hut. And in particular, I noticed Joey mentioned that for those satellite stores, the payback could be similar to that of KFC. So can you actually elaborate on the unit economics of those satellite stores? And also among the 1,300 store addition target this year, can you offer us a rough breakdown between our brands such as KFC, Pizza Hut and other brands. And also, lastly, in terms of margins, is it fair to say that we can -- our medium-term normalized restaurant margin for Pizza Hut could possibly return to the level that we saw during the years of 2017 or 2018 before we started to turn around the Pizza Hut business.

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

Luo Chen, thank you. I'll comment on the Pizza Hut confidence and then the payback for the stores. And then Andy will address the other 2 questions that you asked. I hope you can see our increasing confidence on our business, on our Pizza Hut business in the last 4 years. But we did take the prudent approach, and it's very clear what are the steps that we have taken. Traffic first, and then sales and then profit. And when we get to the point that we can get all 3, then we'll grow more.

It's just like, as I mentioned in previous earnings calls, sales is vanity, profit is sanity, and we like both sales and profit. What is even better is even more profit, right? So that's the growth that come in.

The confidence of the Pizza Hut business model, it does not come from 1 or 2 quarter positive results. It comes from the fact that we have been working very hard on improving fundamentals of the business. So the pain of working on the fundamental is good thing does take time. And the joy of the fundamental improvement is that benefit is long lasting. It will help our business model for the many years to come. It's not because of one-off promotion or et cetera. It's because the improvement in food, value for money, store look and feel. I mean the majority of our stores is very, very nice looking right now. I mean, unfortunately, you guys cannot see because you -- it's very difficult for you guys to come from to travel from Hong Kong and China. I really look forward for your visit to our new stores. It might be a bit too feminine for gentlemen but it's okay. We care about the ladies because they make the critical purchasing decision most of the time.

So the improvement at all fronts and the technology and now the customer like -- and last year, the challenge on COVID-19 further challenged our business model. And we took the challenge positively and with great results.

To give you an example, last year, with the big impact on our dine-in business, our Pizza Hut business took the opportunity to make the virtual out of necessity to use our existing ingredients to make very high value food, such as one-person meal Yirenshi. And that right now is bringing in incremental sales because our party size traditionally has been big, but the one-person meal is incremental business to Pizza Hut.

And also because of the pandemic, we push ourselves to grow the new retail business, not only we deliver cooked steak, but we also sell raw steak, marinated but raw steak that yourself or your Ayi cannot destroy. So all these are the result of hard work in the last 4 years and particularly last year. And therefore, we are at the point that we can be very responsible with our view that we believe Pizza Hut is another growth engine.

Given the size of the store, right, we have over 2,400 stores of Pizza Hut and in over 500 cities with fantastic brand particularly in casual dining business. So that's the fundamental.

And for the payback for the small store, particularly hub and spoke store, which is the business model I introduced to our shareholders and investors back to 2019 March. So much lower investment, it really supplements our current Pizza Hut store density. It also helped to make our current Pizza Hut stores, which are not too small, make it a real asset because the original stores will be what we call mother stores. These are the big stores, and they will be helping to open the kid store, which is the satellite store, to provide better convenience to our customers, focusing on off-premise consumption.

So now the satellite stores together with our original casual dining store, it's a fantastic network. It's a great way to grow our business. It's not like we have to go to -- we go very far away, and we're just putting one satellite store. And logistically, it's very difficult. No. We have stores there already. We have the casual dining store there already. We're just going to increase the density of our stores that will help the delivery of off-premise business. And when I say the cash payback is good, comparable to KFC and our numbers show that the success rate is very high because the investment is very low. And the payback is about 2 years. So that's fantastic.

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

Okay. So Luo Chen, let me address the question about the 1,300 new builds that we're looking at for this year. I think if you look at the breakdown, I think we obviously somewhat similar to before mainly KFC is a very strong powerful machine. It continues to generate very strong cash payback. So we should continue to expect very robust growth for KFC and it's going to continue to be the lion's share of the new store build.

As Joey mentioned, we continue to gain confidence in the economics for Pizza Hut. And then especially for the satellite store and the small store format. So you should see some accelerations on Pizza Hut's new store openings in the second half as well.

We also -- you probably have -- and Joey has mentioned on her prepared remarks, we're seeing, obviously, very strong consumer reception for Lavazza. We tripled in our store count, almost tripled, from about 5 stores to 14 stores in the second quarter. So I mean, we also have a number of stores in the pipeline. So you should also expect our Lavazza coffee business to be a driver.

And then hot pot, the Chinese cuisine business, hot pot business also will see an uptake in store opening in the second half. So -- but that's generally the composition of the 1,300 stores. But again, like I will mention that usually, the store opening will be probably faster in the second -- in the latter part of the year. So that's certainly the trend before the Chinese New Year. And so it's not completely linear, but generally you should see some acceleration in store growth -- new store openings.

Now in terms of Pizza Hut margins. I think, we're very pleased with Pizza Hut improvement. As we mentioned, it's not only it grew very strongly on SSSG or system growth, more importantly on the traffic. And then so the biggest driver, obviously, for margin improvement is sales leverage. And so the other part is for -- and also labor productivity improvement in the store economic model. And so if you look at the first half, though, we did benefited from, as I mentioned, 2 factors: one, lower commodity prices, right; and two we have sort of like a more moderate labor cost increase, that defrayed -- that helped improve the margins in the first half.

Now in the second half, I think, similar to KFC and Pizza Hut, we have rolled out wage increase across China in June and July for our restaurant staff, and so you should -- and also likely to increase hiring as well. So you should expect an increase in labor costs there. And then the other part is that we're also seeing commodity prices will be less favorable, and it was very favorable in the first half. Commodity price is down 7% year-over-year. So -- and I think we have seen, for example, poultry prices like, which is low in the first quarter and then have been rising since. And so we do expect that commodity prices also would build some pressure there and then perhaps come into inflation pressure year-over-year.

But those are the long-term headwinds that we're facing. But I think for Pizza Hut, we have continued to drive. I think the priority for them obviously is still to drive traffic, drive sales back to the store. We're still at a recovery phase for the pandemic. So the #1 thing for them, obviously, is to continue to focus on making sure that customers will come back to the store, come back to -- and then increase spending. And then we will continue to drive that possible improvement as business returns. And then we're also looking into driving that long-term profit improvement of Pizza Hut, but that should be a longer-term point of view. It shouldn't be taken as immediately to strive, to squeeze profit.

So in terms of the new store economics, I think, I think there's a couple of things right way. One is that a small -- the stores are generally smaller. The satellite store is smaller as the name would imply. So the throughput per store -- for a new store, probably lower than the existing portfolio. However, the profit margin is good, and then we have lowered our upfront investment, so the overall return is very strong. And as Joey mentioned, a satellite store is almost comparable to what KFC can do, so that's very strong and good return. So hopefully, that -- with that, we addressed all your questions. Thank you.

Operator

Our next question comes from the line of Anne Ling from Jefferies.

Kin Shun Ling ***Jefferies LLC, Research Division - Equity Analyst***

Most of my questions have been answered, but just one follow-up question on the cost side. Andy, you mentioned about the cost increase for commodity as well as labor. In the past, you shared with us that in terms of quantifying it, like, for example, in the beginning of year 2021, you mentioned about labor cost increased by mid-single digits. Now we're in the second half, maybe I have missed it, but would you share with us like the cost increase for commodity side, labor cost as well as G&A. And also maybe a breakdown in terms of the CapEx for the $700 million to $800 million CapEx which is a revised number.

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

Okay. Anne, so let me address the first question about commodity price and wage increase. Commodity prices, I think if you look at the first half, we benefited from the lower commodity prices by almost 7% year-over-year. As I mentioned, we have seen commodity prices, especially poultry prices have -- which is, I guess, the recent low in the first quarter and have been rising. And then -- so we're going to see less benefit, much less benefit of the lower commodity prices in the third quarter compared to the first half.

Now we -- obviously, the commodity price is very hard to predict. But the current trends suggest that based on our contract prices and whatnot, suggest that maybe perhaps in later half this year, the commodity prices could turn from a favorable 7% year-over-year deflationary pressure to an inflationary pressure, right? So that's our near-term outlook for commodity prices.

Now in terms of labor costs, in the first half, our wage increase was about -- wage cost compared to last year was about 3% increase. As I mentioned, we have decided to adjust our restaurant staff wage. And so we have rolled out that wage increases in June and July. And that is about approximately 7% year-over-year increase there. So that's second part of that.

And then the third part, I think, for the cost of labor is twofold. One is that obviously the delivery continues to be a higher mix of that. And then if you look at the hiring, I think we also have mentioned over the past few quarters that there are some -- labor shortage. And hopefully, with the salary and wage increase over there will ease that situation as well, so we're going to increase hiring.

Now obviously, as Joey mentioned, we continue to look for ways, savings to pay for that. And then we will continue to do so in the second half to look at productivity improvement how we can better utilize our IT technologies to help that. And then as Joey also mentioned, we continue to try to improve our delivery operation as well and drive efficiency. So -- that's a short-term outlook for us in terms of both COS and COL.

Now the second question is about the $700 million to $800 million CapEx for this year. I think, obviously, the lion's share of that is going to be in new store -- new build. And then some part is going to be for remodeling. Remodeling continues to be an important part of our capex program. We want to keep our restaurants fresh. And so we genuinely have a pretty robust remodeling program.

And then the third one, obviously, is investment in our IT and infrastructure. And then sort of like the main categories of our spending roughly in that order.

And then in terms of -- what was the second question?

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

G&A.

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

G&A, right. G&A. Yes, so obviously, on a year-over-year basis, G&A -- one is we would have less government-related subsidy. Last year, as you remember, there were general reductions in the social security insurance payment for working here in China. And so that has expired. The other part is that, obviously, we also have moderate salary and wage increase, compensation increase of our staff. So that's one. And the second point I believe folks will forget, is that last year, we had 2 acquisitions. One is the consolidation of our Suzhou operation. The other one is the acquisition of Huang Ji Huang. Both of them, we would absorb that G&A expenses. And then finally, and then last year, because of the pandemic, we basically have stopped almost all the business travel. And with the improvement in the COVID situations, there will be some return to -- some not all, but some return to some business travel. I think that's a normal path. And hopefully, that gives you some ideas about the expense and cost environment that we're facing right now. Thank you, Anne.

Operator

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

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

I have a question on the new store expansion because I think so far, you've been doing a very good job in terms of managing both very fast store expansion and margin improvement. So I just want to understand more in detail about the increase of store density impacting the existing stores. Does that have any impact on the same-store sales growth of the existing stores. That's one side.

And the other side is, yes, the payback and the return of new stores are quite good. So how are we going to look in the future with continued store increase, especially we uplift the target again. What kind of a dynamic we should look at in terms of new store margin and also the impact to the existing stores.

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

Lillian, thank you for your questions. Obviously, we are very pleased with the pace of store opening. We -- with that, we continue to capture the market opportunities that this presents to us, especially in the lower-tier cities. But also -- and also allows us to better serve our existing market. And we have designed, as we mentioned, our store network in an existing markets so that we can increase the density and better serve customers' need for delivery and takeaway.

So obviously, when you open a new store, especially increasing the density, it's natural to see some sales transfer. New store opening -- but that also the impact is not the same everywhere. And today, if you look at SSSG impact, I think the pandemic obviously is the most important one right now. The sales overall is still quite sensitive to, for example, some of the regional outbreaks as we have seen in the first quarter and as we have seen in June. And so we have always asked analysts and investors to sort of pay attention to the regional outbreak as we are.

We don't need to be overly alarmed by that, but we need to stay above because our experience tells us that periodic regional outbreak is to be expected. We have seen that in December, January. We have seen that in June in Guangdong. Now we're seeing a potential outbreak here in Nanjing. And is that still a relatively recent situation.

So what is driving SSSG, there's many impact, many different factors there. But again, going back to the main point here, which is near term. For lower tier cities, there will be some impact. But if you look at lower tier cities overall, the SSSG are actually faster, right? So -- and for some urban area, I think as we design our network, one thing that will impact SSSG is to reduce that delivery trade zone. So for example, if you have a store that was 5-kilometer before now you're going to shrink it to 3-kilometer because you want to have better delivery services and whatnot. And so that would naturally -- with that increased density, we are able to cover that, we are able to do that to serve our customer better. But that would naturally mean that we will have to shrink some of the delivery trade zone for some of our existing stores.

So -- but I think would that have an impact on SG&A, probably a little bit, but is that the right thing to do? Absolutely. And especially when we look at some of these changes that have been accelerated by COVID 19, one of them stand out is obviously, delivery sales, right, off-premise consumption or at-home consumption. So this is something that I think when we mentioned the store opening and SSSG, I think is something that to be aware of.

The other one is what's the other one here, payback in the future with increased target.

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

With increased store target.

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

In store target. So if you look at our store opening, we always have a very disciplined process. And that has been so for the past many years. And then this continues to be slow and will continue in the future. That's why when Joey mentioned, we're going to try to accelerate growth, to put a special emphasis on profitable growth. And so -- and then if you look at our payback period for both KFC and Pizza Hut, they have been very robust and very stable. For KFC, roughly 2 years and for Pizza Hut roughly 3 to 4 years. And as Joey mentioned, for some of the smaller stores and satellite stores nowadays, the payback period could be even shorter than that. And so we'll continue to do that, making a balance between faster growth to capture market opportunities, to better serve our customers. But also to maintain our financial discipline for profitable growth.

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

Thank you, Andy. Really, I just want to add 2, 3 color -- 3 highlights to your question. First of all, we would really like to reiterate our focus on system sales growth in the short term and the long term because this is not a mature market yet. This is still a developing market with huge opportunities to open new stores. We are only in 1,600 cities in China and there's still a few hundred cities for KFC and there's 1,000 cities for Pizza Hut. So let's look at the systems sales in the short term and long term. And margin, we always have the balance on the profitable margin growth.

And I would like to add 3 things. One is, in the past few years, both KFC and Pizza Hut particularly KFC, we have made ourselves very flexible. And that flexibility is part of resilience for us to open stores -- to open more stores within the gap of existing stores and to open more stores in the new cities. I'll give you a few drivers here. Andy, mentioned it, and I would just like to touch upon it.

Well, the dine-in traffic is subdued right now. It probably will stay. We see that. Therefore, what are we doing? We try to grow incremental growth from the dayparts, for example, late night Shenyangjijia, is a chicken bone from Shenyang. It's a fantastic new product innovation that really drives the sales of the late night. Is it enough to fill the gap of the dine-in? No. But for now, the dine-in business is challenging probably will stay, but we see the opportunity to grow incremental business.

We also see the opportunity in regional menu, which we did not -- we have not further explored the opportunity. For example, the Wuhan reganmian. It's not only selling well in Wuhan. Actually it is selling even better in Jiangxi and Shenzhen because for Wuhan people in Jiangxi and Shenzhen, KFC is the only place that they can buy the reganmian hot dry noodle.

So -- and we also started new retail that's across all the brands. That is a fantastic incremental business to delivery business as well as off-premise business. So this internal -- internally, we become Neigong internally, we become more flexible, stronger, that allow us to take advantage of more store locations to open more stores.

Well, secondly, we have become a better tenant. If you think about last year, what happened is we are one of the very few retailers, food retailers that can continue to pay rent. And we did not lay off any people. Tenant -- whether you're a good tenant or not is decided by the landlord. And the landlord right now really like us and if not love us, particularly in the lower-tier city. We're a clear traffic driver and anchor tenant. And the rent that we are getting in lower-tier cities is fantastic. And that helps the economics of the new store opening.

And then we also have become more clear with our new franchise strategy. The channel franchise strategy, the remote area franchise strategy so that we are helping our franchisees to open more stores in the area that -- we can still do it, but it's not as efficient as for the franchisees to run the operation locally in the remote areas.

So with the 3 combined factors, we believe that we can continue to pursue system sales, which is a combination of profitable new store opening and the recovery of SSSG. And then also protect the margin because it will not be right for our shareholders in the short term and in the long term if we buy market share. We don't -- it's a discipline. We only pursue profitable new store growth with industry-leading cash payback and in-store profitability. Thank you, Lillian.

Operator

Our last question comes from the line of Christine Peng from UBS.

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

Thank you, Joey and Andy to share so many colors on your company's latest operation as well as management of stores towards many questions investors have been asking the analysts about. So I have a question regarding the coffee business. I think Joey mentioned briefly about the latest operations about Lavazza COFFii & JOY. I remember when I was in China at the end of last year, I visited the store of Lavazza near your office. And when I looked at some of the commentary on the social media platform, I realize there has been a lot of changes to Lavazza's newly operated stores in China compared with one I visited end of last year.

So Joey, maybe can you share with us more color about the latest progress you are making to Lavazza, especially how you think about the long-term positioning of the brand compared with existing competitors such as Starbucks. And if you can share with us some of the financial details such as store economics, that'll be even more appreciated.

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

Thank you, Christine. I hope one day, you got -- you can try our Wuhan reganmian and see whether you like it as a local person. Compared to the coffee business, let's take a step back. We have 3 coffee brands in Yum China, K-Coffee, C&J and Lavazza. I'll come to Lavazza a bit. I'm very happy to report K-Coffee for 2021 first half, we increased the sales of coffee per cup by as much as 30% compared to the pre-pandemic 2019 number. And that shows that our focus on good coffee at affordable price is a viable strategy. Good for the coffee business, good for KFC same-store sales, right?

C&J, we have been working on it. Now we have 38 stores. And we've been very transparent that we are learning the operation side of a business, of a new business. We have huge respect towards new business. And I'm happy to report that we are there because a meaningful number of stores will be breaking even by end of this quarter and more will be by end of year-end. And that allows us to build the people. Business is about people. Without good people, there's no business. So we build our operation people. And we become sharper with our marketing positioning and pricing, et cetera. And these learnings are all helpful, very helpful when it comes to the experience of building Lavazza brand in China. It takes much less time compared to C&J for us to get the operation right, to get the marketing right and also with our fantastic partner Lavazza to help to get the food right, to get the Italian flavor of the whole environment, the food, the drink, et cetera.

So Lavazza, Andy said it earlier, I'm going to emphasize, we are going to have an accelerated pace of development for the second half of the year compared to first half. So first half, we moved from 5 stores to today 15 stores, mainly in Shanghai and now one store in Hangzhou. So for the second half, we have -- we will accelerate the store opening pace and will enter into more cities in China. So that's in terms of footprint.

In terms of business model, right now, we so far had -- in Shanghai for the 14 stores, we have -- half of the store what we call large store to build the brand. And then the other half are either smaller, slightly smaller stores, or medium stores. And these are the stores with much better economics to make money faster. So a combination of flagship store to build a brand and then smaller store to build the sales. That seems the right thing to do, and we are very happy with the initial results. So that is the second.

Third is, we already are encouraged by the initial results and working on daypart, menu combo, delivery and others. Our off-premise sales mix right now is over 50% for Lavazza store. And that's good, right? Because we know that right now, the off-premise is the trend. And for Lavazza, obviously, finally, my comment is the positioning is premium, it's authentic Italian style coffee with a nice environment. We believe the Chinese consumers can have a choice, can have alternative, other than one single choice in this beautiful premium coffee segment.

So that's where we are right now, and we cannot wait to see more beautiful stores. With fantastic food-- I suppose it's hard to get Italian partner to produce bad Italian food, and we are not complaining about it. So we really look forward to have opportunity for investors and for analysts to try our Lavazza coffee and food in China. Thank you very much, Christine. And hopefully, in Hong Kong, one day, by the way. Thank you.

Michelle Shen ***Yum China Holdings, Inc. - Director of IR***

Thank you, Christine. Before we end today's call, please note that we will host a virtual Investor Day on the morning of September 23, Shanghai Time. We will announce more details as we get closer to the date. With that, we will conclude today's call. Thank you for joining. Have a great day.

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

Thank you. Thank you.

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

Thank you, everyone, and thank you, operator.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.