REFINITIV STREETEVENTS

EDITED TRANSCRIPT

Q2 2022 Yum China Holdings Inc Earnings Call

EVENT DATE/TIME: JULY 29, 2022 / 12:00AM GMT

CORPORATE PARTICIPANTS

Joey Wat *Yum China Holdings, Inc. - CEO & Director*
Ka Wai Yeung *Yum China Holdings, Inc. - CFO*
Michelle Shen *Yum China Holdings, Inc. - IR Director*

CONFERENCE CALL PARTICIPANTS

Lillian Lou *Morgan Stanley, Research Division - Executive Director*
Michelle Cheng *Goldman Sachs Group, Inc., Research Division - Executive Director*
Bryan Wang *China Merchants Securities (HK) - Equity Research Associate*
Xiaopo Wei *Citigroup Inc., Research Division - Director & Head of Asia-Pacific Consumer Research*
Sijie Lin *China International Capital Corporation Limited, Research Division - Analyst*
Kin Shun Ling *Jefferies LLC, Research Division - Equity Analyst*
Yan Peng *UBS Investment Bank, Research Division - Executive Director and China Consumer Staples Sector Analyst*
Lucy Yu *BofA Securities, Research Division - Research Analyst*
Wing Hong Woo *CMB International Securities Limited, Research Division - Research Analyst*

PRESENTATION

Operator

Thank you for standing by, and welcome to the Yum China Second Quarter 2022 Earnings Conference Call. (Operator Instructions)

I would now like to hand the conference over to Michelle Shen. Please go ahead.

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

Thank you, Melanie. Hello, everyone, and thank you for joining Yum China's Second Quarter 2022 Earnings Conference Call. Joining us on today's call are our CEO, Ms. Joey Wat; and our CFO, Mr. Andy Yeung. We are dialing in from different locations today. If we experience a technical difficulty during the call, please remain on the line as we reconnect.

Before we get started, I'd like to remind you that our earnings call and Investor Presentations 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 our performance in the second quarter. Andy will then cover the financial performance and outlook in greater detail. Finally, we will 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.

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. Second quarter was the most difficult quarter in the past 2.5 years. With our main focus always on keeping our employees and customers safe, we also want to bring joy to our customers. We kept our morale high and came together to deliver better-than-expected results. I'm both glad and honored to fight the battle alongside the wonderful Yum China teams.

We operated with our Shanghai headquarters under lockdown for over 2 months and still managed to execute with extraordinary agility, quickly forming cross-functional and across brand crisis management team [working from home], while we developed flexible tool kits to tackle each problem as it arose. Through it all, we have stood firm and built the business stronger in so many ways.

We have innovated new menu offerings, delivery and digital solutions as well as cost optimization initiatives. These solved not just the imminent problems but can serve as our learning base to make us more agile and resilient for the longer term.

During this trying time, we continued to execute our RGM strategic framework. That is Resiliency, Growth and Moat. Let's start with resiliency. Our resilience shines brightest in tough situations. Let me share with you some of the measures we implemented to overcome considerable operational difficulties. During the city lockdown in Shanghai with very limited restaurant staff and riders, our goal was to sustain minimum level of restaurant operations and serve desired food to customers.

We simplified menus, we reduced complexity of operations and inventory management. At the extreme, we just had 1 bucket of fried chicken on the menu, one item on the menu and that's it. Fried chicken was perhaps one of the most desired food items in Shanghai during lockdown and brought our customers great happiness. We launched community purchasing (Tuangou), as early as in mid-March, including packaged food products not just for KFC and Pizza Hut, but also for our emerging brands, Lavazza, Taco Bell and Little Sheep.

In the Q1 earnings call, I shared that with 10% to 15% of the stores opened in April, Shanghai achieved 40% to 50% of pre-lockdown sales. In May, with less than half of our stores open, we reached pre-lockdown sales level. This was a remarkable achievement. We were able to continue serving our customers, thanks to our in-house and agile supply chain management system as well as dedicated last-mile delivery riders. We obtained the necessary permits and managed to serve the majority of Shanghai under severe mobility restrictions.

Digitization also played a very critical role. In just a day's time, our stellar IT team launched an AI-enabled delivery route planning tool for community purchasing in Shanghai. The tool optimize full day delivery routes covering a wide geography well beyond our usual store-based vicinity radius.

Across the country, where we faced a challenging operating environment, we dialed down advertising and promotions to save costs. Some of you may remember the Psyduck (Kedaya) and other Pokemon meal companion tours we launched around Children's Day on June 1. The Psyduck instantly went viral becoming a smash hit with children and adults alike. The sensational buzz from this campaign drove almost 20% of sales in the first 2 days of the promotion. Who would have thought that we chose Psyduck just to accommodate our reduced advertising budget.

The results were phenomenal. We were thrilled to bring joy to a customers' life during an exceptionally hard time and to see their social media posts. We also focused on driving off-premise sales, delivery grew 7% year-over-year and reached a record sales mix of 38% in the second quarter.

Combined with takeaway, off-premise dining contribute to almost 2/3 of sales. Also, excitingly, our new retail packaged food sales reached CNY 200 million in the second quarter. This more than doubled the sales compared to last year. These initiatives partially offset the reduced dine-in services.

Let's move on to growth. Even in conditions like this, we don't stop delighting our customers with innovative food and value campaigns. Our ability to innovate is an important pillar to capture growth opportunities.

KFC diversified into adjacent categories to drive additional growth. With Wagyu and Angus beef burgers as premium options, we launch entry price choices at only around half of the price, which is CNY 18 versus CNY 33. On the weekends, we are now offering juicy whole chicken at CNY 29.9 to drive sales. This juicy whole chicken is one of my personal favorites now, and it's absolutely delicious. These 2 new categories have proven popular, accounting for mid-single digits of menu mix combined in June.

Our food innovations team lets their creativity fly when designing new products. At KFC, we launched a super abundant chicken bucket (Duoduotong) in select cities. This bucket features chicken feet, chicken wing tips, necks and other parts traditionally favored by Chinese people. For some of the analysts who asked me before when would we start to sell chicken feet, we are officially selling chicken feet right now after 35 years.

This follows on the heels of KFC's launch last year of its super popular late-night snack Chicken bone nibblers (Jijia). In addition, the usage of all parts of chicken provides an intriguing variety to our customers at a very good cost.

Pizza Hut's new menu received amazing customer feedback and generated a boost in sales. We launched the campaign on social media and sponsored TV shows instead of using celebrities. With just 1/3 of the advertising costs, the menu achieved the same customer awareness as last year's menu. The new menu included 35 brand new or upgraded items such as Stuffed crust pizza with sausage and meat floss (Rousong), while Wagyu Supreme pizza and Deep-fried cereal prawns. Yes, we put the cereal around the prawns and it tastes wonderful.

Taco Bell launched a Wrist burrito (Shouwanjuan) with a lighter sauce and more vegetables tailored for Chinese customers. It gained great popularity and appealed to our more health-conscious customers. Value for money resonates well with customers under the current circumstances. As part of the 35th anniversary celebration in China, KFC offered its signature product at amazing prices. Original recipe chicken at its CNY 19.87 price and the Family bucket at almost 60% off a la carte price. This campaign brought back fond memories and became a hit with customers. We rotate the offers weekly to have the flexibility to adjust according to the market conditions in different regions and customer response.

Our iconic Crazy Thursday value campaigns have won the hearts of our customers. Since we first launched it back to 2018, we have been constantly spoiling our customers with very attractive offers. The campaign now inspires scores of creative social media posts. Thursday's also generate significant sales uplift compared to regular weekdays and sometimes even weekend.

At Pizza Hut, we brought back its signature buffet. And sold all 400,000 buffet sets in a preorder promotion in just 15 days. We also launched a Buy More Save More combo offering more abundant options. The new combo successfully lifted ticket average and lowered our costs.

Let's move on to moat. Digital initiatives and supply chain infrastructure are the key enablers in our strategic moat. Leveraging our dynamic digital ecosystem, we generated around 4 billion in digital sales in the first half of 2022. This represents 88% of our sales.

Our loyalty program exceeds 385 million members as of the end of the second quarter. We shared the latest launches and engage with members through our Super App, mini programs and social media groups. We, also, constantly upgrade these tools to improve our customer service. KFC Super App now features a senior-friendly interface option with simpler graphics, less promotion information, bigger forms for mature eyes and streamlined ordering functions. We tailored it to the need of our older customers.

Pizza Hut also upgrade their mobile ordering menu for more flexible Buy More Save More combos and customized product displays. Our digital capabilities were crucial to streamline restaurant efficiency. Tools like our restaurant sales forecasting system and Pocket Manager gave us full visibility of the situation in each store. With these, we can rapidly adapt to changing scenarios.

Our real time inventory visibility from logistics centers to stores helped enable us to dispatch raw materials with greater precision. Restaurants could adjust orders daily based on their operating environment and share inventories across the stores when fulfilling community purchasing or other large orders.

As an ongoing effort of Delivery 3.0, which allows rider sharing across trade zones, we now offer the same flexibility to our restaurant staff. Staff now can schedule shifts across stores and even across cities. We continue to invest in building a world-class intelligent and digitized supply chain to improve operating resiliency and support business growth.

Our first 2 greenfield logistics centers in Chengdu and Huai'an, in Jiangsu are now complete and operational. And a week ago, we announced construction starting on our new Jiading Supply Chain Management Center in Shanghai. This project is our largest greenfield project yet and will serve as the headquarters for our 33 logistics centers across China. It will integrate the latest state-of-the-art digital technologies and support restaurants in Eastern China.

2022 has indeed been extremely challenging. We learned many lessons and now emerge as a stronger and more resilient organization. And I'm not saying this just for KFC and Pizza Hut. Some of our emerging brands have also demonstrated great agility and potential during lockdowns. I'm convinced that by executing on our RGM framework, we are well positioned for sustainable long-term growth.

True to our hallmark DNA of resiliency, we are taking every action to quickly drive returning traffic to our stores by providing good food, great value and good customer experience. Going forward, we will continue to delight our customers and seize new opportunities to grow our business in China.

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

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

Thank you, Joey, and hello, everyone. Let me share some color of our second quarter performance. The COVID situation has significantly impacted our second quarter results. In April and May, same-store sales declined by more than 20% year-over-year. On average, more than 2,500 stores were temporarily closed or provided only limited services.

The situation gradually improved in June. We were able to capitalize on that improvement with same-store sales decline narrowed to high single digits year-over-year and the number of temporary store closures also reduced. We achieved operating profit of $81 million and restaurant margin of 12% in the second quarter. We were able to generate meaningful profit in the quarter, which exceeded our expectations, not only by capturing sales when the COVID situation improved in June, but also, by taking swift and decisive actions.

We adjusted offers and promotions, spent tremendous efforts in driving productivity gains, secure onetime release and rebase our cost structure. Let me go through the financials and our cost control initiatives. Unless noted otherwise, all percentage changes are before the effects of foreign exchange. Foreign exchange have a negative impact of approximately 3% in the quarter.

Second quarter total revenue decreased 13% year-over-year in reported currency to $2.1 billion due to the same-store sales decline and temporary store closures. This was partially offset by the contribution of new units and the consolidation of Hangzhou KFC. System sales were down 16%. Same-store sales were 84% of prior year's level.

By brand, KFC's same-store sales were 84% of prior year's level with same-store traffic at 75%. Ticket average grew 12%, mainly due to the increase in delivery mix and higher ticket average of community purchasing orders.

Pizza Hut's same-store sales were 85% of prior year's level. Same-store traffic was at 80% while ticket average increased by 6%. This was driven by the higher ticket average of community purchasing.

Restaurant margin was 12.1% down 370 basis points compared to last year. This was mainly due to significant sales deleveraging impact, significant sales cost inflation and higher delivery costs. To take actions, we have taken actions to mitigate their impact. Let me next go through each expense line and the actions we have taken. Cost of sales was 30.9%, almost flat year-over-year. We took prompt actions to reduce promotional activities and discounts to keep commodity price increase to low single digits and to optimize the distribution frequency from warehouse to store to in order to reduce logistics costs.

Cost of labor was 27.1%, 290 basis points higher than last year, mainly due to sales deleveraging, wage inflation of 5% and more delivery-rider costs, resulting from higher delivery mix. This was partially offset by improved labor productivity as we simplified promotions and menu items, reduced operating hours as necessary, reduced hiring and prioritize scheduling of full-time employees.

Occupancy and other was 29.9%, 60 basis points higher than last year. The modest increase was mainly attributable to sales deleveraging and rise in utility prices, which was partially offset by our cost initiatives.

Over the past few years, we spent considerable efforts to reduce the fixed components of our rental expenses, shifting them more to variable components. These efforts continues to improve the flexibility of our operations. In addition, we negotiated meaningful rent relief from landlords. Apart from that, we pulled back on marketing and advertising and took on more energy-saving initiatives.

G&A expenses increased 6% year-over-year, mainly due to increased compensation and benefit expenses as well as the consolidation of Hangzhou KFC. This was partially offset by lower share-based compensation expenses.

Operating profit was $81 million. The net contribution from Hangzhou KFC's consolidation was roughly 3% of operating profit in the quarter. It includes the amortizations of intangible assets acquired, which is roughly $16 million per quarter, and that would run through the end of this year.

Below the operating profit line, we incurred a $16 million mark-to-market net gain on our equity investment this quarter. It was $9 million more than the same period last year. Effective tax rate was 26.5%, 170 basis points higher than last year, mainly due to Hangzhou KFC consolidation and lower pretax income.

Prior to consolidations, the equity income from JVs was not subject to tax, resulting in lower tax rate. The effective tax rate in the first half of this year was 30.4%. We expect full year effective tax rate to be around low 30s. Net income was $83 million. Diluted EPS was $0.20. The mark-to-market gain in Meituan positively impacted our diluted EPS by $0.04.

Despite the challenges in the second quarter, we returned $218 million to shareholders in cash dividends and share repurchases. In total, we returned USD 0.5 billion to shareholders in the first half of this year. We will continue to execute on our disciplined and balanced capital allocation strategy.

As always, our priorities are to have sufficient cash for daily operations to deal with contingencies and to invest in capital expenditures to drive organic growth. Now let us take a look at the third quarter outlook. We saw some gradual improvement in restaurant traffic in June. Still, we remain cautious on same-store sales. The external environment remains very challenging, given the recurrence of COVID outbreaks, weakening consumer sentiment, downward economic pressures and commodity price inflation.

In July, the more infectious Omicron subvariant appeared in Shanghai, Beijing and other cities. Nationwide, the number of cases has increased again after 2 months of sequential decline. Many cities, including Xi'an, Chengdu and Lanzhou, have experienced some kinds of lockdown conditions, following the dynamic Zero COVID policy. Therefore, we expect sales recovery to take time to be nonlinear and uneven and potentially volatile.

Our focus is to drive sales recovery. We have planned a variety of new product launches and marketing promotions. We are also working to ensure great value for money to attract consumer spending. In additions, our teams employed extensive scenario planning with regional focus to stay agile in this ever-changing environment.

We're delighted with the better-than-planned cost savings in the second quarter. As we look into the third quarter, we are dialing back some of these austerity measures to sustain long-term growth and operational excellence. For example, reduced promotions, simplified menus, shorten store operating hours and rent relief are temporary. In addition, sales deleveraging impact is real and will continue to impact our margins.

Also, we continue to face headwinds from the inflationary environment. Prices of commodities such as cooking oil and beef as well as utilities have risen significantly this year. On the labor side, we expect labor inflation to soften, given different the downward economic pressure. However, the increased mix in delivery sales will likely increase rider costs.

Despite challenges we face, our expansion strategy positions us well for long-term growth. In the second quarter, we slowed store openings in response to the COVID outbreaks. Yet, we remain committed to open good profitable stores that will grow for years to come.

Over the past few years, we have been innovating store models to cater to different business needs like delivery and takeaway services to enhance store densities in higher-tier cities and to expand into lower-tier cities. This year, we expect more than half of our new stores to be in smaller formats. We lowered up-front investment and streamline restaurant operations to be more efficient. The smaller format together with our reputation as a reliable tenant opened up more potential sites for new store openings.

Our new stores remains healthy. The latest batch of new stores yielded store paybacks of 2 years at KFC and 3 years at Pizza Hut. The majority of stores opened in the first quarter this year were able to achieve breakeven in 3 months. The healthy payback period reflects our disciplined approach to store openings. Reassured by a strong pipeline and healthy new store performance, we maintained the target of 1,000 to 1,200 net new stores for this year. In the near term, we continue to expect volatility in our business due to the resurgence of COVID outbreaks, softened economic conditions and their impact on consumer sentiment. Nevertheless, we continue to focus on the elements of business that we can control.

As demonstrated in the past 2.5 years, we are confident that our people, our execution and our strategy position us well to deal with this very challenging environment, perhaps better than others. Also, our investment in new stores, supply chain and digital will bring growth opportunities and make us even more resilient. With that, I will pass you back to Michelle to start the Q&A. Michelle.

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

Thank you, Andy. We'll now open the call for questions. (Operator Instructions)

Melanie, please start the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Lillian Lou with Morgan Stanley.

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

Congratulations to the very solid results. My question is, I mean, on the margin side because, obviously, I think every cost line was controlled much better than expectation. Just want to understand with business gradually reopen, especially more stores are reopened and running at normal hours, How do we see this cost line on a trend, whether some of the -- because I think, and Andy and Joey, you mentioned some of relatively temporary measures for cost savings? So I want to understand would same-store sales growth continue to be negative? How we're going to project this, I would say, cost changes, especially on the margin side on a year-on-year basis?

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

Thank you, Lillian, So let me answer your question. I think, first of all, I think, as we mentioned, the second quarter margins and profit were -- exceeded our expectations. I think it's made all possible -- I think, first of all, is that it's all thanks to the very incredible effort and resilience and dedication of our team, especially our restaurant employee who did everything humanly possible and endure a lot of hardships during the lockdowns and the pandemic to continue to serve customers in need and keeping our store open, running as normal as possible.

So I think those efforts, the superior effort, I don't think it's possible on a sustainable basis. In terms of -- and obviously, the outperformance was also benefited from the improvement in June in terms of the COVID situation and our ability to actually capitalize on that improvement. And so as we mentioned, same-store sales decline narrowed to high single digits in June.

But in terms of cost front, we mentioned already, some of these initiatives are temporary. So for example, like we have cut back quite significantly on marketing and promotional activities. I think as we try to drive sales, I think we stopped that. We also mentioned that in terms of managing this inflation, cost inflation in COS in the first quarter, phenomenal. But I think if you look at the commodity price, you're still -- in a fairly elevated level, and we expect that to continue to go up.

In terms of labor, I think, obviously, we have simplified menu items. We have shortened some offering hours during the second quarter and then we also reduced hiring. And so some of this is going to have to be dialed back, especially as we sort of try to return to a more normal operations. So we will have more normal menus and normal offering hours. In terms of, again, going back to O&O, we do advertising spending would have, I think, would be dialed back. I think we will return to more proactive advertising to drive spending.

And then we actually mentioned also, too, there was some one-off in terms of rent relief and government relief, and so some of these directly related to COVID some of these not. And so we have about roughly close to $20 million of that in the quarter, and we're not certain -- we're quite uncertain about if we can receive the amounts in the third quarter.

So I think when we look into the third quarter, as I mentioned, the key thing obviously is sales, right? [Sales] leveraging is real. And as we see the COVID remains one of the biggest uncertainty going forward, and we see some resurgence in cases in July, nationwide. And then we see some cities, for example, Chengdu, Lanzhou, and also Xi'an were under some lockdown measures. And so this is -- so that's why we say the recovery of that remain -- take time, will be nonlinear and potentially volatile.

Now obviously, we will continue to sort of like focus on cost control, trying to have scenario planning and try to stay nimble. But I think we need to be realistic about the uncertainty that we face and then the sales leveraging and also global inflationary pressure there. Thank you, Lillian.

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

Lillian, I just want to give some color about these numbers, behind the numbers. Let's say take COL. Some of the savings will not continue, some of it will continue. For those who will continue such as the sharing of staff across the store, some of them will not continue such as in the extreme situation. During April and a bit of May, these stores are run by very few number of employees.

Typically, they stay in the store for 1 week. They literally live in the store for a week and work nonstop. And then a week after second shift of staff moving. However, for some smaller brands, the most extreme case is one of my staff stayed there for 33 days. The other one stayed there for 44 days. I have the fortune to invite some of them to have lunch with me recently to thank them. It's truly heart-warming behind these numbers to really grateful that we have such amazing operation teams.

They work this hard so that they can protect their job and they can serve the customer and thus, they can protect the company. But this kind of extreme arrangement, of course, cannot be sustainable. But if we have gone this far, other innovation and creative arrangements, our team become even more open minded to embrace any sort of innovation in terms of rebasing the cost structure. Thank you, Lillian.

Operator

Your next question comes from Michelle Cheng with Goldman Sachs.

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

My question is about the incremental opportunity we observed during the tough time. So you mentioned that there is some of new business we are driving the community group purchase. And on top of that, the retail products are selling pretty well during the tough time. So are we going to be more aggressive exploring this new business line?

And in addition to that, from the way we do the business, Joey, earlier, you mentioned that we have these AI-enabled route to improve the delivery efficiency, et cetera. So just wondering like those opportunities will observe during the tough time? How we should think about the sustainability and how we are going to grow this opportunity even further in the future? Thank you.

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

Thank you, Michelle. Let me take a step back and then comment on your question about the incremental opportunities. Overall quarter 2, we delivered substantial operating profit versus expected loss. The absolute number is not the highest quarter, $80-some million, but the quality, the amount of effort going into it and the resiliency our team has demonstrated is phenomenal. And we can see the result. April is tough. May improved a little bit. June came back quite a bit.

So the core of the core are the questions that you just asked, what do we do? How do we manage to do it? Well, I mean, if we want to go back to our strategic framework, which hopefully make it much easier for our key stakeholders to understand the management team, it's going back to RGM the resiliency, the growth and the moat.

In terms of resiliency, the 2 examples that you mentioned, Michelle, the new retail, the community purchasing and the AI, these are great examples about our resiliency. We react very, very quickly. We are talking about putting together the community purchase program, starting with the hot line and later on with the mini programs (Xiaochengxu) within a week across the brands. We got the entire process team program done by the middle of March. And then we roll it out and wait for 2 or 3 days and then the demand came in.

And that's the kind of speed, agility and determination, ability to execute innovative solutions. That earn us the resiliency and thus the results. So the Tuangou, the community purchase happen. And then when that happens, of course, we are selling what we can sell, at that time, which is fried chicken, but that's not enough. Because of all kinds of limitation, and also, at-home consumption, you can imagine increased dramatically. So we pull in the new retail, the packaged food. and at the height of the new retail Pizza Hut, I believe is April, 50% of the Pizza Hut sales in Shanghai is from the new retail. Well, now time has moved on. Later on, by June, it became 20%, and then now the percentage is smaller. But to go back to your question, Michelle, we doubled the new retail business to -- during the quarter 2 compared to last -- year-on-year last year. And for the first half of the year, we delivered RMB. This is our RMB number CNY 450 million sales for new retail. And now you can do the math, is that start to be some decent number.

And for the entire year of this year, 2022, we are looking at reaching CNY 1 billion sales for new retail alone. In China, if you compare that sales to many other new retail business, this is not small. I mean it's a relatively small percentage compared to Yum China business, but as the new retail business alone, it's not -- it's a wonderful complement to our business because you can imagine that we have our scale in terms of supply chain. We have our network of distribution, which is our stores, 12,000 stores. And our online channel that our little brand (Shaofaner) has started 2018, and we have our own riders to deliver these new retail to customers directly without incremental delivery costs charged to customers. So this will continue, a very good complement to our business. And even emerging brands achieve breakthrough with the new retail, Lavazza, Taco Bell Little Sheep, I mean, during May, again, sales exceed pre-lockdown level because of the packaged products that they have been trying to put together within a very short time. And then the next thing you talked about -- mentioned the AI, the digital, the supply chain, et cetera. Absolutely, that's the absolute right thing for us to do, and we have been doing it for 35 years.

We are one of the few, if not the only one, at our scale, we have dedicated supply chain tailormade so that we can continue and keep the supply chain logistics going even during quarter two, such difficult times. And now we are building our greenfield logistics center with digitized and AI-enabled supply chain to provide us the visual -- image and the visibility of the supply chain process and the traceability of upstream so that we can move things around, and we can be very efficient in terms of cost of doing business.

So this incremental opportunity will certainly continue. Therefore, despite such difficult quarter, the morale is best ever. Because as the 450,000 people company, we work so well together, the execution, ability, agility is second to none. The team is very proud that we protect the business, protect their jobs. We look at every single cost opportunity possible except the promise and the sense of security that we are not doing any layoffs for staff for 2022. So our staff know that their jobs are protected and they're all in it doing everything we could possibly to protect the customer and to protect the shareholders. Our policy and mission.

Operator

Thank you, your next question comes from Bryan Wang with CMS.

Bryan Wang ***China Merchants Securities (HK) - Equity Research Associate***

So basically, actually, I have one question. So I would like also to understand your number of (inaudible)...

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

Bryan, would you mind speaking up a little bit? We have very difficult time hearing you, Bryan.

Bryan Wang ***China Merchants Securities (HK) - Equity Research Associate***

Yes, can you hear me now?

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

Yes.

Bryan Wang ***China Merchants Securities (HK) - Equity Research Associate***

So basically, I would like to understand your number of stores, the increase. How do you plan to increase your number of stores in the second half, say, to break them down by different brands. So for example, like so like your plan of increasing your store counts in KFC and Pizza Hut. And there will there be a breakdown by tier of cities. And that's my question. Thank you so much.

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

About our new store openings, I think as we mentioned, we as always deploy a very disciplined process and different methodologies to evaluate store opening. And usually, with some sort of bottom up from the market where they propose the appropriate site, we will run through the financial models, run through the committees to think about the financial returns, the special implications and overall market conditions to approve those sites.

So I think we'll -- I don't think there's any change to that process. And so in terms of by brand because KFC is -- continue to be obviously the largest brand within our portfolio and will continue likely to be -- to account for the majority of the new-store opening. Pizza Hut, as you can see, the store -- new-store performance also very good, especially with the satellite store, and you have seen the store opening accelerated last year and in this year as well. So I think you can also expect that.

In terms of our other brands, I think we can expect coffee, for example, Lavazza, will continue to -- and also, Taco Bell too, will continue to expand in the second half, although they are still a smaller portfolio of store. But in terms of percentage-wise, I think it will be big, but in absolute numbers, it will be smaller. And then in terms of Chinese cuisine business, there's some seasonality to store opening there. They are opened by franchisee. So generally, there will be more store opening before the Chinese New Year, for example.

And so there is potentially more. But again, like this year, because the COVID situation is a little bit more challenging for restaurant operator and to franchisees, so we will continue to monitor the situation in the market, especially given our Chinese cuisine business, hot pot, and steam pot business concentrated in northern part or Northwestern parts of China, and we'll have to see how the Covid situation evolves in second half. But that's by brand.

In terms of tier that we have seen over the past couple of years, we are beginning to see more opportunities in lower-tier cities and the concentrations or a number of new-store openings in lower-tier cities will have now account for the majority of the store open. Now obviously, we continue to see opportunity to increase the densities of our store network in the Tier 1, Tier 2 cities. But I think that's the general trend. I think that trend will continue. So that's how we generally look at the store opening.

Again, like this year, we have a target of about 1,000 to 1,200 net new store. And as we mentioned, given the strong pipeline that we have, and also, given the strong economics that we have seen in our new stores that have opened over the past couple of years, and also recently, we're pretty confident that we will have a good opportunity to open more good profitable store that can help us grow our portfolio in the long term.

Bryan Wang ***China Merchants Securities (HK) - Equity Research Associate***

So I think this is very clear. So actually, I have one more question. So on the competitive landscape. So because I heard that in Tier 2 and Tier 3 cities, there are some kind of low-priced peers. They are similar to KFC. So they are kind of like the Chinese version, the cheap version, say, some are like (Hualaishi). So how do you think your strength compared to them is because I have seen their menu, and then their menu is actually quite cheap. So how do you plan to compete with them in these lower-tier cities?

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

Right. I think we have we always seen competition both in lower-tier cities and higher-tier cities. And so we think the best thing that we can do is not to be just being cheap, but we are focusing on having a great value for consumers. Great value does not mean making cheap or lower price. What it means is to give good food at great values, good price to consumer. And so that they can enjoy it.

We have a fantastic brand, our customers are very loyal to our brand. We have great quality of products, delicious food with a very comfortable, fun environment that epitomize our brands identity.

So as we mentioned, if you look at during the pandemic and the lockdown in Shanghai, for example, I think by some indications KFC fried chicken was the most desired food during that period of time. And so I think our brand resonate very well with consumer our food and will continue innovate. You can see, as Joey mentioned, each brand continue to innovate new products with great fun food for consumer, and we continue to deliver great values. As mentioned, one of the reason why we focus so much on cost and controlling cost is that in order to compete in value propositions, most important thing is you have a cost structure advantage. And that's what we're trying to do and deliver great value to consumer.

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

To be more specific, at least in 3 ways, we do it slightly differently in lower-tier city compared to Tier 1 city. One, we have slightly different menu. The fried chicken we sell there, we could have (Yansuji), something like that, which is targeting for lower-tier cities to start with. We might sell it in other top-tier city later on, but we do have different -- slightly different menu. And the pricing is differential. So we incorporate it. And then also promotions, we give our store manager flexibility to run certain promotions. That's first.

Secondly, the different models. So Andy mentioned investment, yes, the cost of building up these stores in lower-tier city could be slightly lower, and we have a slightly different way of doing it. So the operating model, the kitchen blah, blah, blah will be slightly different.

Third is we are very, very focusing on children in lower-tier city, which is something very, very unique to us in the last 35 years. To give you an example, in northern part of China, which is the most difficult part of our business even in the last 2 or 3 years, despite the impact of the pandemic in the eastern part of China. Northern part of China, the business is still the more challenging one.

For this summer alone, we have run more than 10,000 children's summer events. So the store manager will organize this event for kids during the summer. So you can see we do have a different price, different model.

Of course, if I can take this opportunity to remind our analysts, other than lower-tier city, we have so many different business models of catering and customized for slightly different customer groups in different regions, in different consumption, occasions like the transportation hub, the highway station and university these days, you name it. Okay. I'll pause here. Let's move on to the next question.

Operator

(Operator Instructions) Your next question comes from Xiaopo Wei with Citi.

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

Congratulations for another resilient quarter result. I think in the past few years, Yum China have shown great agility of being defensive, but being defensive -- but being agile in operation also means that you can switch back to offensive mode when opportunity arises. If China reopening continues, which I presume you share the same view, how could you be offensive again in operation?

Joey had touch base on the new brands, new retail opportunity, et cetera? But if we only talk about the core operations of KFC, Pizza Hut, in the reopening scenario, how could you do differently versus pre-COVID operation with what you learned in the bad lesson or good lesson in the past 2 years?

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

Thank you, Xiaopo. Let me share my thoughts here. Indeed, the business has become more agile. We just look at the number for quarter 2, our same-store sales is at 84% and same as about system sales. So 16% down. However, we still deliver 4% profit. So technically, we reduced the breakeven point to about 80%. And roughly, in our business is, I guess, pretty normal to have the breakeven point at about mid-80s. So our ability to reduce to sort of the 80s is phenomenal. It gives us this agility to do things.

Going forward, I think even for quarter 2, you can see when our fundamentals are intact. And when things are a bit more stable, even the COVID situation is relatively more stable, we are able to bounce back rather quickly. That's what we can see even for quarter 2. So we hope -- although for quarter 3, as Andy mentioned, there's still a lot of uncertainties, even as of right now, still Lanzhou, Xi'an are still in challenging situation. But in the long term, we are optimistic. And we are still very committed to this market and that we're still growing the store. But when things become better, how can we grow faster if that's your question.

The strategy is there. It's not going to be any different from what we have shared since 2019 is the RGM, it's the resiliency, the growth and the strategic moat. We might do it slightly faster, but the strategy is the same. It might be a bit difficult to say that in the last few years, but right now, I think we can see that sometimes resiliency is even more important than growth. We have the resiliency and we'll continue that with our digital capability, with our product, innovative product, with our great value for money, with our ability to control costs and then we'll grow more stores. And the growth here comes from KFC, Pizza Hut and other emerging brands.

We'll continue to do what we are very good at for opening the stores, and also, increasing the sales from off-premise. You can see our number right now, our off-premise sales is about 65% for KFC, and 55% for Pizza Hut. And all these numbers move quite a bit in the last few years. And that gives us both the growth and agility because without this high percentage of off-premise sales, we won't be able to deliver the number that we delivered in the last quarter -- in the last 2.5 years.

So the growth will continue. And then we'll continue to build strategic moat on a daily basis, firm and steady. So the supply chain will continue. With 33 logistics center right now, we'll continue to do more greenfield logistic center. We continue to invest in our automation from the front all the way to the back. We'll continue to work on our sustainability commitment, the science based, the target that we have commit to. So I hope that gives you a sense that the directions are clear. We might pick up the speed a bit faster whenever we could but nice and steady. Thank you.

Operator

Your next question comes from Sijie Lin with CICC.

Sijie Lin ***China International Capital Corporation Limited, Research Division - Analyst***

Congrats again for such a strong and resilient performance. I have one follow-up question on the margin side. So we achieved a very resilient restaurant margin in Q2 through the extraordinary efforts since we adjustment and some onetime relief. And meanwhile, Andy mentioned that in the future, we are dialing back on straight cost control measures to sustain long-term growth. So how should we expect our restaurant margin in the long term under the new normal? Would this be like around 17% target?

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

Thank you, Sijie. So obviously, as we talk a little bit about short term and long term and as we mentioned, in the second quarter, some of the cost-saving initiatives efforts, a lof of them are more temporary in nature. And then in the short term, the biggest driver for restaurant margin right now is sales leverage and deleveraging is that to a great extent depend on COVID situations.

But in terms of longer term, I think our goal is obviously to continue to drive growth on the top line and also return to profit on a more normal level. As we have mentioned in our last year's Investor Day, our longer-term goal is to drive sales growth by high single digit and to drive our profit growth by high single-digit too. And so I think there's in parallel with what we were trying to achieve in the long term.

And one thing I think it appears your question was saying in the new normal or when things return to normal, are we confident in sort of capturing that opportunity both in sales and also potentially in margin? I always say although history is not always the predicter of the future, but it's probably the best predicter of the future and show us some lessons. If you take a look at the period, the full year period between third quarter 2020 and the second quarter 2021, when the COVID situation was markedly more stable, you would see that we were able to drive our sales growth. We're able to see a significant gross margin improvement. And that's going back to what Joey has a lot of time emphasized on resiliency and also in terms of our excellent execution.

And so our scenario planning, help us to design our operations in case things get worse, but also in case things get better, how we can capitalize on the opportunity and drive sales growth and then also drive sales and margin recovery. So hopefully, that gives you some perspective in terms of how we look at the shorter-term and also the longer-term margin perspective.

Operator

Your next question comes from Anne Ling with Jefferies.

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

My question is on the coffee business. I know it is still very small at this stage, but at the same time, I understand that this will be one of our potential growth driver moving forward, more like mid- to long term.

And if I look at the new store opening plan versus the peer, it seems that it's still a little bit slower. So maybe would you share with us your pace of your coffee like network rollout, like are we still in the process of testing our model? Or are we already find the right model to roll it out? And once we roll it out, normally, this is the type of business that we need to scale with back-end support. And meaning that if we have like 200 stores, we possibly might have to bear some investment initially. So -- but I do think any of us, as analysts factor in any investment in our model. So just wanted to check if the company, if management can share with us some of your initial plan? Or what will be the investment for the coffee business, that would be great.

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

Anne, thank you for all your questions. So I think, first of all, we are very pleased to see the progress. And the progress may not be same as how they measure it by other companies -- other companies may measured by hundreds of stores opened in the quarter or what-not. As we have mentioned with all our investments, including our store network expansion as with any other investment, the very disciplined process. Although like for the newer brands in coffee, building a brand, I don't expect them to be profitable immediately on short term. There's we generally expect that we will figure out the right business model before they scale up because otherwise, you got to scale a big problem, right?

So -- but we're so far, we're very pleased with the progress so far. Lavazza (company correction) store network right now, we have expanded quite significantly from last year. We have 74 stores right now in 4 Tier 1 cities and plus a number of third-tier cities as well.

In terms of sales, we have more than double year-over-year. And then even in very challenging time, as Joey mentioned, the team have been a very tremendous job in sort of like putting together packaged products to sell in the new retail channels and it would sustain almost better than last year same-store sales up in the last few month with a very small number of stores, mainly in Shanghai.

In terms of our customer base right now and we continue to see growing customer royalties. If you look at member and now members of Lavazza have grown 4 times year-over-year. And then this member contributions continue to grow, a very significant number now. So obviously, the coffee business, this new brand has also been impacted significantly by COVID as you probably know, a large number of their stores, almost the half of that is in Shanghai.

We have to lock down and so it was impacted. But usually, as I mentioned, they were able to very quickly put it into community purchasing packaged coffee, retail products like pastry and whatnot. And these products really help, I think, sort of like us reach to bigger audience. The audience that maybe historically have not tasted our product, but able to do it through community purchasing and some of the new retail initiatives.

Now obviously, we cannot say we have everything all figured out in a perfect model. I think it still will take some work to sort of streamline the restaurant operation there to strengthen some of the fundamental and you take a while for KFC and Pizza Hut to figure out the right store format and some of these product menus and then also improve efficiency. I think we should still need to be a little bit more patient with that.

And so yes -- so I think we're happy with the progress so far, but still a lot more work to do. But nevertheless, we're very confident and we think it's very important work for us, and we have a long term partnership with Lavazza to do that in the coming years. Thank you.

Operator

Your next question comes from Christine Peng with UBS.

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

So I actually have a similar question, which I'm sure some of the analysts like Xiaopo and Anne have asked previously. But I just want to ask management providing us some updates about the new initiatives that you previously mentioned as we are looking for post-COVID full recovery in China possibly in 2023.

So I think the 2 key initiatives, management previously mentioned, one is the integration of Huang Ji Huang and Little Sheep. Can you provide us more update as regards to this initiative here? And in relation to that, maybe can you provide us more updates in terms of your maybe 2023 plan in terms of the extent of the Chinese cuisine business? I know that business has been struggling with COVID in the past 3 years. But when we think about 2023, what are your initial thinking behind the store expansion plan, et cetera? So I think that's the first initiative I want to check out.

And the second initiative is regarding introducing more franchise stores. Is this something management is thinking right now, given that management is -- I remember previously, you mentioned about your initiative to emphasize the supply chain resiliency to provide more possibility of franchising. So I just want to check out what are the latest thinking behind those long-term initiatives we are going into 2023?

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

Christine, yes, so let me try to...

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

Go ahead.

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

Joey, do you want to go ahead?

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

No, no, go ahead. Go ahead. Go ahead.

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

Okay. So yes, so for Huang Ji Huang will and Little Sheep, as you mentioned, obviously, have been impacted by the outbreak because it's dine-in nature and then a lot of locations are in northeastern -- northwestern part of China. So I think, obviously, the number one priority for them is we need to try to drive sales recovery and then also help the franchisees to strengthen their operations, particularly in the delivery business. So in a sense, they so far have not been -- have a big part of the business in delivery. So I think this is something that we can help the franchisee to do given our for corporate ability.

Little Sheep also during the pandemic, also been quite creative and innovative and make pretty good progress in improving foods and services and then also their overall cost management. And especially in Shanghai, during the lockdown, they were able to sell like -- capture a lot of the opportunities in both delivery and also community purchasing in the retail business. So I think the priority for the Chinese business next year is really try to drive sales recovery, help the franchisees to run their business and then also continue to work on the fundamentals and integrations. So Joey, do you want to comment on the franchise questions?

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

Christine, equity store will continue to be the driving force of our business going forward. However, we do have to clarify franchisee strategy. So right now in market, there are a bit of long and thin market like Tibet and Qinghai, and these are very good franchisee market and then also for some emerging business, new business models such as the stores along the highway station. We have established strategic partnership already to build the store.

So the franchisee strategy is not going to be too general. It will have its own strategic purpose. And given the time today, I think I'll just pause here. We could have more detailed exchange of thoughts later on, okay?

Operator

Your next question comes from Lucy Yu with Bank of America.

Lucy Yu ***BofA Securities, Research Division - Research Analyst***

My question is more on the GP margin side. So how should we think about the promotion and discounting plan in the second half? Especially, we are fighting against commodity headwinds and COVID uncertainty while at the same time, we're trying to stimulate the sales. So how should we think about the promotion and discounting in second half?

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

Thank you, Lucy. Yes, as we mentioned, in the second quarter, obviously, we sort of cut back on marketing and also in promotional activities. And then as we move into the second half and the third quarter with the position improve a bit even though with some volatility, I think the key focus for us is we're driving sales recovery. And so we're likely going to see prepare marketing and promotional activities there and then also have more value campaigns, value-for-money campaign.

Because as you mentioned, consumer sentiment is relatively weak because of the prolonged COVID situation, and then some of these macroeconomic pressure. And so value for money is very important. And so that's how we see in the second half of this year. But as always, like we're always trying to -- we're being very cautious about using price increase to sort of like to offset inflationary pressure. We always try to first ask, if it's a way for us to run our business better and lower the cost before we say like we say like we have increased prices. But we do increase price annually by a small amount, but usually it's below the inflation rate.

Operator

Our final question today is from Walter Woo with CMB International. Please go ahead.

Wing Hong Woo ***CMB International Securities Limited, Research Division - Research Analyst***

Andy and Joey, congratulations for your highly resilient result. My question was asked by another analyst previously. So perhaps I can ask about your member sales. So while the number of members continue to grow very healthily, but it seems the member sales as a percentage of total system sales has declined year-on-year. So do you mind explaining the reason behind? And is that a concern for you guys? And how do you see the growth potentials and your strategy over the members and member sales going forward?

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

Really quick, Walter, the member sales is around 60%-ish. It's not a concern for us because the total members= size is still growing, which is very nicely actually. I mean, our member count (company correction) is 355 million roughly for KFC and then 115 million for Pizza Hut. And when it comes to member and nonmember sales, the member sales 60-some percent is already high enough. And the next target for us is to -- other than quantity is to work on the quality, the stickiness of the member, the overall experience of the member, et cetera, et cetera.

So I guess we cannot just increase the member sales forever. It does not make much strategic sense. For us, it's quantity first and then quality. But it's a very, very important part of our business and there's still so much that we can do to improve and to get something out of it. Just to give an example, what about the cross-brand sales of KFC and Pizza Hut. How can we do better? And how can we serve the same customer better with KFC, Pizza Hut, Little Sheep and et cetera? So a lot to do here, but the focus is more on the quality and overall experience for now. Thank you, Walter.

Wing Hong Woo ***CMB International Securities Limited, Research Division - Research Analyst***

And just a little bit follow-up. So as the members growth is still very healthy and the member sales mix has declined, so is that means we have more new customers being inducted in the second quarter or in the past few months? So do you see that trends? We have more new customers or new clients, yes.

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

I mean the China population -- oh, go on, Andy. Yes.

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

Yes. Yes. So Walter, I think as Joey mentioned, like we have a very large member base. We already have like 380 million members, and it's a very large population in the urban area already. The other part of this is that this always -- it's not always higher than member sales, percentage of member sales the better. But if I have 100% member sales, that means you have no new customers. So there's always a balance between a mix of member sales and the new members. And so there will be some fluctuations from time to time, depending on the marketing campaigns and depending on the macro conditions. But I think at 62% it's a really healthy level. And so, and then in terms of, for us, we, as Joey mentioned, which is how to drive that quality of member sales, driving cross sales among our customers and then continue to increase their stickiness and frequency for the long term so that the payback for our marketing and new customer recruitment will continue to improve, so those are a number of metrics. I think member sales is one of them, and it's not always the higher the better.

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

Thank you. That concludes the call today, and we look forward to speaking with you on the next earnings call. Have a great day.

Operator

That does conclude our conference for today. Thank you for participating. You may now disconnect.