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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Yum China Fourth Quarter and Fiscal Year 2020 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded.

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

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

Thank you, operator. Hello, everyone, and thank you for joining Yum China's Fourth Quarter 2020 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 contains 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 the non-GAAP and GAAP measures is included in our earnings release.

Today's call includes 3 sections. First, Joey will highlight our accomplishments over this past year and review our strategy and key priorities. Andy will review our financial performance and outlook in greater detail. Finally, we'll 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, our CEO.

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

Thank you, Debbie. Hello, everyone, and thank you for joining us today. I hope you and your families are safe and healthy no matter where you are.

First, I want to acknowledge the great work of our 400,000-plus employees and express my heartfelt appreciation. With their dedication, creativity and tireless effort, we have been navigating the difficult times and effectively managing our business.

Looking back at the past year, we put the health and safety of our employees and customers as our #1 priority. Our team kept most of the stores open, even at the peak of the outbreak. Our execution capabilities and agility helped us overcome many challenges. We captured off-premises consumption opportunities and drove recovery in dine-in volume. Sales and traffic recovered sequentially since the first quarter. Our operating profit remained solid and grew double-digit year-over-year in the second half. This is the result of strong execution and efficiency improvement.

KFC remained resilient. We accelerated store expansion with attractive returns and maintained solid profitability. We made remarkable progress in strengthening the fundamentals of Pizza Hut across all aspects that is reflected in the sales and margin improvement. Going forward, we will continue to fortify the resilience of Pizza Hut's business model.

At the core of all these is our ability to innovate. KFC's premium Wagyu Beef Burger resonate well with consumers and was sold out within days and their sweet pumpkin congee, (GuiYuanLianZiNanGuaZhou), is the perfect item for the winter. Portuguese Chicken Curry at Pizza Hut became an instant hit on the delivery menu.

We demonstrated our commitment to be a responsible corporate citizen. The pandemic reinforced our determination to look after our employees. We extended our Family Care coverage designed for our restaurant managers to 13,000 restaurant management team and supervisors and their families. Our efforts are recognized in the industry. For the third consecutive year, we were certified as a Top Employer in China and included in the Bloomberg Gender Equality Index. We were also recognized for our commitment to sustainability and we were named an industry leader in the 2020 Dow Jones Sustainability Indices.

Let's move on to growth strategy. Despite the challenges, we are optimistic about the future opportunities in China. We have been staying the course with our long-term strategy, centering around 3 key growth initiatives. Let me give you some update on our latest thinking.

First, store growth. We opened 1,165 new stores in 2020, marking the highest new store openings in the 33-year history of operating in China. This is equivalent to opening 1 new store every 8 hours. Our new stores' payback remain healthy at approximately 2 years for KFC and 3 to 4 years for Pizza Hut. We intend to sustain this store-building momentum into 2021 and beyond and reach the next 10,000 stores much faster than the first.

There's still plenty of white space in which we can expand. We are tracking over 700 cities in which we have no presence in China. To penetrate new markets, KFC is piloting small-town model designed for the needs of Tier 6 cities or below. This model has localized menus, store layouts and operating models that require less CapEx. We are encouraged by the initial result of these pilot stores, and we will open more small-town model stores in 2021 in KFC.

In more established cities, we will increase store density with our multiple store formats as the mix of off-premise occasions continues to increase. We have further reduced the average store size and CapEx per new store. One example is Pizza Hut's hub-and-spoke model, which we introduced in 2019 Investor Day. I'm excited to report that with nearly 50 stores -- 50 hub-and-spoke stores at the end of 2020, the results are very promising. We will roll out more of these stores and other small store formats and adapt our store models to evolving consumer needs.

To create an even stronger foundation to accelerate expansion, we are stepping up investment in our infrastructure. More details will be provided by Andy later on.

Second, portfolio growth. While KFC and Pizza Hut remain our key growth drivers, we are also leveraging Yum China's resources, execution capabilities and learnings to develop our emerging brands. --Great things are brewing in coffee, we now have 3 distinct brands with clear segmentation and strategies. We are committed to accelerate expansion of our coffee business and make a meaningful part of Yum China.

K-Coffee fulfills that daily ritual with good quality coffee at affordable prices at over 7,000 KFC restaurants in China. 140 million cups of K-Coffee were sold in 2020, making us one of the top 3 players in terms of cups sold. COFFii & JOY has evolved to offer specialty coffee for coffee lovers while utilizing an asset-light model. We are working on improving the profitability of C&J and exploring other potential avenue of growth. Meanwhile, Lavazza offers premium coffee in an indulgent atmosphere. We now have five beautiful stores in

Shanghai, and we are pleased with the initial results. We plan to accelerate openings in 2021 to test different store models, ranging from mini to flagship stores.

On the Chinese cuisine market, post-acquisition integration of Huang Ji Huang has progressed well. We have driven synergies in product innovation, franchisee development and supply chain. Huang Ji Huang sales recovered sequentially and delivered solid profits since acquisition. We will further work on the menu and operations for our Chinese cuisine brand to drive store expansion and growth in the seasoning and packaged food business.

The third growth initiative is digital and delivery. The COVID pandemic highlighted the power of digital from member engagement, delivery to operations. Our membership has grown to over 300 million. Member sales now account for 60% of our sales. Privilege subscription program is effective in boosting frequency. We sold 38 million subscriptions in 2020. The average spending of privileged members doubled during their subscriptions.

More targeted promotions help us keep marketing expense down. Delivery has been growing rapidly and even faster during the pandemic and now accounts for 30% of our sales. In 2020, we upgraded our rider platform with AI-enabled zoning, rider routing optimization and real-time monitoring. In the test market, on-time rate, customer satisfaction and efficiency have improved. We also test that rider sharing between KFC and Pizza Hut in Eastern China. We will expand this initiative into more brands and more markets.

In 2021 and beyond, we are allocating more CapEx to further strengthen our digital and delivery capabilities. To make our organization more efficient in the long run, we will deploy AI and automation in more of our operations and continue to advance end-to-end digitization from farm to fork. We are committed to driving long-term growth with these 3 growth initiatives. Investments across all 3 are necessary to build our leadership and agility.

Let's move on to 2020 Q4. And I would like to make a few comments. First, sales improved sequentially from the third quarter, although the pace of recovery was impacted by regional outbreak of COVID. October sales benefited from the National Day holiday. The sales in November, December was pressured by increased regional outbreaks. Traffic at transportation hubs remained significantly below the prior year due to reduced travel. Dine-in remained pressured but recovered a bit sequentially. Delivery and takeaway remained popular options and account for over 50% of sales. Digital orders increased to 83%. Pizza Hut tableside mobile ordering has increased in popularity as we enhanced the user interface and now accounts for over 35% of sales, up from just 7% in the prior year period.

Operating profit grew to $180 million. Andy will cover the financials in detail in his session.

As we look into the first quarter of 2021, we see the resurgence of COVID-19 adversely impacting our business. Nationwide, authorities have tightened preventive measures and advised against travel, large gatherings and dining out, especially during the Chinese New Year holiday period. Given the current situation, we see significant headwinds for the first quarter.

Our teams are closely monitoring the situation and leveraging learnings from the past year. Our marketing programs encompass a wide array of compelling offers, targeting both dine-in and off-premise occasions and different party sizes. We will stay agile to adjust our marketing programs and operations to the evolving situation. Most importantly, we remain confident in the long-term potential of China and stay focused on generating sustainable shareholder returns.

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. I will first address key financials and developments in the fourth quarter, then provide some color on our 2021 outlook. Unless noted otherwise, all percentage changes are before the effects of foreign exchange.

Let me first cover our Q4 financial results. Revenue grew 5% and same-store sales recovered to 96% of the prior year period. The sequential improvement was supported by continuous strength in delivery and takeaway, while dine-in volume gradually recovered.

KFC's same-store sales recovered to 96% of the prior year period compared to 94% in Q3. Our transportation and tourist hub sales improved but remained challenging. System sales grew 3% year-over-year, reflecting the contribution of new build acceleration. Pizza Hut same-store sales recovered to 95% of the prior year compared to 93% in Q3. Same-store transaction volume recovered to 98% of the prior year period. Huang Ji Huang and the consolidation of Suzhou KFC contributed to 4% of total -- revenues.

We opened 505 stores in Q4, which helped us achieve the record level new store opening for the year. Restaurant margin was 15.1%, up 2.7% compared to last year. I want to thank our team for their excellent work in driving operational efficiencies and managing costs.

Cost of sales was 31%, 1.2% better than last year. This was mainly helped by lower poultry prices and more targeted value promotion at Pizza Hut.

Cost of labor was 24.2%, almost flat year-over-year. Wage inflation and increase in rider costs associated with delivery volume increases were largely offset by labor productivity improvement and shortage in part-time workers.

Occupancies and others was 29.7%, 1.7% better than last year, mainly attributable to reductions in advertising and savings in other operating costs. We also received around $7 million in rental and government relief, which is expected to phase out in 2021.

G&A expenses decreased 9%, mainly due to lower performance-related compensation, timing shift of government incentives and cost control. Operating profit was $180 million, up 78%, mainly due to restaurant margin improvement. Please keep in mind that some of the factors driving Q4 profit are not expected to recur such as lower advertising costs and performance-related compensation and onetime relief. Some of the productivity improvement due to labor shortage is also temporary as we intend to increase staffing levels.

Our effective tax rate was 28%, net income was $151 million and adjusted net income was $153 million. Excluding $23 million of net investment gains in Meituan, it was $130 million, up 65% year-over-year. Diluted EPS increased 43% to $0.35.

Now let's turn to our outlook for 2021. Heading into the first quarter, a cluster of outbreak surged, impacting a large swath of the countries, especially in Northern and Northeastern China, Beijing and Shanghai. Government implemented stricter public health measure across China such as advisory against travel, large gathering and dining out. Several cities have also been put on citywide quarantine, including Shijiazhuang, a city of 11 million people. We anticipate significant headwinds for the first quarter.

Our transportation and tourist locations, representing high single-digit of sales, will likely be more significantly impacted. Government statistics show that the number of travelers was down over 70% in the first few days of the Chinese New Year travel this year, which started in late January.

Overall, dine-in traffic has been affected. We expect trading during the important Chinese New Year holiday period to be subdued, with sales impacted by substantially less travel, smaller gathering and generally reduced social activities. Sales in lower-tier cities, which represent over half of our sales, will also be impacted as fewer people will return to their hometown for Chinese New Year. As KFC has a higher percentage mix of store in lower-tier cities and transportation hubs, it will be disproportionately impacted.

So Q1 will be all hands on deck. In response to the headwinds, we have stepped up our value campaigns and tailored our marketing calendars according to city tiers and trade zones. We have also adjusted our operations and delivery resources to capture shifting dine-in and off-premise demand. We will endeavor to do everything we can to mitigate the headwinds.

Please also keep in mind that January and the first quarter will be a tough comparison. Last year, COVID-related lockdowns started only in late January. On a year-over-year basis, last year's sales benefited from strong first few weeks leading into Chinese New Year. We anticipate the recovery will remain nonlinear and uneven, influenced by regional outbreaks, reduced travel and lingering effect on consumer behavior.

In 2021, margin will remain subdued compared to pre-COVID levels as we face several headwinds. We expect full recovery of sales to pre-COVID levels to take some time.

Compelling value campaigns to drive traffic will continue to be our focus. We expect 2-year wage increase since 2019 to be high single-digit, including 3% in 2020 and mid-single-digit in 2021.

We are stepping up our efforts in sustainability. In light of the latest regulations in China, we are replacing plastic packaging with more eco-friendly materials.

It's expected to increase our cost of sales by over $30 million in 2021. On a year-over-year basis, we are lapping over $100 million of COVID-related government and rental relief in 2020, which is mostly phased out now.

On the pricing side, our commodity prices are expected to decline by low to mid-single digits, mainly driven by lower poultry prices. Since we usually lock our poultry contract 1 quarter in advance, prices may still fluctuate throughout the year.

We will build on our momentum in 2020 and target to open approximately 1,000 new stores in 2021. We will step up investment in digital, logistics and other operational infrastructures to support accelerated growth. Total CapEx in 2021 will increase to approximately $600 million. This investment will impact profitability in the near term, but will yield benefits in the long term.

With that, let me cover our capital allocation framework. With over $4.3 billion in cash and short-term investments and strong cash flows, perhaps as much as $8 billion of capital will be deployed over the next 5 years. As we think about our long-term capital allocation, our key goals are to deploy capital efficiently, to accelerate growth and to create long-term value for our shareholders.

Now before I outline the use of cash, I want to emphasize that we will continue to run a prudent financial strategy, ensuring sufficient cash on hand for working capital and sufficient reserves to deal with potential contingency.

Organic growth remains the most important driver for our long-term strategy. As Joey mentioned, we aim to achieve the 20,000-store milestone much faster than the first 10,000-store milestone. We will prioritize our capital to support organic growth. Hence, we will more than double our CapEx over the next few years.

A majority of our CapEx will be used for accelerating store network expansion and store remodeling for our core brands, KFC and Pizza Hut, growing them while keeping them fresh. We also plan to invest several hundred million dollars in our emerging brands, especially the coffee business, building them into meaningful scale and a mature part of our business mix.

While expanding network of physical store is an important growth driver, enhancing our digital and delivery capabilities and logistics infrastructure is equally important to our future success. We efficiently and adequately support a network of 20,000 stores would require a bigger, more robust and more agile digital and physical capabilities and infrastructure. In addition, we also like to see greater digitization, automation and intelligence across our operations. So we have earmarked over $1 billion investment to advance our end-to-end digitization program, including digitizing our stores, marketing, supply chain and back-office operations. Roughly another $1 billion has also been earmarked to expand our logistic infrastructure to enhance automation capabilities to drive efficiencies.

The rest of the capital will be allocated for shareholder returns and M&A. We resumed cash dividend in the fourth quarter and have returned $1.2 billion to shareholders since the spin-off. In the future, we expect steady returns to shareholders in line with our profit growth. We will also maintain a disciplined approach to M&A and investments, while exploring opportunities to invest in brands with excellent growth potential, to acquire new capabilities and technologies and to build and support our ecosystem. We believe this approach to capital planning will drive long-term shareholder returns.

All in all, we are encouraged by the solid financial results we delivered in 2020. We will continue to invest for the long term. I'm confident that we are on the right path to emerge from the COVID pandemic, stronger and better prepared for future growth.

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

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

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Xiaopo Wei.

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

Joey, Andy, my question will be regarding the Chinese New Year. As -- Joey, you mentioned that there are a very challenging environment in the first quarter, but we know that Yum China and yourself are so good at handling the challenges as we can see last year. So after learning a lot of experience in coping with the COVID situation in 2020, how could you do differently and make your business more flexible to capture any emerging demand while protecting yourself on the downside in terms of the business in the upcoming Chinese New Year? Any color would be highly appreciated.

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

Thank you, Xiaopo. The quarter 1, which is driven mainly by the Chinese New Year, would be a quarter that's rather difficult to model because, as I mentioned earlier, we do anticipate significant headwinds and we do expect recovery will take some time because the situation is still fluid.

3 things for sure in terms of trend. One is the surge in cluster outbreak, and that result in tightened preventive health measure or advise against travel, large group gathering and dining out. Second is the traveling and the social activities are significantly reduced. So we already have seen the first few days of the travel volume is down significantly. And then the lower-tier city sales, which is more than 50% of our sales, particularly for KFC, and large party size ticket will be reduced. And also, we do also expect more competitors will stay open during Chinese New Year versus 2020.

The first thing we know is KFC is slightly more impacted than Pizza Hut because of higher mix in the lower-tier cities and transportation locations. I mean, the next important question is how are we going to deal with it. And certainly, we take all the learnings from 2020. The overall tone and the importance and the priority is still the safety of our employees and customers. And on that foundation, the focus is to stay nimble and agile. We do closely, very closely monitoring -- we are closely monitoring the situation.

And that -- the 2 focuses here in terms of staying nimble and agile. One is to step up the value campaign and to line up all our digital and delivery resources, including our membership program to prepare for the Chinese New Year. Second is we adjust our marketing calendar according to city tier, trade zone, party size and occasions.

I suppose compared to the 2020 program is this time, when we plan the marketing campaign, we have -- you can see we have multiple scenario planning, and that shall help us stay even more agile compared to last year. Last year, things happened before we know it's going to happen. So we react really fast, and our team is doing a fantastic job. For this year, we have more scenario planning, and that shall help our team still react quite fast to the evolving COVID situation. Thank you, Xiaopo.

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

Yes, a quick follow-up on the new store. You did a great job in 4Q opening many stores, but if you look at the result, actually we didn't see that a new store really dragged down the restaurant margin. So looking forward, shall we say that a new store will be the key driver for the growth without compromising our margin on a sustainable basis?

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

Thank you, Xiaopo. Quick answer as well. When we open stores, as you guys know us already, we have rough idea how many stores we want to open, but the most important decision is whether this is a good store or not. So if we see opportunity to open the store, we'll open more or less depending on the quality. So we always keep our quality and, as you can see, we still are opening more stores in lower-tier cities. Our quality control continue there. So it's always the disciplined approach that we have been following and will continue to pursue. Thank you.

Operator

Our next question comes from the line of Lina Yan from HSBC.

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

Thanks management for the presentation and congratulations on the very good results. My question is also related to the store opening. We have seen like the very high-quality store opening in 4Q, but I will also note, like normally, like there will be more remodeling in 4Q. And as Xiaopo said, like new stores might not contributing so much to profitability. So I'm wondering like whether what we have seen in 4Q is sustainable? As like asked earlier, like when we expect like the store opening might continue to beat expectations, whether it's going to lead to higher than -- like the contribution to total revenue will increase as well as driving higher profit growth as well.

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

Lina, this is Andy. Thank you for your question. Let me first address the question about the store opening pace. Obviously, we are very pleased that we have opened 505 stores in the fourth quarter. But I also want to remind folks that even though it's probably still higher than what we expected, but we have already told folks that because of the COVID impact, the store opening will be more back-end loaded. And so with a little bit easing in the cold situations in fall and winter past year, our development team have reaccelerated the pace and try to take advantage of that window and open as many stores as possible. And then we also try to push some of the store opening earlier in the fourth quarter, so in anticipation of the Chinese New Year holiday period.

So as we mentioned, we expect to open 1,000 stores this year. And it's a very high pace, right? So if you think about our store right now, we have more than -- a little more than 10,000 stores, and that's almost like opening almost like 10% of new store.

Now putting perspective for you, last year, we opened almost like 1 store every, I think, 8 hours, and so that's a very fast pace. So we'll do maintain a fast pace, but probably not at the level that we're seeing every quarter, 500-plus stores. I don't think that is sustainable at least in the near term. We do have plans, as we mentioned on the prepared remarks, to accelerate store network expansion, and we will put and allocate resources to do that.

Now in terms of the possibilities of a new store, as Joey mentioned, is -- we have a disciplined approach to store opening. So if you look at the payback period for KFC, it's very strong, 2 to 3 years, and have been very consistent over the past few years. Now Pizza Hut, it's about like 3 to 5 years, and also with very strong returns. So we have a lot of incentive to open a store -- as many stores as possible, but within that framework of disciplined approach to store opening to make sure that we have the right financial returns.

So hopefully -- and then one thing, as you can tell, obviously, with that kind of fast pace of store openings, it demonstrate our confidence in the market in China and also the potential opportunities here in China. So we always encourage investors to look at the overall system sales rather than sometimes too focused on the same-store sales growth because China is still a growth market.

Operator

Our next question comes from the line of Michelle Cheng from Goldman Sachs.

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

Joey, Andy, congrats for the good results. My question is about Pizza Hut. I think clearly last year, even the deleverage was mostly significant, we see a strong margin improvement. And also into fourth quarter, we also see -- we actually opened many Pizza Hut stores. So can you share with us, after like 2 years of our revitalization plan, what's our new focus into 2021 and whether we will start to see improving same-store sales trend and also further market upside?

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

Thank you, Michelle. So for Pizza Hut, I think overall, we did what we promised about sales first, profit later in our turnaround journey. And our second half OP more than doubled compared to the previous year.

And so the focus of Pizza Hut in the last few years is about improving the fundamentals of the business, which we believe will have an impact for years to come. And I think that kind of set the tone about our focus going forward. So our focus going forward is to continue to improve across all these key aspects to cement the changes made in the last few years and make Pizza Hut a resilient business model. I think this is a very important work because I think we believe we have a very resilient KFC business now. And after few years of hard work, Pizza Hut business will be also resilient as well.

So in terms of focus, maybe I'll just highlight 3 things that we have done -- we have worked very hard in the past 3 years, and we'll continue to do that in the coming periods. One is the new menu. Our new menu roll out in late Q2 is 75% items are new or upgrade compared to 2 years ago. And food is -- I mean, I cannot emphasize how important it is, right? And one example I mentioned earlier is the Portuguese Chicken Curry. It's fantastic food and it's innovative, and we'll continue that innovation.

And then the second highlight is our double-digit growth in off-premise dining, which including the delivery and takeaway because we all understand our concern towards dine-in business, rightly so. So after a few years of hard work, you can see the mix right now is a lot healthier. I mean, it's 40% plus of the total sales. So that also makes our overall business more resilient.

Third, digital order. The digital capabilities are absolutely critical in any restaurant business right now. The ability to connect the online and offline operation is part of the efficiency, is part of the customer service experience.

So let's take one example, the tableside ordering. We moved the mix of tableside ordering. Q4 actually is 37%. So 37% of our orders on the tableside is done digitally, and that's compared to 5% during 2019. And we only started to work on this back in 2018. And you can imagine that all improved the customer service and, of course, the labor cost.

So on top of that, the fourth thing, we also launched ready-to-cook steak and pasta to capture home consumption trends or demand. And that is partly, as a result of the pandemic, such growth is the opportunity -- the growth opportunity has become even more visible, and we captured that.

So as a result of all these 1, 2, 3, 4 and more efforts and initiatives, we have seen the improvement of our money-to-value perception -- value-for-money perception and also overall customers' perception towards the food, the service level, the value, the dining environment. Therefore, the fundamental and the momentum is promising. And as I mentioned earlier, sales first, profit later. So now the sales is in good and decent place, and we start to see the improvement in profit, and we want a bit of both going forward.

Operator

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

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

I have a question regarding CapEx and also in our investment. In the past, now we have around like $400 million to $500 million CapEx, and depreciation roughly similar as well. So with the step-up in terms of like more store opening and also a step-up in the CapEx of $600 million, does it mean that we will have a disproportionate increase in terms of the depreciation from year 2021 onwards, i.e., EBITDA growth will be higher than that of the EBIT growth? And then our $2 billion, $1 billion each investment in digitization and also on the logistics, does that include this $600 million CapEx plan? And how does it roll out? Like for each year, how much will we spend on this part? And how will it impact our P&L?

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

Thanks, Anne. So CapEx spending, I think if you look at our historical CapEx spending, it has been very efficient and very stretched actually. If you look at over the past 5 years or 3, 5 years, our CapEx spending was roughly $450 million plus or minus some. And then we have been opening stores more and more. So if you look back a few years ago, we're opening maybe like 500, 600 stores a year, and now we're opening more than 1,100 stores in 2020. So we were able to do more with less. And the team has been very frugal in how they spend the money, looking into savings, in store development and infrastructure.

Now what we want to do with this capital allocation plan is really sort of like reframe this plan to focus more on growth, driving more efficiency and to think about this longer term. So we will still have a very disciplined store investment strategy, as we have mentioned earlier, for new store openings. But we will definitely look into ways to accelerate our market penetration, both in terms of lower-tier cities. We have tracking several hundred cities that we have not have a presence yet for KFC and 1,000 more for Pizza Hut. So there's a lot of white space ahead of us. And then for cities that have already a restaurant, we're likely going to try to increase density. Especially, we will invest more in store catered toward delivery and takeaway. So definitely, the majority of our CapEx spending is going to be in store expansion, accelerated store expansion for our core brands, KFC and Pizza Hut.

Now if we look a little bit longer, and we also try to grow our emerging brands, especially with coffee, what I mentioned in the prepared remarks. We want to grow that into scale and also become a material part of our business. So we're going to invest more. And so for investment in new emerging business in the near term, you're likely going to see an impact on some of the cost and expenses because obviously, ramping up a new brand requires some investment.

The other one, I think, for CapEx spending, as you mentioned, is digital. $1 billion in digital is going to be a very large investment over the next few years. But this is a very important transformation for the restaurant industry. For us, our company have undergone that for a number of years, but we're going to accelerate that and in a much bigger way and you will see more technology being deployed. Throughout our operations, you would also see more automations deployed in our restaurant, in our supply chain. You will also see more intelligent data analysis that would help us in marketing, supply chain and overall operations in the back office.

So all this -- so you think about this, like if you think about 30 years ago, CapEx is probably all invested in store openings. But today, investment in digital, the digital capabilities, having the right robust infrastructure to support a very large network of store will really require a significant increase in investment. So we're basically trading capital for labor. So if you think about our store operations, we have able to run more store over the past few years with relatively stable workforce, somewhere between 400,000 to 500,000 employees. And all that is possible because of the investment and the infrastructure that we have built. So as I mentioned, store expansion is important. The operation -- investment in digital, the investment is equally important for the success of our future.

So yes, so in the near term, as we ramp up, as we mentioned, we -- over the next few years, we're going to ramp up, doubling our CapEx spending, that would have the impact on depreciation. But I think in the long run, you will see gains from other area, productivities, greater sales and in the long run would be a fantastic return for our investment. Hopefully that addressed your question, Anne.

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

I just had one little point to add for Anne. Over -- we look at these savings in terms of efficiency from automation and technology investment, just think about it. 2015, we have roughly about 7,000-plus stores. 2020, we have 10,000 stores. Our number of employee actually still stay at a number of 400,000 plus. So that gives you a sense of the achievement in the last 5 years. And hopefully, that gives you a sense about what kind of potential achievement we would like to achieve with the investment -- further investment in digital delivery and the supply chain infrastructure because before opening the stores, we need to get the infrastructure in place in order to enable the acceleration of store expansion. Otherwise, if the infrastructure is just catching up to the store expansion, then we are dragging our feet totally, well, if I could describe it that way, if that makes sense.

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

Right. And also I want to give you one more anecdotal evidence of how important digital and infrastructure investment is and how that helps us to actually be more productive and keep costs down.

You think about our membership program. We developed that and invest in that over the past couple of years. Our whole digital CRM program will help us to keep our AMP lower compared to our revenue growth. And that's all possible because we have the ability to reach our customers and effectively utilizing that technology. So you may see cost increasing as part of the P&L, but hopefully, in the long run, you see also improvement on the other side. And again, as we mentioned, if you think about China today, over the long term, you see more labor shortage as the population age. So it's very important for us to stay one head of -- one step ahead of the game and anticipate that and invest in productivities, in technology and infrastructure.

Operator

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

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

Joey and Andy, so I would apologize if my question has been addressed by previous speakers as my line was disconnected in the middle of the call. So I'm more interested on the food and paper cost side. So we understand that the chicken cost is coming down pretty dramatically these days. Meanwhile, we are also stepping up our value initiatives.

During our recent China checks, we also noticed that actually -- we possibly have actually raised price a little bit for KFC at the beginning of the year. So we guess this should be more than enough to offset the costs associated with our eco-friendly initiatives. So given all these kind of moving pieces, is it fair to say that food and paper cost is not going to be a major concern for 2021?

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

Thank you, Chen Luo. And I think -- yes, that's right. Like -- so if you think about the cost of poultry have come down over the last few months, and we have locked up the contract a month ahead of time. So I think in the near term, that would be a tailwind for us in the cost of sales. However, as you correctly mentioned and we have mentioned, we see quite a bit of headwind for the first quarter. Lower traffic in terms of transportation hubs, significantly lower traffic in the transportation hubs business for the CNY sectors. And then we also see other headwinds in terms of less social gathering, a small-sized group, less social activities. So we do see some headwinds for our first quarter sales.

And so at this stage of the recovery, it's very important for us to continue to focus on value proposition to consumers. And so you should expect we stepping up that campaign, as you have seen in the earlier part of the first quarter. And traditionally, we don't do as much value campaign for Chinese New Year, but this year, you probably will see a bit more.

Now on the other hand, I think the sustainable initiative this year, as I mentioned, would likely cost us about $30 million for the full year in packaging by replacing plastic with other eco-friendly materials for packaging. I think it will be an ongoing initiative to ESG. And so in the future, you probably will see additional initiatives as well. So it's not a one-off event for us in terms of our ESG initiative. So -- but all in all, I think with -- for the overall the entire commodity prices that would probably (inaudible).

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

I would like to just add the philosophical comment on food cost. Our Yum China employees all know that we believe in saving all the costs we could save, particularly the G&A, hotel, mail, whatever. So we don't save on the food cost for customers. It's our sincerity and our belief that we shall serve the best food we could to the customers. If we do get some savings from the commodity costs, we actually will reinvest that saving, big part of the saving to treat our customer better as well. And we believe that is the right thing to do in the short term and in the long term.

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

Thank you, Joey and Andy. So just a very quick follow-up, if I may. I understand that we see a lot of headwinds coming to Q1. But meanwhile, we also need to bear in mind that with a very weak February and March last year -- of course, the government is taking some measures at the moment. But last year, we were talking about nationwide lockdown with almost everything being shut down for about 2 months. So I do believe head into February and March, things or comps -- will be looking much better. So it's fair to say that we actually could see year-on-year recovery in Q1, but maybe it could be a bit difficult for us to return to the level that we saw in Q1 of 2019. Would that be a fair comment?

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

Chen Luo, let me address these questions. I really appreciate the challenge to model the first quarter. And internally, we also see a lot of moving parts. And one thing I want to emphasize is that definitely this year, the number of infected cases want to be limited for 1,000 plus. However, it does not mean that the preventive measure will ease. In fact, the opposite because the learnings from last year, government authorities are more cautious and consumer are more cautious and taking a lot more preventive measure.

So as we have mentioned, if you look at the CNY or Chinese New Year period for travel, the government have put out advisory against new travel and encouraged folks to stay put in the cities to celebrate Chinese New Year. And we have seen railway traffic and, of course, air traffic as well, down more than 70% in just the first few days of very important Chinese New Year period. Now Chinese New Year period have been historically very important to our business, especially for KFC, which has high single-digit of its sales and especially in Chinese New Year period, double-digit in terms of the sales coming from the transportation hub and tourist locations. That would be disproportionately impacted.

Now if you also look at the trading situation, it will be more complex. Historically, once folks go home, they celebrate, they go out with their families. So we generally see a boost in sales at lower-tier cities. Now given that people are staying in the cities, that will be a little bit different situation. So again, this would probably have a bigger impact on KFC because it has presence in more lower-tier cities, and so that's one complexity there.

Now the other complexity that's going on there is that if you think about last year, we go into the first few weeks -- in January last year with very strong momentum. And, it only happened in the late January. We don't have that benefit this year. So that's one -- another thing.

Third thing is that KFC have recovered very strongly in March and later part of 2020, the reason is because we were able to keep a lot of our stores open. We're able to ensure safety of our employees and customers. We see tremendous boost in our delivery business. And then even though quite a few stores were closed at that time, we were able to enlarge trade zones to serve those customers. Now with most of our stores open, very few stores closed because of impact today. The trade zone -- the delivery trade zone will have been withdrawn. So therefore, things will be also more challenging.

So all in all, I think that's why we want to highlight that both in our prepared remarks and also in our earnings release so that we can give a fuller picture to folks outside of China, in Hong Kong and the U.S. and Europe, so that they can understand, even though the pandemic, the infected cases maybe less, but the current measures -- stricter preventive measures and the impact on consumer behaviors are not less. And with -- and then with the Chinese New Year complexity, even more challenging for people to model, but we'll try to give you a sense that that's what happened in the first quarter.

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

Luo, the TC and TA of last year Q1 summarize what Andy just described. Because although the same-store sales for Q1 last year was minus 11%, which is a pretty decent number given the pandemic due to all the things that Andy just described, the TC was down 30%. However, with everything that we did, including when people are going back to work because our stores were -- many of our stores still opened, we benefit a lot from it, and also we focus on the high ticket item of delivery, the TA increased by 27%. So TC was down 30%, TA was up 27%. And that supported the same-store sales for last year Q1. And you could imagine, for this year, such benefit of the ticket increase will be very difficult to lap.

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

And actually, I took a train from Shanghai to Hangzhou last week. So I can understand how empty rail stations are at the moment and all the challenges that you are facing. And we really appreciate all the high efforts that you are making to sustain the business. Good luck. Thank you.

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

Thank you.

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

Thank you, Chen Luo. We try to be straightforward and present the forward picture here in the following quarter.

Operator

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

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

And the -- most of my question answered. I have a simple follow-up question because, Joey, at the beginning you mentioned this year and then going forward in the next couple of years, multi-format store are going to be a focus. Just trying to understand the economics of the small format, i.e., the small town format. The unit sales basis, how much lower per unit sales versus our previous average? Because I understand if we look at the unit store sales, pre-COVID-19 level is about USD 1.1 million per year per store. And just trying to get some picture of how lower it could be when we get more new stores in the smaller format.

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

Thank you, Lillian. I just have 2 quick comments. One is we -- forever, Yum China, at least while the business is going through such high growth, we are always struggling to balance the system sales with the same-store sales growth because it's absolutely right thing to do to drive the system sales when we can open that many stores, but it has certain pressure on the same-store sales growth as well. But we have to continue to do the right thing by hopefully delivering both system sales and same-store sales growth.

For the smaller stores, the revenue is smaller, but we can open more stores, while the profitability level is comparable to a big store. And that, I think, is very important. Therefore, net-net, the system sales is improving when we open more smaller stores.

In the past, not only now, in the past, we actually has already have multiple store format, big stores, smaller stores, depending on the location. But just right now, when we are going into Tier 6 city and below, we are open -- even smaller store and with lower CapEx, but the return will still be comparable.

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

Right. I just add a little bit to what Joey mentioned. Obviously, with the smaller format, we would likely see a smaller sales throughput. But we have a disciplined philosophy, and that helps us to be comfortable that the profitability will be comparable and the return to our investment will be comparable.

Now I think a couple of reasons we kind of like the small store to penetrate in the lower-tier cities, we are also developing small store that are geared toward more delivery and takeaway, especially in the urban center area. I think it's important to note that for delivery and takeaway, that's a network effect, right? They're closer, the more dense your network is, that help your customer service improvement, the delivery speed. And then also drive incremental sales because folks, you ask them to walk a thousand -- 2 kilometer, how are we going to do a takeaway, right? And then if you want delivery for like 5-mile -- 5 kilometer, they're probably not as good either. But when you constrain that into 3-mile and you can change the walking distance to 500-meter, a lot more folks would probably be happy to do that.

So that is some of the things that we're doing. And we have been doing that for the last couple of years, but obviously, the COVID-19 pandemic have accentuated and accelerated that consumer behavior change. And so we're going to accelerate that kind of development as well. So hopefully, we have addressed your question.

Operator

Our next question comes from the line of Sijie Lin from CICC.

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

Thank you, management, for taking my questions. And congratulations on the strong results for...

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

Sorry, Sijie. We have very hard time to hear you. Would you mind speak up a little bit, please?

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

Sorry. Could you hear me now?

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

Better.

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

Okay. Okay. Sure. And I have one question on margin. KFC's margin still recorded a year-over-year decline in Q3, but recorded significant Y-o-Y increase in Q4. So I wonder that -- what's the reason behind it? And will this continue into next few quarters?

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

Well, thank you, Sijie. In our margins, obviously, as we have mentioned a little bit in the prepared remarks, there are some of the factors in the fourth quarter that was not expected to recur. For example, some of the government and rental relief. And then we're also looking at some of the timing shift in government incentives that may not recur next year and likely not recur next year, especially for the COVID-related rental relief and government relief.

Now the second part of that is that our labor improvement has been very strong. And we -- however, a part of that is also due to some labor shortage, part-time workers. So that, as we have mentioned before, we -- it's going to be temporary. And when we increase our staffing level, that may also ease a little bit. But all in all, I think we have done -- our team have done a tremendous job in controlling costs. And so some of those cost control will continue to next year.

Now -- and we have a little bit of discussion about commodity prices. Commodity prices also eased a little bit in the fourth quarter. So that also helped our cost of sales despite we're stepping up promotional activities. So that's the other part of that.

So I think some of the -- I think, in short, is that some of those cost savings, some of those margin improvements due to productivity improvements would carry forward next year. Some of them would likely be a more temporary situation.

But all in all, I think this year, in 2021, the focus will be really continue to drive that sales and traffic recovery. So we should expect a stepping up in cost of sales in terms of promotional activities. We also should expect an increase in advertising spending. And again, because this 2-year period lap impacted by COVID-19, our same-store growth is not -- was not as strong as over the past couple of years, but if you look at our cost of wage, it would be -- the increase will come out for 2 years.

So that's why we -- in our prepared remarks, we caution folks that in 2021, margins overall compared to pre-COVID level will still remain subdued. And one thing is that we still have some ways to go before we see sales recover to the pre-COVID level. So that's why despite some of the productivity improvements, some of the easing in commodity prices, we are still a little bit cautious on that margin part.

Operator

Our next question comes from the line of Terrance Liu from CLSA.

Terrance Liu ***CLSA Limited, Research Division - Research Analyst***

Okay. So I'm just curious about your statement on your coffee business. Because based on our understanding previously, I think you have been talking about refining the business model and I think store format for your coffee business, especially as to the COFFii & JOY. So I think Andy just mentioned a couple of times since you will accelerate the expansion of your coffee business in the next couple of years to scale up to a meaningful scale. So I'm wondering, does this mean that you are [redefining] the current business model or the store format? Or you have redefined from the replicable model for your COFFii & JOY business going forward? So could you just elaborate more about your strategy as to your coffee business for next 3 to 5 years, especially in terms of like the store openings and its sales contribution? So anything you can share with us is highly appreciated.

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

Thank you, Terrance. Let's talk about C&J a little bit, and then we'll move on to Lavazza. C&J, we so far have roughly about 50 stores, and we have been working on the business model and then refine it and build on it. The focus is on getting the fundamental right. For example, we built a daypart, we built the delivery, we improved the store economics. To give you a sense, quarter 4 of 2020, the delivery business is already 30% sales of the C&J, which is much, much higher compared to the year before. The delta here is the availability of the system and also food and et cetera.

And then for C&J, we are also building the B2B business. It has a 3-year partnership with another company so that we supply coffee in the office that's provided by our partner. And that partnership it's about opportunity for 100 sites, and we'll continue to explore that. So the potential avenue of growth is on store expansion opportunity, but also on the store economics. Because when we have 50 stores, we have certain scale, then we can really work on the economics. It's very hard to really have a true sense of the economics when we have a few stores.

But let's move on to Lavazza. Lavazza, we only have 5 stores right now in Shanghai. However, the improvement of economics, the speed of improvement is quite fast. As I mentioned earlier, we are actually quite happy with the result. I mean, the brand is very well received by the customer. And because of the technology and all the fundamental we work on C&J and that helped the delivery daypart of Lavazza immediately as well. So we -- our delivery business for Lavazza, even with 5 stores, is already one-quarter of the sales. And of course, we are also building the CRM and we already start to improve the economics.

And the Lavazza business for 2021, we do plan to accelerate the opening quite fast in 2020. We shall go out of Shanghai for Lavazza this year as well. So I think without going into more and more detail, I'll pause here.

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

I'll add a couple of things. I think as Joey mentioned, we see the fundamentals at C&J is improving. So if you look at the store over more than a year, I think they have returned to positive SSG in late 2020. And then with better sales and better mix of products, we also see more store are going to breakeven. So that's, I think, overall, a positive trend there.

And for Lavazza, it's obviously a very new initiative, but I think what we can say is that the reaction from consumer and their initial sales number were better than what we have initially forecast. So it's still early in the game for coffee for us, but we're very confident. And more importantly, I think we internally have decided coffee is a very important category for us in the longer term, and we'll invest what's needed to make it successful and material and an important part of our business going forward.

Operator

I would now like to hand back the conference to today's speakers. Please continue.

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

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

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

Thank you.

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

Thank you, everyone.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.