



1999 annual report

# the power of YUM

## financial highlights

(\$ in millions, except for unit and share data)

Number of stores:	1999	1998	% change
Company	<b>6,981</b>	8,397	(17)%
Affiliates	<b>1,178</b>	1,120	5%
Franchisees	<b>18,414</b>	16,650	11%
Licensees	<b>3,409</b>	3,596	(5)%
System	<b>29,982</b>	29,763	1%
System sales (rounded)	<b>21,800</b>	20,600	6%
Company revenues	<b>7,822</b>	8,479	(8)%
Ongoing operating profit	<b>881</b>	768	15%
Accounting changes	<b>29</b>	—	NM
Facility actions net gain	<b>381</b>	275	38%
Unusual items	<b>(51)</b>	(15)	NM
Operating profit	<b>1,240</b>	1,028	21%
Net income	<b>627</b>	445	41%
Diluted earnings per common share	<b>\$3.92</b>	\$2.84	38%
Diluted ongoing operating earnings per common share	<b>\$2.58</b>	\$1.83	41%
Cash flows provided by:			
Operating activities	<b>565</b>	674	(16)%
Refranchising proceeds	<b>916</b>	784	17%

## average U.S. sales per system unit

\$ in thousands (Compounded annual growth rates)

	1999	1998	1997	1996	1995	1994	5-year growth
KFC	<b>\$837</b>	\$817	\$786	\$775	\$733	\$706	3%
Pizza Hut	<b>696</b>	645	630	620	651	634	2%
Taco Bell	<b>918</b>	931	902	886	925	953	(1)%

## worldwide system sales

\$ in billions (Compounded annual growth rates)

	1999	1998	1997	1996	1995	1994	5-year growth
KFC	<b>4.3</b>	4.2	4.0	3.9	3.7	3.5	4%
Pizza Hut	<b>5.0</b>	4.8	4.7	4.9	5.1	4.9	—
Taco Bell	<b>5.2</b>	5.0	4.8	4.6	4.4	4.2	4%
Total U.S.	<b>14.5</b>	14.0	13.5	13.4	13.2	12.6	3%
Total Intl	<b>7.3</b>	6.6	7.0	6.9	6.5	5.6	5%
Total	<b>21.8</b>	20.6	20.5	20.3	19.7	18.2	4%

# our passion

is to put a yum on people's faces around the world...  
we offer that special eating experience that makes you smile  
and creates lifelong customers. And we'll do that with:

**food you crave,  
comeback value, and  
customer-focused teams.**

Our jobs are the best in the world  
for people who are committed to quality food and  
satisfying customers better than anyone else.

**2 letter to shareholders**  
**7 our formula for success**  
**8 people capability first**  
**12 satisfied customers follow**  
**20 then we make more money**  
**22 tricon facts**  
**24 financials**

On the Cover:

Three Restaurant General Managers,

our #1 Leaders, demonstrating our Passion the way we start  
all of our major system meetings — with a "YUM Cheer!"

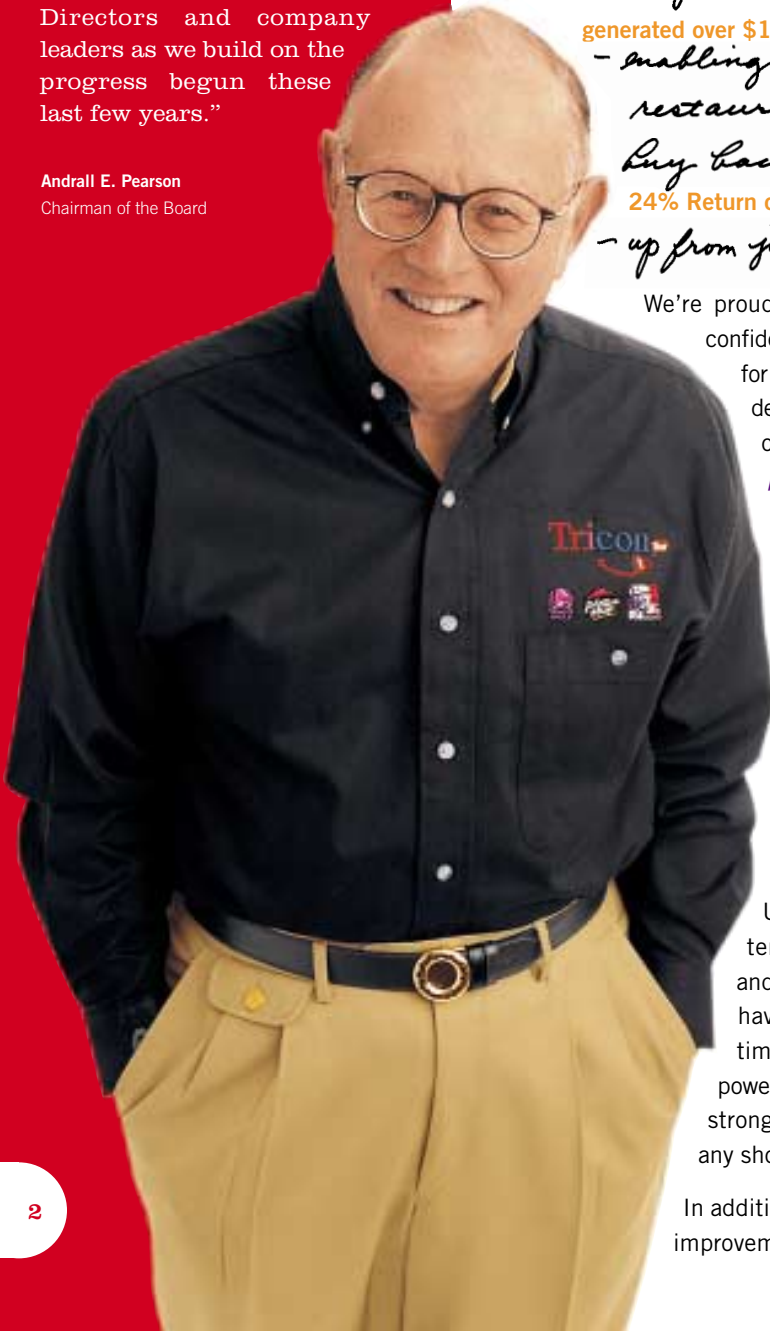
Give me a "Y"! **David Alston** KFC Restaurant General Manager

Give me a "U"! **Jackie Lopez** Pizza Hut Restaurant General Manager

Give me a "M"! **Carlos Diaz** Taco Bell Franchise Restaurant General Manager

“Stepping back, it has been a great privilege these last two years to serve as Chairman and CEO, alongside David Novak, Vice Chairman and President. The Board and I were pleased to name him CEO on January 1, 2000. He has earned this recognition based on his considerable accomplishments and is the best possible person to lead the company into the new century. As Chairman, I will continue to play an active role working with our world-class Board of Directors and company leaders as we build on the progress begun these last few years.”

Andrall E. Pearson  
Chairman of the Board



## dear partners,

When we launched Tricon as an independent company, our goal was to take three leading restaurant brands that had been under-managed over time, and ultimately become the best restaurant company in the world. Toward that end, we're pleased to report that 1999 was an outstanding year for Tricon, with solid progress made against almost every operational and financial goal we set for ourselves. We've worked hard at increasing our performance by developing our culture, driving same store sales growth, improving our restaurant economics and cost structure, while expanding our system.

Some key highlights include:

**41% ongoing operating EPS growth**

*- on top of 35% growth in '98*

**4% combined same store sales growth in the United States**

*- the 2nd year we've grown by that amount*

**generated over \$1.5 billion of cash flow**

*- enabling us to invest \$470 million in our restaurants, pay down \$1 billion of debt and buy back 3.3 million shares of our stock*

**24% Return on Assets Employed**

*- up from just about 10% at the time of our spin-off*

We're proud of all our system has accomplished. What's more, we're confident the actions we've undertaken this past year will pave the way for greater success. While we've been disappointed by the recent decline in our stock price, we know we will build shareholder value over the long term by focusing on these *five differentiating performance drivers*:

**#1 Consistent Same Store Sales Growth with a Portfolio of Three Leading Brands:**

The primary way we're measured in our industry is by consistently delivering same store sales growth. In 1999, we delivered strong combined U.S. same store sales growth of 4%, on top of 4% combined growth in 1998. We are committed to consistently delivering 2-3% combined same store sales growth, year after year.

Importantly, our unique portfolio of three leadership brands enables us to deliver these results in the U.S., even if one of our brands is temporarily experiencing some ups and downs. Our intention, of course, is to have all three brands clicking at the same time; but it's a unique strength to have a powerful portfolio of leading brands where stronger performance by some can offset any short-term softness at others.

*That's  
the power  
of YUM!*

In addition to our existing delicious products and continued operations improvement, a key driver of same store sales growth and one of our



most important achievements in 1999 was our new product success. We entered new product segments with considerable long-term growth potential at each of our brands:

“on the go” with sandwiches at KFC

“value” with The Big New Yorker at Pizza Hut

“big taste, hot value” with Chalupas at Taco Bell

These new products add to our leading category market share. As a result, we are going forward with a significant opportunity for future growth off an even stronger competitive foundation.

*Pizza Hut has had 10 straight quarters of growth!*

In 1999, **Pizza Hut** had another outstanding year, with same store sales up 9%. On Super Bowl Sunday, Pizza Hut launched The Big New Yorker pizza, the most successful new product introduction in the pizza category in recent history. This 16" authentic New York style pizza is offered at a unique \$9.99 value price, appealing directly to the heavy pizza consumer compelled by value and product innovation. With our existing popular Pan, Thin Crust, Stuffed Crust and Hand-Tossed pizzas, Pizza Hut is delivering on its competitive positioning to have the “Best Pizzas Under One Roof.” In fact, Pizza Hut outperformed its major competitors for the year in same store sales growth and grew market share in the key traditional segment.

At **KFC**, our strategy is to reposition the brand as the “chicken experts for *all* chicken occasions,” not just fried chicken on the bone. KFC grew same store sales by 2% in the year. However, while KFC dominates the chicken on the bone segment with our world-famous Original Recipe and about a 40% market share, this segment has been relatively flat. Our growth in recent years has come from adding concept layers, like the introduction of Colonel’s Crispy Strips, which added about \$120,000 to the average KFC restaurant. We now own about a 10% share of the \$4 billion strips category after four years. Our goal with the introduction of chicken sandwiches is to add another concept layer to reignite KFC’s topline growth. After our introductory quarter, we now own 8% of the \$5 billion sandwich category. Nearly a fifth of all Quick Service Restaurant users have tried our sandwiches, and they’ve told us their intent to repurchase is over 85%. Research says we have the best chicken sandwiches of any national competitor and we’re currently generating \$130,000 of annualized sales per restaurant — our challenge now is to make sandwiches more incremental to the base business. Our entire system, especially our franchisees, are committed to making sandwiches a success because we know we have such a strong consumer proposition.

While **Taco Bell’s** same store sales were flat for the year, we began to make great progress by refocusing on Quick Service Restaurant consumers who already crave Taco Bell’s great-tasting food and rate it #1 on “value.” Our strategy is to reinforce *Grande Taste, Loco Value* — Big Taste, Great Value —



David C. Novak  
Chief Executive Officer

every day, and communicate this in everything we do. Following this strategy, transactions turned positive with the launch of our freshly fried hot Chalupas late in the year. Having now transformed the quality of Taco Bell food by reinventing the taco with our highly popular Gorditas and Chalupas, Taco Bell will continue to feature more quality upgrades of existing products, like Enchiritos, burritos and nacho chips.



**#2 International Growth:** One of our greatest success stories this past year has been the outstanding results we generated from our international business. In 1999, Tricon achieved a 39% increase in international ongoing operating profit — the strongest increase in almost a decade. Our strategy has been to focus equity (Tricon-owned restaurants) in about 10 key countries, while growing elsewhere around the globe with our growth-ready franchisees. This strategy is paying off. For example, our KFC businesses in Mexico, Australia, the U.K. and China all are booming, as is Pizza Hut in China, Canada and the U.K. In fact, one-fourth of our total ongoing operating profit in 1999 came from our international business, and we expect it to grow on average at least 15-20% per year. We plan to build over 700 new restaurants across our system outside of the United States in 2000, on top of the 700 units we opened in 1999. We are convinced our international business will continue to be a primary growth engine for Tricon in the years ahead. We've only begun to scratch the surface of marketplace presence and the global popularity of our food is phenomenal.

*We have more restaurants in China than any other company - with great profit increases - so watch for further investment there*

**#3 Multi-Branding and New Unit Expansion:** Tricon is uniquely positioned to offer more than one brand under one roof, providing customers an opportunity to please the entire family at one counter. We've proven the success of "2-n-1's" — KFC/Taco Bell Express...Taco Bell/Pizza Hut Express...and KFC/Pizza Hut Express. We're going to accelerate building these restaurants, increasing growth opportunities for our franchisees. We're also still testing "3-n-1's" — restaurants that serve all three of our popular brands. Given our category leadership in pizza, Mexican-style food and chicken, no one else can offer this unique opportunity. We ended 1999 with over 700 multi-branded restaurants in the system. In 2000, we plan to build a total of about 1,300 multi-branded and single-branded restaurants across our system — 600 restaurants in the U.S., and an additional 700 international restaurants. This kind of growth will continue and we expect it to increase as we go into the future.

*That's solid performance in our industry*

**#4 Margin Improvement:** We will continue to leverage topline growth, productivity improvements and cost savings to drive growth in base margins year over year. We achieved over 125 basis points in margin improvement from base operations in 1999, on top of 70 basis points of improvement from base operations in 1998. Our ownership mentality is to run each restaurant like it's our only one, and that's helped make our store margins industry competitive. Importantly, improved margins have helped raise our Return On Assets Employed from 10% to about 24% in just two years. We expect to improve our base margins in 2000 by up to 20 basis points. With the added benefit of refranchising, our margins should be up by about 50 basis points next year.

*We've paid down more than \$2.1 billion in debt since our spin-off in 1997*

**#5 Improved Cash Flow for Reinvestment:** Our final performance driver is to continue to achieve great results from our financial strategies, and, in turn, improve our cash flow, enabling us to further reinvest in our business growth. We've taken a series of strategic actions to improve our balance sheet and returns. In 1999, we sold over 1,400 restaurants to franchisees, reducing company ownership of the system from 28% to 23%, closing in on our target of about 20%. Cash from operations and this refranchising strategy generated over \$1.5 billion in cash flow. This, in turn, enabled us to pay down over \$1 billion in debt last year. Significantly, we also reinvested about \$470 million in new and existing restaurants in 1999. We also bought back 3.3 million shares of our stock since September, underscoring both our strong cash generation and confidence in our growth potential. Additionally, we've greatly improved our

effective tax rate, providing an annual cash benefit to Tricon that ultimately increases shareholder returns. As a result of progress we've made implementing our financial strategies, we've greatly strengthened our balance sheet and increased our financial flexibility.



In 2000, we expect to generate close to \$500 million in free cash flow, enabling us to reinvest in the business by continuing to upgrade our assets and open new restaurants while also buying back shares.

**Looking Ahead:** Our outlook for 2000 remains optimistic off our strong 1999 results and the demonstrable progress that we're making on these five performance drivers. We're on track to deliver 2-3% combined U.S. same store sales growth, 6% systemwide sales growth, and an ongoing operating earnings per share growth in the range of 23 to 27%, on top of our 41% increase in 1999. However, it's too early to know for certain what the impact to our results, *if any*, might be as a result of the recent Chapter 11 bankruptcy filing by AmeriServe, our principal U.S. distributor. We're pleased that we've been able to maintain service to our restaurants in a cost-effective manner to date, and we intend to continue this performance in the future.

We're going to stay focused on our performance drivers in all that we do to make Tricon a great investment for our shareholders over the long-term. We are putting the building blocks in place to drive dynasty-like performance. In fact, Tricon has all the characteristics to become one of the world's great companies over time: leading brands, a proven international business, tremendous cash flow to fund reinvestment — *and* the people to make it happen. Our goal is to become nothing less than a "dynasty" by driving consistent performance, year after year. On the next page, you'll see how we communicated this vision to our system's employees and franchisees on New Year's Day.



As you read further, you'll notice a lot of energetic people who will tell you what we've done and what we're going to do to keep moving forward. In fact, on our front cover, we've featured three of our Restaurant General Managers — our #1 leaders — who represent a system built around restaurant teams committed to serving customers better than anyone. David Alston (KFC), Jackie Lopez (Pizza Hut) and Carlos Diaz (Taco Bell) are demonstrating our "YUM Cheer" — the way we begin every major system meeting, because we know if we put a "YUM" on our customers' faces, our financial results and shareholder returns will follow. We'd like to thank the nearly 600,000 people across the Tricon system, our franchise partners and outstanding Board of Directors for their dedication and inspired ideas.

From all of us at Tricon, YUM to you,

David C. Novak CEO

Andrell E. Pearson Chairman



NEW YEAR'S DAY 2000

David C. Novak  
Chief Executive Officer

Tricon Global Restaurants, Inc.  
PO Box 32220  
Louisville, KY 40232-2220

Dear Team Members,

I'd like to be one of the first to wish you and yours a very happy and healthy New Year.

I'm writing because a number of you have asked me to share our vision for Tricon as we enter the next decade.

The goal we have is bold and achievable: BUILD THE YUM DYNASTY!

We will become a dynasty by driving consistent year over year sales and profit growth. In so doing, we'd like to be one of the world's top ten companies to work for and become one of the top ten admired companies. We'd also like to go into the next decade clearly acknowledged as the best restaurant company in the world.

How will we do it? We will do what great dynasties do! We've identified five dynasty drivers and will pursue them diligently: 1) Culture where everyone makes a difference; 2) Customer and Sales Mania; 3) Competitive Brand Differentiation; 4) Continuity in People and Process and 5) Consistency in Results. I'm asking for your full commitment to bring them to reality in your business.

TOGETHER WE WILL BUILD THE YUM DYNASTY! The next step is to start this decade out right by making 2000 a huge success. Let's do it and be sure to have fun recognizing the achievements of others along the way!

Yum to You!

Did





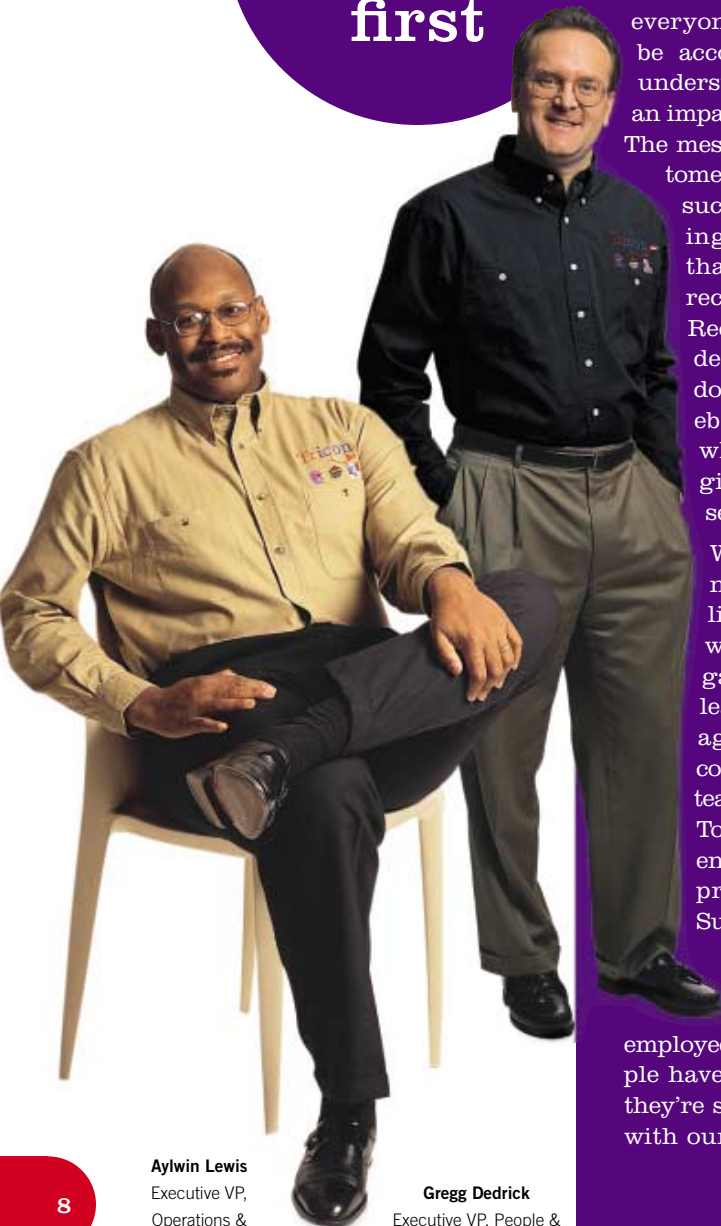
**our  
formula  
for success  
is working**

**1  
people  
capability  
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**3  
then we  
make more  
money**

# 1 people capability first



**Aylwin Lewis**  
Executive VP,  
Operations &  
New Business Development

**Gregg Dedrick**  
Executive VP, People &  
Shared Services

**GREGG DEDRICK, EXECUTIVE VP, PEOPLE AND SHARED SERVICES:** One of our “Founding Truths” and one of our key strategies is putting people capability first. This means we must support our employees by giving them the tools they need to be successful and then reward and recognize them for that success. We all know when we do that, satisfied customers and profits follow. Why is that? Because the restaurant industry is a highly people-driven business — one where success with the customer depends on enthusiastic, well-trained, service-driven teams. So our challenge is not only to attract great people, but also to retain and motivate them, particularly in our restaurants. To do that, we’re creating a unique work environment where everyone counts and knows they make a difference. In fact, our goal is to build an ownership and recognition culture that drives the best results in the industry.

How are we doing this? First, by encouraging everyone to think and act like owners and be accountable as owners, too. That means understanding how our actions and ideas have an impact with customers and on the bottom line. The message is “own your teams, own your customers and own your results,” and given our success with driving margins and increasing customer satisfaction, it’s a message that’s paying off. Second, we’re making recognition a key part of our operation. Recognition shows you care and, in this demanding quick-service business, if you don’t care, people leave. So every day we celebrate the achievements of our people, which builds commitment and puts energized, motivated teams on the frontline serving our customers.

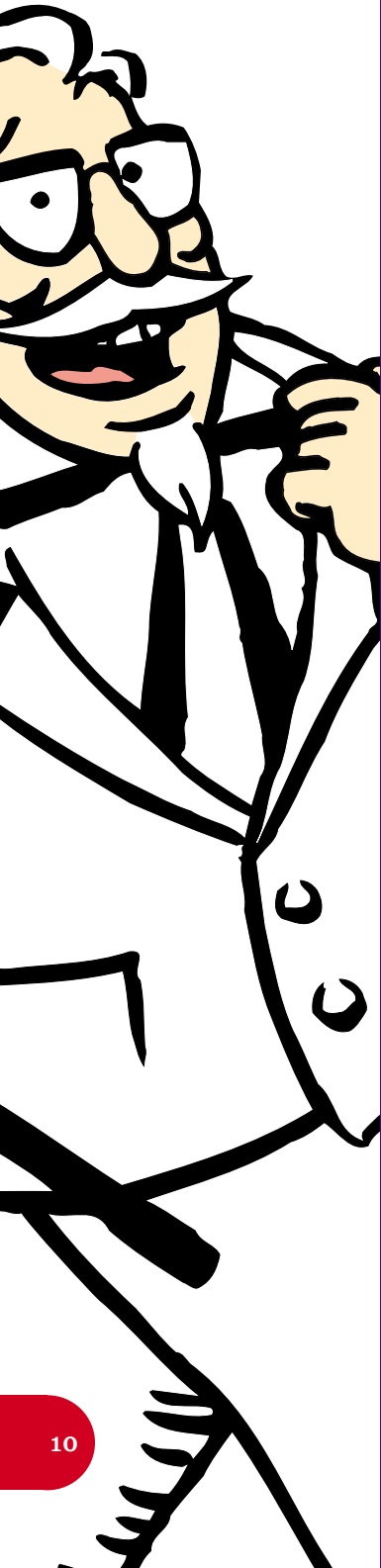
We bring our unique culture to life in a number of ways. For example, we established our YUM Leadership program, where franchise and company leaders gather with David Novak to learn how to lead and build teams with a common agenda. We’ve also begun cascading our core values of accountability, excellence and teamwork — what we call our How We Work Together principles — throughout our entire system. We then get feedback on our progress. We launched the “Founders Survey,” an annual survey that tells us how we’re running the business. In fact, our 1999 survey scores were great: we registered extremely high levels of employee commitment around the globe. Our people have pride in their jobs, their company and they’re staying with us. We rated especially well with our RGMS, who showed great enthusiasm



**Jonathan Blum**  
Senior VP, Public Affairs

Whether they work for the company or a franchisee, whether they are in the United States or someplace else in the world, our RGMs are our #1 leaders. They are the frontline to the world and are casting mighty large leadership shadows. We wanted to introduce you to some of our outstanding leaders — pictured here with their individual awards. Each of them is the best at driving their business with a passion toward putting YUMs on customers' faces around the world. (from back to front) **Jackie Lopez**, Pizza Hut RGM, Big Cheese Award; **Goh Kim Yian**, KFC Market Manager, Globe Award; **Carlos Delgado**, KFC RGM, Bulldog Award; **Henry Yip**, Pizza Hut Franchise General Manager, Globe Award; **Joy Beltman**, Pizza Hut franchise RGM, Big Cheese Award; **Carlos Diaz**, Taco Bell franchise RGM, Royal Order of the Pepper Award; **Mike Potter**, Taco Bell RGM, Royal Order of the Pepper Award; **David Alston**, KFC RGM & Training Coach, YUM Award; **Jennifer Cook**, KFC/Taco Bell 2-n-1 franchise RGM, 2 Floppy Chickens & Bulldog Award; **James Cummings**, Pizza Hut RGM, YUM Award; **Aric Hill**, Pizza Hut RGM, Big Cheese Award.





for serving our customers and for teaming with their fellow RGMs to share best practices. We held our first-ever RGM meetings for Pizza Hut, our first-ever systemwide (company and franchise) meetings for Taco Bell and also our first-ever international RGM summits in Asia and London.

**AYLWIN LEWIS: EXECUTIVE VP, OPERATIONS AND NEW BUSINESS DEVELOPMENT:** Best practice sharing is a key element of the way we do business. One of our primary challenges is to formalize best-practice sharing across the globe and to learn from both inside and outside of the company. Recently, we've looked outside of the company and benchmarked some of the most successful businesses in the U.S. to learn from them and are incorporating those learnings into our business.

Internally, our greatest success story to date with best practice sharing is demonstrated through C.H.A.M.P.S. — which stands for Cleanliness, Hospitality, Accuracy, Maintenance, Product Quality and Speed. C.H.A.M.P.S. is our umbrella operations program for training, measuring and rewarding our employees performance against customer standards. Not too long ago, we were a restaurant system with three great brands but many different procedures and training manuals. So we went to work to weed out redundancies, leverage learnings and create a uniform approach for everything from the way we train our people to how we cook our food. The goal was, and still is, to ensure that our customers receive the same level of superior service and food quality at all of our restaurants.

The results have been great! The combination of our C.H.A.M.P.S. standards library, our Developing Champions training initiative, our CHAMPSCheck mystery shops and other C.H.A.M.P.S. programs is paying terrific dividends, namely charged-up, customer-focused teams and dynamite sales — as well as improved operations. And though C.H.A.M.P.S. started out at our international business, TRI, we've since spread it across the entire system — first to KFC then to Taco Bell, and we recently rolled it out to Pizza Hut last year. And what's more, our restaurant teams love it!





**Left:** TEENSUPREME® mentor, **Rick Rodriguez** is one of Taco Bell's outstanding franchise RGMs who is keeping teens "off the streets and in school" through his work with the TEENSUPREME® Career Prep Program.



**Below:** Pizza Hut RGM, **Richard Elston** coaches and motivates young students — like 9-year old Nicole Gormley — to read more frequently through the BOOK IT! program. Nicole is one of BOOK IT!'s most enthusiastic supporters.



We are also charged up about further aligning our operations teams around our "one-time, one-way" initiative to make sure we're operating as efficiently as possible. One such program that does this, is an innovative systems and operational initiative called TriYUMf. Aimed at our back-of-the house and above-restaurant systems, TriYUMf gleans the best demonstrations of food quality maintenance, labor cost control and other operational procedures in an ongoing effort to improve margins in our stores.

We know that there's no substitute for experience in our people — and C.H.A.M.P.S. is a great catalyst for that. We're executing process and discipline around what really matters, gaining the valued input of our franchisees and driving results that impact both our people and our profits. That's the power of a unique ownership and recognition culture at work. What could be better?

**JONATHAN BLUM, SENIOR VP, PUBLIC AFFAIRS:**

At Tricon, we're walking the talk of community service by creating and sponsoring programs that support our customers across the globe. Pizza Hut's BOOK IT!® National Reading Incentive Program encourages 20 million kids every year to learn the joy of reading. Taco Bell's TEENSUPREME Program, in partnership with the Boys and Girls Clubs of America, provides critical leadership and life skills to nearly a million more young people each year. At KFC, we'll be launching a national daycare initiative that's been in test this past year, called "Colonel's Kids." We know the Colonel would be proud of the way we're helping needy families. And Tricon's Harvest Program donates millions of pounds of food so those who are less fortunate can enjoy a good hot meal. Internationally, we're also making a difference in the community. We've sponsored KFC school scholarships in Singapore and Thailand, disaster relief funds in China and aid to terminally ill children in the United Kingdom, just to name a few of the hundreds of fine organizations receiving our aid.

We'd like to thank our thousands of employees and franchisees who give so generously to make our world a little bit better for all.



2  
satisfied  
customers  
follow



## 1999: Pizza Hut Reaches New Heights

Pizza Hut's 1999 performance blasted into stratospheric heights with one of its most successful years ever. Same store sales growth reached a whopping 9%, marking an impressive record of thirty-three periods and ten quarters of uninterrupted growth!

The reason for this success is simple — a keen focus on customers, culture and competition.

Our customers told us they wanted lots of pizza at a great value and we delivered — big time. The Big New Yorker, an authentic New York street corner pizza, is 16 inches and eight slices of floppy, foldable, crusty delight, loaded with tons of tomato sauce and dripping with cheese — all at great value of just \$9.99. Launched with high-profile celebrity advertising and sustained with an innovative promotion with Blockbuster and barrier-busting price points, this breakthrough product was and remains an enormous customer win.

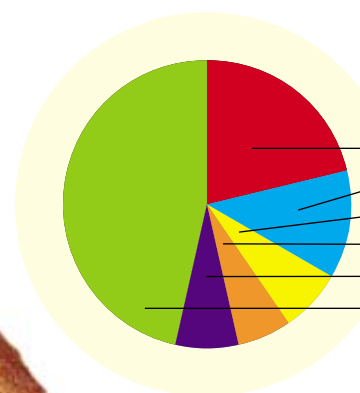
Of course, we also know that great service and great operations also drive sales. So this past year, for the first time we brought together every one of our Restaurant General Managers at a landmark Leadership Summit, which reinforced a culture empowered by teamwork, accountability and excellence.

The combination of customer and sales mania and an RGM empowered culture is helping us successfully drive margin improvement in our stores across the globe. It's also helping us attract and retain highly motivated employees. It's no wonder that Pizza Hut had its lowest turnover since spin-off for both RGMs and front-line team members.

Higher margins and lower turnover are powerful competitive weapons. So are our new dine-in and high-volume market assets. They've got a new, contemporary look and feel and customers in both company and franchise markets love them. In fact, 1999 sales from these assets were extremely promising.

Truly, 1999 was another great year for Pizza Hut. And with strategies in place to continue to drive sales, develop new units, build out our delivery segment and satisfy our customers unlike any other pizza brand in the business, we know more growth and success are still to come. What else would you expect of the #1 pizza company in the world?





**Pizza QSR Sales**  
21% Pizza Hut  
12% Domino's  
7% Little Caesar's  
6% Papa John's  
7% Regionals  
47% Independents\*

\*Highly fragmented



**Mike Rawlings**  
President & Chief Concept Officer

**Mike Miles**  
Chief Operating Officer





## KFC®: The Place For Chicken — In a Bucket or On a Bun

KFC now has sandwiches! Long the favorite for chicken-on-the-bone, KFC has entered the chicken sandwich market.

Chicken sandwiches, one of the fastest-growing QSR segments, has been dominated by the burger chains. KFC is out to change that competitive landscape with our new freshly made sandwiches — Original Recipe®, Tender Roast®, Triple Crunch®, Triple Crunch Zinger™ and Honey BBQ.

KFC launched sandwiches in mid-September 1999. By the end of November, the QSR chicken sandwich market had grown at a faster rate than it had anytime over the last five years. And KFC led the way — driving more chicken sandwich growth than any other QSR. In less than three months, KFC's share of the QSR chicken sandwich market had increased more than five-fold.

"Mooove over, burger boys!" exclaimed the animated Colonel as he led the advertising and publicity charge for KFC's sandwiches. The lovable cartoon character has helped our advertising awareness jump 50% to all-time highs.

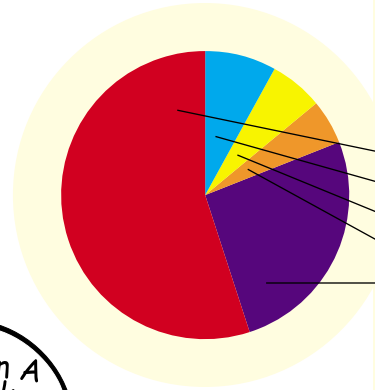
We also introduced programs to help make sandwiches successful operationally. With special equipment and an intense focus on training and recognition, we successfully added "freshly made" sandwiches to our restaurants while simplifying operations and improving service speed.

Speed is so important to on-the-go sandwich customers that we declared 1999 "The Year of Speed." The emphasis worked. Consumers now rank KFC fourth out of 12 national QSR brands in speed of service — jumping from seventh in just one year.

For five years, KFC had same store sales increases. But 1999's 2% same store sales increase was somewhat disappointing. However, we're confident that the products and programs put in place in 1999 should have positive long-range effects on our brand.

In 1999, KFC franchisees and company operators built 190 new restaurants and upgraded another 200 — even more activity in restaurant development than last year's aggressive action. These new restaurants are generating outstanding results and increasing shareholder value in our brand.

KFC will continue to grow both chicken-on-the-bone and great on-the-go products like sandwiches and strips. With a bold new look on an increasing number of new restaurants, we'll build our brand for a new generation of chicken lovers.



Chicken QSR Sales

55% KFC  
8% Popeye's  
6% Church's  
5% Regionals  
26% Independents



**Terry Davenport**  
Chief Concept &  
Marketing Officer

**Chuck Rawley**  
President &  
Chief Operating Officer



## Becoming America's Favorite Quick Service Restaurant

In 1999, we laid the foundation to become America's Favorite Quick Service Restaurant through great-tasting new Mexican food, value leadership, consistent customer satisfaction, and expanded points of access!

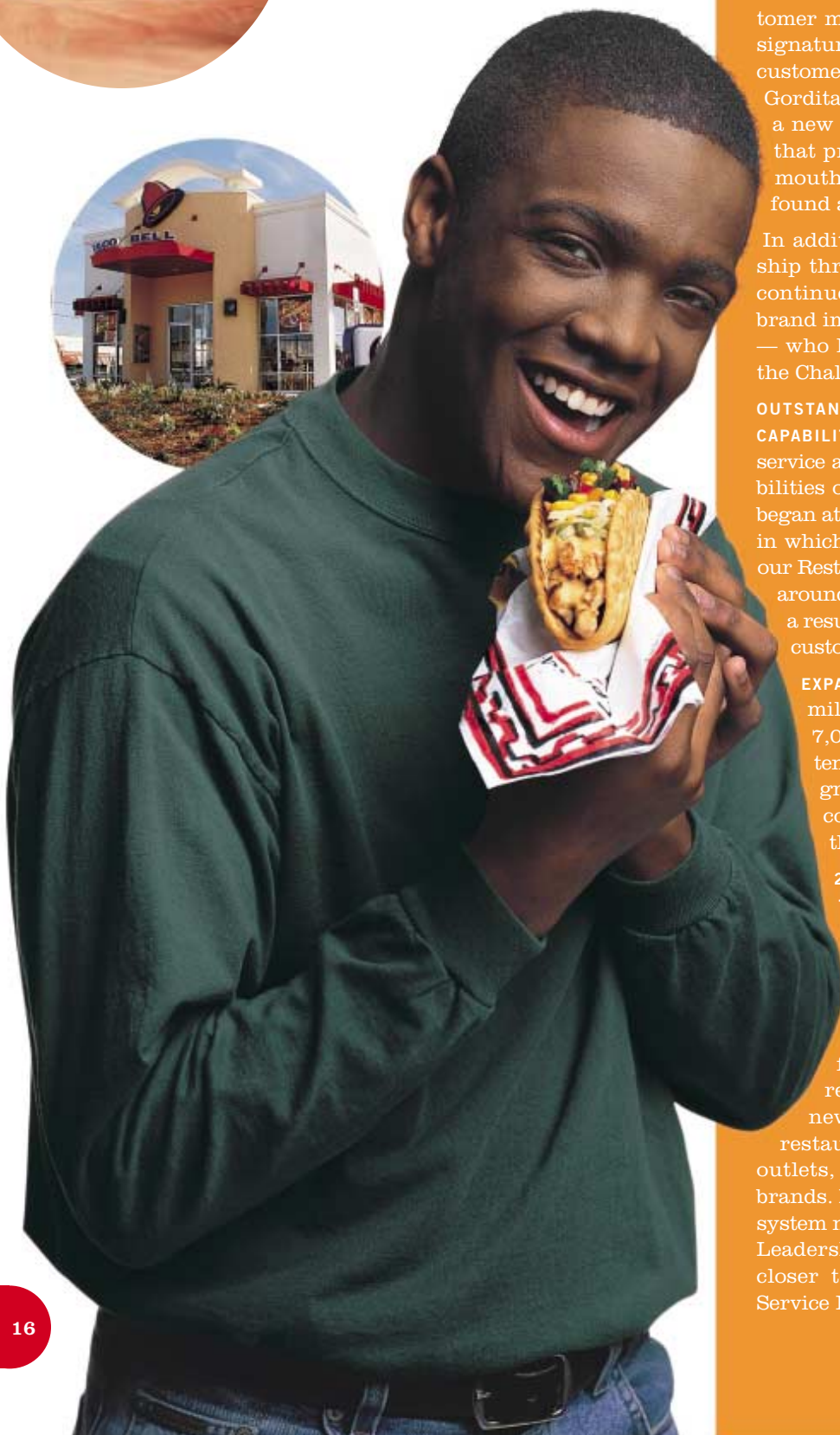
**"DROP THE CHALUPA!"** Last year we took our customer mania to a new level with Chalupas. This signature product scored off the charts with our customers, even topping the sales success set by Gorditas in 1998. Chalupas also set the stage for a new pipeline of transaction-driving products that provide us brand differentiation through mouth-watering taste sensations that can't be found anywhere else.

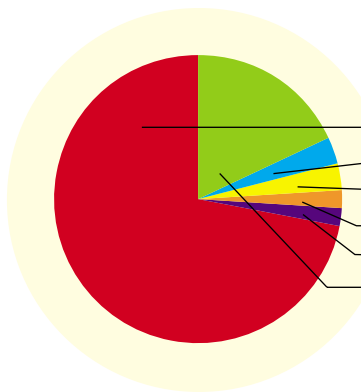
In addition, we strengthened our value leadership through competitive price points while we continued to reinforce our edgy, unmistakable brand image with the feisty Taco Bell Chihuahua — who had everyone in America saying, "Drop the Chalupa!"

**OUTSTANDING CUSTOMER FOCUS THROUGH PEOPLE CAPABILITY** In 1999 we committed to delivering A+ service across our system by developing the capabilities of our greatest resource — our people. It began at our landmark Leaders' Millennium Expo, in which we gathered 7,000 of our #1 Leaders — our Restaurant General Managers — to focus them around a common set of objectives and skills. As a result, we improved measurements across key customer metrics.

**EXPANDING THE SYSTEM** We reached important milestones in 1999 by expanding to nearly 7,000 locations nationwide, and driving systemwide sales to \$5.2 billion. This aggressive growth was fueled by our franchisees, whose confidence in our brand was reflected in their significant investment.

**2000: "GRANDE TASTE. LOCO VALUE. ONLY AT TACO BELL"** We've declared 2000 "The Year of the Food!" We'll build sales and transactions by introducing several great-tasting new products and differentiating Taco Bell as the best QSR value, bar none. We'll also drive our customer-focused culture even deeper into our restaurants. And you'll find us in many new locations — not just at traditional restaurants, but also at exciting multi-brand outlets, which offer great food from our sister brands. Finally, by leveraging the power of a one-system mindset and our "How We Work Together" Leadership Principles, we'll move dramatically closer to becoming America's Favorite Quick Service Restaurant!





**Mexican QSR Sales**

- 72% Taco Bell
- 3% Del Taco
- 3% Taco John's
- 2% Taco Bueno
- 2% Taco Time
- 18% Independents



  
**Grande taste. Loco value.  
Only at Taco Bell.**



**Peter Waller**  
President & Chief Concept Officer

**Bob Nilsen**  
Chief Operating Officer



## Tricon Restaurants International: A World Ahead

What a year it's been for our international business. We've seen increased profits, continued development of operating systems, like C.H.A.M.P.S., outstanding product launches, a stronger franchise relationship and a culture that is changing — for the better.

In 1999, our operating profit was \$265 million — that's up 39% from 1998! We had an overall improvement in company restaurant margins — 140 basis points ahead of last year.

**HOW DID WE MAKE THIS HAPPEN?** Employees have embraced C.H.A.M.P.S. in strengthening customer focus. Used globally in over 80 countries, it's now being implemented in the U.S.

KFC's Twister debuted in some large markets (Australia, the United Kingdom, Korea) and has been a terrific success.

Pizza Hut introduced its version of the Big New Yorker in Europe with hopes it will be big internationally.

The addition of our new franchise partners has allowed us to continue to build a solid franchise system. The Franchise Partners Advisory Council (FPAC) is a strong initiative for gaining alignment and serves as a resource for TRI senior management and franchisees to share business ideas and best practices.

TRI has rebounded from economic turmoil in Asia, posting over 70% operating profit growth over last year. PH Korea more than doubled its operating profit. KFC Thailand saw profit growth of 40%. The continued progress we've had in our established markets, like Australia and the UK, is outstanding. KFC Australia had same store sales growth of 8%, while KFC same store sales in the UK were up 5%.

We built over 600 new system units in 1999. Future projects will accelerate development and position us for more in the long term. In 2000, we'll develop Pizza Hut as the second strong brand in China where KFC's over 300 units already stand on firm ground.

Global improvements from operating systems, like C.H.A.M.P.S., will strengthen our customer-focused business. We've reduced spending by nearly \$30 million over the last two years and will continue to grow our franchise system.

TRI has enormous potential, and 1999 further establishes credibility that we can deliver. We now have scale, capability and focus to ensure a solid growth platform for the future.

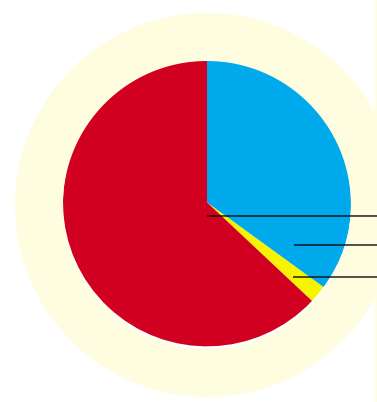




**Peter Hearl**  
Executive Vice President



**Pete Bassi**  
President



**International System  
Sales By Brand**

- 63% KFC
- 35% Pizza Hut
- 2% Taco Bell



3  
then we  
make more  
money



**Dave Deno**  
Chief Financial Officer

**DAVE DENO, CHIEF FINANCIAL OFFICER:** Though 1999 was an outstanding year for Tricon by any measure, our goal is to make each financial result we deliver a benchmark to beat going forward. To do that, we're boldly pursuing key growth strategies designed to drive performance year after year.

First and foremost, we've made same store sales growth our superordinate goal. While we are committed to consistently delivering 2-3% combined same store sales growth each year, we exceeded even our own expectations with U.S. combined same store sales growth of 4% in 1999. Recent entry into three new product segments — with more great menu variety on the way — promise to strengthen our three leadership brands even more by adding to our already dominant share of each market category.

Second, we're driving margin improvement worldwide by building process and discipline around what really matters — strong operations, training, flow-thru, labor retention and cost management. In our view, Tricon must always earn the right to own stores by operating high-return units — so, for company stores that don't perform up to potential, we're reducing risk by selling restaurants to our franchisees and other third parties. This past year we refranchised over 1,400 stores to talented, experienced operators, which in the process, generated a healthy cash flow that's enabled us to pay down debt and reinvest in the business.

Third, we're focusing on international growth — as we see it, our single greatest performance driver for the long term. This past year, TRI delivered operating profit of \$265 million up from \$172 million in 1997. Returns have almost doubled and system sales grew 10% in 1999. To build on this momentum, we're continuously exploring new growth opportunities while working to improve return on company assets in the key countries in which we operate.

**MARK COSBY, CHIEF DEVELOPMENT OFFICER:** Fourth, we're also building and upgrading more stores. Over the last two years, we built a new unit growth machine and completed a plan for every market and trade area in the United States. This plan identifies 4,700 new unit opportunities, which should sustain a 500-600 unit growth pace for the system for eight to ten years.

A cornerstone of this new unit opportunity is multi-branding, a strategy that allows us to penetrate trade areas where single branding doesn't work. So far, our KFC and Taco Bell 2-n-1's have averaged over \$1.4 million in sales and 3-n-1's have opened at well over \$2 million in sales. We have over 600 multi-brand units in the U.S. today and plan to have over 2,500 units within the next

three years. In fact, our plans indicate that 40% of our U.S. system new unit growth will come from multi-branding.

We want to get the most out of our existing units, and since only 30% of our company assets are at our current image standards, our plan is to upgrade our company units to standard by 2004. These upgraded restaurants should experience a same store sales increase of 10-60%, depending on the current state of the asset — so you can bet that we'll continue to invest in our assets over the long term and expect our franchisees to do the same.

**CHRIS CAMPBELL, SENIOR VICE PRESIDENT, GENERAL COUNSEL AND SECRETARY:** Fifth and finally, we're targeting consistent performance by leveraging our enormous scale. We call this the Power of YUM, a systemwide commitment to drive a one-way, one-time approach and to zap out redundancies wherever they may exist. So rather than duplicate efforts, we've begun operating as one system, sharing everything from information systems to accounting functions to media buying. We've also teamed with our franchisees to form the largest purchasing cooperative in the restaurant industry. The cooperative purchases more than \$4 billion in product each year for the Tricon system — everything from cheese to restaurant signs — resulting in substantial savings that allowed us to absorb inflation and increased costs from product promotions and introductions.

We are also working with our franchise partners and the Pepsi-Cola company to forge an industry leading beverage arrangement for the Tricon system in the United States.

In the future, we'll be doing all we can to drive sales and maximize profits with even further initiatives — all designed to improve upon each great result we deliver. We have infrastructure and management teams in place to do so, as well as a growing track record of identifying unique and profitable opportunities within the market. And today, we see these opportunities in every direction we look.



**Chris Campbell**  
Senior VP, General  
Counsel & Secretary

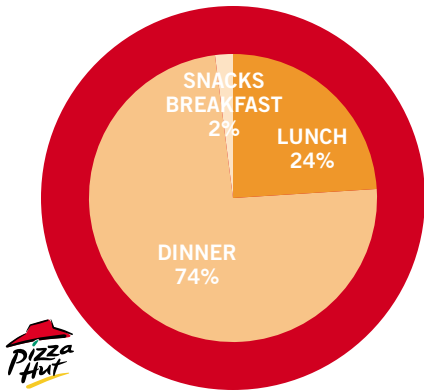


**Mark Cosby**  
Chief Development Officer

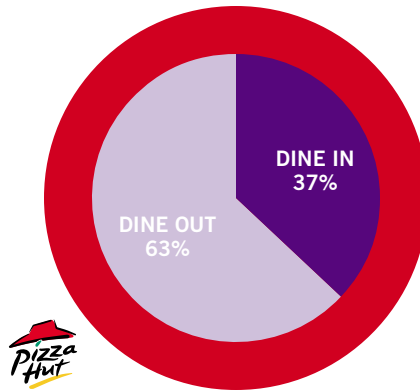


# Tricon facts

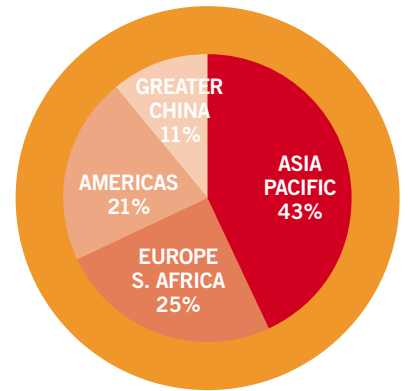
**U.S. Sales by Daypart**  
(% of Sales)



**U.S. Sales by Distribution Channel**  
(% of Sales)

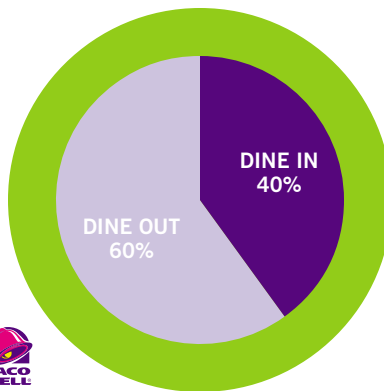
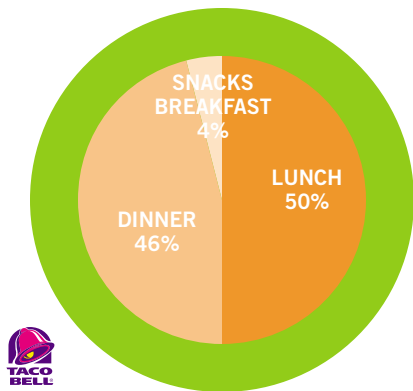
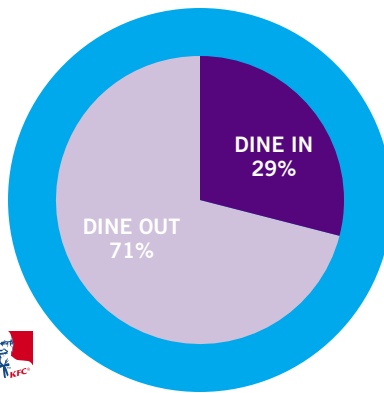
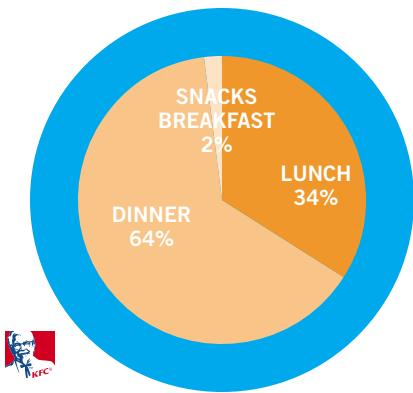
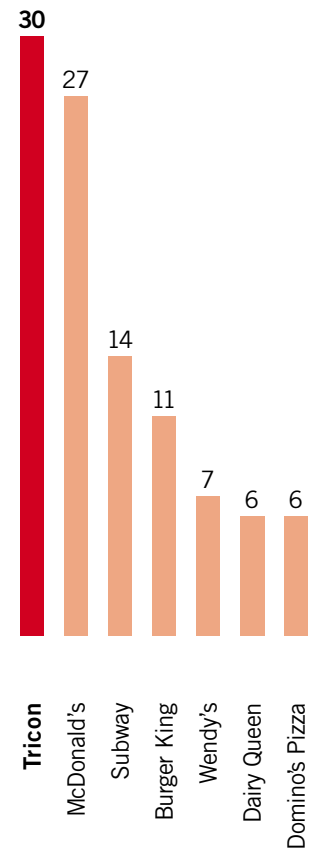


**Sources of System Sales in International Restaurants**



**Worldwide Units**

(In thousands, year-end 1999)

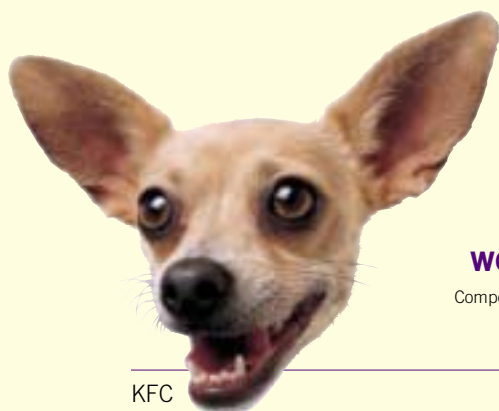


Sales across our brands are driven by dinner and lunch. Marketing innovations like new dayparts can help grow sales.

Most of our sales come from off-premises dining, which reflects customers' desire for convenient food.



# Tricon facts



## worldwide system units

Compounded annual growth rates, year-end 1994-1999

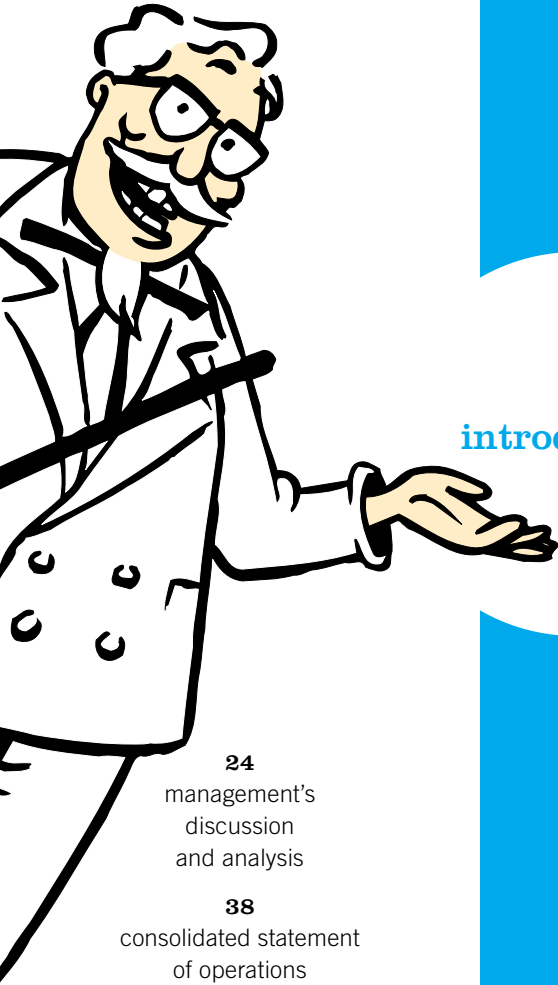
	1999	1998	1997	1996	1995	1994	5-yr growth
KFC	<b>5,231</b>	5,105	5,092	5,078	5,103	5,081	1%
PH	<b>8,084</b>	8,412	8,640	8,696	8,584	8,348	(1)%
TB	<b>6,879</b>	6,852	6,741	6,642	6,099	5,331	5%
Total U.S.	<b>20,194</b>	20,369	20,473	20,416	19,786	18,760	1%
KFC	<b>5,595</b>	5,318	5,145	4,783	4,526	4,326	5%
PH	<b>3,961</b>	3,873	3,894	3,694	3,386	2,920	6%
TB	<b>232</b>	203	200	203	196	206	2%
Total International	<b>9,788</b>	9,394	9,239	8,680	8,108	7,452	6%
Total	<b>29,982</b>	29,763	29,712	29,096	27,894	26,212	3%

Certain units have been reclassified from U.S. to International to reflect the transfer of management responsibility.

## breakdown of worldwide system units

Year-end 1999

	company	uncon- solidated affiliates	franchised	licensed	total
<b>U.S.</b>					
KFC	1,439	—	3,743	49	5,231
Pizza Hut	2,355	—	4,446	1,283	8,084
Taco Bell	1,190	—	3,921	1,768	6,879
Total U.S.	4,984	—	12,110	3,100	20,194
<b>International</b>					
KFC	1,185	514	3,841	55	5,595
Pizza Hut	774	664	2,306	217	3,961
Taco Bell	38	—	157	37	232
Total International	1,997	1,178	6,304	309	9,788
Total	6,981	1,178	18,414	3,409	29,982



## management's discussion and analysis

TRICON Global Restaurants, Inc. and Subsidiaries (collectively referred to as "TRICON" or the "Company") is comprised of the worldwide operations of KFC, Pizza Hut and Taco Bell (the "Core Business(es)") and is the world's largest quick service restaurant ("QSR") company based on the number of system units. Separately, each brand ranks in the top ten among QSR chains in U.S. system sales and units.

Our 9,000 plus international units make us the second largest QSR company outside the United States.

### introduction

Throughout Management Discussion and Analysis ("MD&A"), we make reference to ongoing operating profit which represents our operating profit excluding the impact of our accounting and human resources policy changes in 1999 (collectively, the "accounting changes"), facility actions net gain and unusual items. See Note 5 to the Consolidated Financial Statements for a detailed discussion of these exclusions. We use ongoing operating profit as a key performance measure of our results of operations

for purposes of evaluating performance internally and as the base to forecast future performance. Ongoing operating profit is not a measure defined in generally accepted accounting principles ("GAAP") and should not be considered in isolation or as a substitution for measures of performance in accordance with GAAP.

In 1999, our international business accounted for 33% of system sales, 27% of total revenues and 25% of operating profit before unallocated and corporate expenses, gains and losses from foreign exchange, accounting changes, facility actions net gain and unusual items. We anticipate that, despite the inherent risks and generally higher general and administrative expenses required by international operations, we will continue to invest in key international markets with substantial growth potential.

TRICON became an independent, publicly owned company on October 6, 1997 (the "Spin-off Date") via a tax free distribution of our Common Stock (the "Distribution" or "Spin-off") to the shareholders of our former parent, PepsiCo, Inc. ("PepsiCo"). See Notes 2, 11 and 21 to the Consolidated Financial Statements. For purposes of this MD&A, we include the worldwide operations of our Core Businesses and, through their respective dates of disposal in 1997, our U.S. non-core businesses. These non-core businesses consist of California Pizza Kitchen, Chevys Mexican Restaurant, D'Angelo's Sandwich Shops, East Side Mario's and Hot 'n Now (collectively the "Non-core Businesses"). Where significant to the discussion, we separately identify the impact of the Non-core Businesses.

This MD&A should be read in conjunction with our Consolidated Financial Statements on pages 38 – 65 and the Cautionary Statements on page 37. All Note references herein refer to the Notes to the Consolidated Financial Statements on pages 42 – 65. Tabular amounts are displayed in millions except per share and unit count amounts, or as specifically identified.

#### Factors Affecting Comparability of 1999 Results to 1998

**1997 Fourth Quarter Charge.** In the fourth quarter of 1997, we recorded a \$530 million unusual charge (\$425 million after-tax). The charge included estimates for (1) costs of closing stores, primarily at Pizza Hut and internationally; (2) reduction to fair market value, less costs to sell, of the carrying amounts of certain restaurants we intended to rebrand; (3) impairment of certain restaurants intended to be used in the business; (4) impairment of certain investments in unconsolidated affiliates to be retained; and (5) costs of related personnel reductions.

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During 1999 and 1998, we continued to re-evaluate our prior estimates of the fair market value of units to be refranchised or closed and other liabilities arising from the charge. In 1999, we made favorable adjustments of \$13 million (\$10 million after-tax) and \$11 million (\$10 million after-tax) included in facility actions net gain and unusual items, respectively. These adjustments relate to lower-than-expected losses from stores disposed of, decisions to retain stores originally expected to be disposed of and changes in estimated costs. In 1998, favorable adjustments of \$54 million (\$33 million after-tax) and \$11 million (\$7 million after-tax) were included in facility actions net gain and unusual items, respectively. These adjustments primarily related to decisions to retain certain stores originally expected to be disposed of, lower-than-expected losses from stores disposed of and favorable lease settlements with certain lessors related to stores closed. At December 25, 1999, we had completed the actions covered by the charge. See Note 5 for a detailed analysis of the 1997 fourth quarter charge, which includes a roll-forward of the asset valuation allowances and liabilities.

Our ongoing operating profit includes benefits from the suspension of depreciation and amortization of approximately \$12 million (\$7 million after-tax) and \$33 million (\$21 million after-tax) in 1999 and 1998, respectively, for stores held for disposal. The relatively short-term benefits from depreciation and amortization suspension related to stores that were operating at the end of the respective periods ceased when the stores were refranchised, closed or a subsequent decision was made to retain the stores.

The following table summarizes our refranchising activities for the last five years:

	Total	1999	1998	1997	1996	1995
Number of units refranchised	<b>5,138</b>	<b>1,435</b>	1,373	1,407	659	264
Refranchising proceeds, pre-tax	<b>\$ 2,990</b>	<b>\$ 916</b>	\$ 784	\$ 770	\$ 355	\$ 165
Refranchising net gain, pre-tax	<b>\$ 1,045</b>	<b>\$ 422<sup>(a)</sup></b>	\$ 279 <sup>(b)</sup>	\$ 112 <sup>(c)</sup>	\$ 139	\$ 93

(a) Includes favorable adjustments to our 1997 fourth quarter charge of \$4 million.

(b) Includes unfavorable adjustments to our 1997 fourth quarter charge of \$2 million.

(c) Includes a 1997 fourth quarter charge of \$136 million.

In addition to our refranchising program, we have been closing restaurants over the past several years. Restaurants closed include poor performing restaurants, restaurants that are relocated to a new site within the same trade area or U.S. Pizza Hut delivery units consolidated with a new or existing dine-in traditional store which has been remodeled to provide dine-in, carry-out and delivery services within the same trade area.

The following table summarizes store closure activities for the last five years:

	Total	1999	1998	1997	1996	1995
Number of units closed	<b>2,119</b>	<b>301</b>	572	632	347	267
Store closure net costs	<b>\$ 312</b>	<b>\$ 13<sup>(a)</sup></b>	\$ (27) <sup>(b)</sup>	\$ 248 <sup>(c)</sup>	\$ 40	\$ 38

(a) Includes favorable adjustments to our 1997 fourth quarter charge of \$9 million.

(b) Includes favorable adjustments to our 1997 fourth quarter charge of \$56 million.

(c) Includes a 1997 fourth quarter charge of \$213 million.

**Unusual Items.** We had unusual items of \$51 million (\$29 million after-tax), \$15 million (\$3 million after-tax) and \$184 million (\$165 million after-tax) in 1999, 1998 and 1997, respectively. See Note 5 for a detailed discussion of our unusual items.

**Store Portfolio Perspectives.** For the last several years, we have been strategically reducing our share of total system units by selling Company restaurants to existing and new franchisees where their expertise can be leveraged to improve our overall operating performance, while retaining Company ownership of key U.S. and International markets. This portfolio-balancing activity has reduced, and will continue to reduce, our reported revenues and restaurant profits and increase the importance of system sales as a key performance measure. We expect that the loss of restaurant level profits from the disposal of these stores will be largely mitigated by increased franchise fees from stores refranchised, lower field general and administrative expenses and reduced interest costs due to the reduction of debt from the after-tax cash proceeds from our refranchising activities.

We currently expect to refranchise approximately 500 to 600 restaurants in 2000 compared to over 1,400 in 1999. However, if market conditions are favorable, we may sell more restaurants than the current forecast. As a result of this decline, we estimate that our 2000 refranchising gains will be significantly less than our 1999 gains. In addition, we expect the impact of refranchising gains to be even less significant over time as we approach our target of approximately 20 percent Company ownership of the total system.

Our overall Company ownership percentage of total system units was 23% at December 25, 1999, a decline of 5 percentage points from year-end 1998 and 11 percentage points from year-end 1997.

The portfolio effect on ongoing operating profit included in our discussions of results of operations represents the estimated impact on revenue, restaurant margin, general and administrative expenses and operating profit related to our refranchising and store closure initiatives described above.

### Results of Operations

Our Spin-off in 1997, the impacts of our facility actions over the last three years, our 1997 fourth quarter charge and the impacts of the disposal of our Non-core Businesses represent significant items which complicate year-over-year comparisons.

Prior to October 7, 1997, our historical financial statements were impacted by our lack of history as an independent, publicly owned company. The amounts for certain items, specifically general and administrative expenses, interest expense and income taxes, included in our historical reported results for periods prior to the Spin-off, include allocations or computations which are not indicative of the amounts we would have incurred if we had been an independent, publicly owned company during all periods presented. See Note 2.

Comparative information is also impacted by the operations of and disposal charges related to our Non-core Businesses in 1997. These disposal charges included an estimated provision for all expected future liabilities associated with the disposal of our Non-core Businesses. We were required to retain these liabilities as part of the Spin-off. Our best estimates of all such liabilities have been included in the accompanying Consolidated Financial Statements. See Note 21. Actual amounts incurred may ultimately differ from these estimates. However, we believe the amounts, if any, in excess of our previously recorded liabilities are not likely to have a material adverse effect on our results of operations, financial condition or cash flow.

### Worldwide Restaurant Unit Activity

Balance at Dec. 27, 1997  
 New Builds & Acquisitions  
 Refranchising & Licensing  
 Closures  
 Balance at Dec. 26, 1998  
 New Builds & Acquisitions  
 Refranchising & Licensing  
 Closures  
 Other  
 Balance at Dec. 25, 1999  
 % of total

Following is a summary of the results of the operations of our Non-core Businesses through their respective disposal dates:

	1997
Revenues	\$ 268
% of total revenues	3%
Non-core Businesses operating profit, before disposal charges	\$ 13
Unusual disposal charges	54
Net loss	(26)

### Worldwide Results of Operations

	1999	% B(W) vs. 1998	1998	% B(W) vs. 1997
System Sales	<b>\$ 21,762</b>	<b>6</b>	<u>\$ 20,620</u>	1
Revenues				
Company sales	<b>\$ 7,099</b>	<b>(10)</b>	\$ 7,852	(14)
Franchise and license fees <sup>(1)</sup>	<b>723</b>	<b>15</b>	627	8
Total Revenues	<b>\$ 7,822</b>	<b>(8)</b>	<u>\$ 8,479</u>	(12)
Company				
Restaurant Margin	<b>\$ 1,091</b>	<b>3</b>	<u>\$ 1,058</u>	—
% of sales	<b>15.4%</b>	<b>1.9 ppts.</b>	13.5%	1.9 ppts.
Ongoing operating profit	<b>\$ 881</b>	<b>15</b>	\$ 768	14
Accounting changes <sup>(2)</sup>	<b>29</b>	<b>NM</b>	—	—
Facility actions				
net gain (loss)	<b>381</b>	<b>38</b>	275	NM
Unusual items	<b>(51)</b>	<b>NM</b>	(15)	NM
Operating Profit	<b>1,240</b>	<b>21</b>	1,028	NM
Interest expense, net	<b>202</b>	<b>26</b>	272	1
Income Tax Provision	<b>411</b>	<b>(32)</b>	311	NM
Net Income (Loss)	<b>\$ 627</b>	<b>41</b>	<u>\$ 445</u>	NM
Diluted Earnings Per Share	<b>\$ 3.92</b>	<b>38</b>	<u>\$ 2.84</u>	NM

(1) Excluding the special 1997 KFC renewal fees, 1998 increased 13% over 1997.

(2) See Note 5 for complete discussion of our 1999 favorable accounting changes.

Company	Unconsolidated			Total
	Affiliates	Franchisees	Licensees	
10,117	1,090	15,097	3,408	29,712
225	63	790	544	1,622
(1,373)	(9)	1,302	80	—
(572)	(24)	(539)	(436)	(1,571)
8,397	1,120	16,650	3,596	29,763
323	83	858	586	1,850
(1,435)	(5)	1,443	(3)	—
(301)	(20)	(434)	(646)	(1,401)
(3)	—	(103)	(124)	(230)
<b>6,981<sup>(a)</sup></b>	<b>1,178</b>	<b>18,414</b>	<b>3,409</b>	<b>29,982</b>
23.3%	3.9%	61.4%	11.4%	100.0%

(a) Includes 37 Company units approved for closure but not yet closed at December 25, 1999.

## Worldwide System Sales and Revenues

**System Sales** increased \$1.1 billion or 6% in 1999. Excluding the favorable impact of foreign currency translation, system sales increased \$1 billion or 5%. The improvement was driven by new unit development and positive same store sales growth in our three U.S. concepts and our international business, Tricon Restaurants International (“TRI” or “International”). U.S. development was primarily at Taco Bell while International development was primarily in Asia. The increase was partially offset by store closures at our three U.S. concepts and in International.

In 1998, system sales increased \$155 million or 1%. Excluding the negative impact of foreign currency translation, system sales increased by \$871 million or 4%. The increase reflected the development of new units, primarily by franchisees and licensees, and positive same store sales growth. U.S. development was primarily at Taco Bell while international development was primarily in Asia. This growth in system sales was partially offset by store closures.

**Revenues** decreased \$657 million or 8% in 1999. As expected, Company sales decreased \$753 million or 10% in 1999. The decline in Company sales was due to the portfolio effect. Excluding the portfolio effect, Company sales increased \$513 million or 8%. The increase was primarily due to new unit development, favorable effective net pricing and volume increases at Pizza Hut, led by “The Big New Yorker,” and at TRI. Effective net pricing includes increases or decreases in price and the effect of changes in product mix. Franchise and license fees grew \$96 million or 15% in 1999. The growth was primarily driven by units acquired from us and new unit development primarily in Asia and at Taco Bell in the U.S., partially offset by store closures by franchisees and licensees.

In 1998, revenues decreased \$1.2 billion or 12%. Revenues in 1997 included \$268 million related to the Non-core Businesses. Excluding the negative impact of foreign currency translation and revenues from the Non-core Businesses, revenues decreased \$749 million or 8%. Company sales decreased \$1.3 billion or 14%. The decline in Company sales was due to the portfolio effect. Excluding the portfolio effect, the negative impact of foreign currency translation and the Non-core Businesses, Company sales increased \$511 million or 7%. The increase in Company sales was primarily driven by new unit development and effective net pricing, partially offset by store closures. Franchise and license fees increased \$49 million or 8%. Excluding the negative impact of foreign currency translation and the special 1997 KFC renewal fees of \$24 million, franchise and license fees increased \$95 million or 17%. The growth was primarily driven by units acquired from us and new unit development primarily in Asia and at Taco Bell in the U.S., partially offset by store closures by franchisees and licensees.

## Worldwide Company Restaurant Margin

	1999	1998	1997
Company sales	<b>100.0%</b>	100.0%	100.0%
Food and paper	<b>31.5</b>	32.1	32.4
Payroll and employee benefits	<b>27.6</b>	28.6	28.7
Occupancy and other operating expenses	<b>25.5</b>	25.8	27.3
Restaurant margin	<b>15.4%</b>	13.5%	11.6%

Our restaurant margin as a percentage of sales increased approximately 190 basis points for 1999. The portfolio effect contributed nearly 50 basis points and accounting changes contributed approximately 15 basis points to our improvement. Excluding the portfolio effect and accounting changes, our restaurant margin grew approximately 125 basis points. This improvement in restaurant margin was primarily attributable to effective net pricing in excess of cost increases, primarily labor in the U.S. Restaurant margin also benefited from improved food and paper cost management in both the U.S. and key International equity markets. Volume increases at Pizza Hut in the U.S. and in key International equity markets were fully offset by volume declines at Taco Bell and the unfavorable impact of the introduction of lower margin chicken sandwiches at KFC in the U.S.

In 1998, our restaurant margin as a percent of sales increased almost 190 basis points. Portfolio effect contributed approximately 65 basis points and the suspension of depreciation and amortization relating to our 1997 fourth quarter charge contributed approximately 55 basis points to our improvement. Excluding the portfolio effect and the benefits of the 1997 fourth quarter charge, our restaurant margin increased approximately 70 basis points. The improvement was largely due to effective net pricing in excess of increased costs, primarily labor. Labor increases were driven by higher wage rates, primarily attributable to the September 1997 minimum wage increase in the U.S., an increase in the management complement in our U.S. Taco Bell restaurants and lower favorable insurance-related adjustments in 1998. The decrease in occupancy and other operating expenses related primarily to higher spending in 1997 on store refurbishment and quality initiatives at Taco Bell and Pizza Hut as well as an increase in higher favorable insurance-related adjustments in 1998. These favorable items were partially offset by increased store refurbishment expenses at KFC in 1998.

## Worldwide General & Administrative Expenses ("G&A")

G&A decreased \$21 million or 2% in 1999. Excluding the \$18 million favorable impact of 1999 accounting changes, G&A decreased \$3 million in 1999. In 1999, the favorable impacts of our portfolio effect, our fourth quarter 1998 decision to streamline our international business and the absence of costs associated with relocating certain operations from Wichita, Kansas in 1998 were partially offset by higher strategic and other corporate expenses. In addition to the items described above, higher spending on biennial meetings to support our culture initiatives and the absence of favorable cost recovery agreements with AmeriServe Food Distribution, Inc. ("AmeriServe") and PepsiCo that were terminated in 1998 resulted in a modest increase in G&A in 1999. Our 1999 G&A included Year 2000 spending of approximately \$30 million as compared to \$31 million in 1998.

In 1998, G&A decreased \$15 million or 2%. G&A in 1997 included approximately \$24 million related to Non-core Businesses. Excluding the impact of the Non-core Businesses, G&A increased \$9 million or 1%. The increase reflected higher investment spending offset by the favorable impacts of our portfolio effect, decreased restaurant support center and field operating overhead and foreign currency translation. Our investment spending consisted primarily of costs related to Year 2000 compliance and remediation efforts of \$31 million in 1998 versus \$4 million in 1997, along with the costs to relocate our processing center from Wichita to other existing restaurant support centers of \$14 million. In addition, we experienced increased administrative expenses as an independent, publicly owned company and incurred additional expenses

## Worldwide Facility Actions Net (Gain) Loss

	1999		1998		1997	
	Total	Excluding 1997 4th Qtr. Charge Adjustments	Total	Excluding 1997 4th Qtr. Charge Adjustments	Total	Excluding 4th Qtr. Charge
Refranchising net gains	\$ (422)	\$ (418)	\$ (279)	\$ (281)	\$ (112)	\$ (248)
Store closure net costs	13	22	(27)	29	248	35
Impairment charges for stores that will continue to be used in the business	16	16	25	25	111	50
Impairment charges for stores to be closed in the future	12	12	6	6	—	—
Facility actions net (gain) loss	\$ (381)	\$ (368)	\$ (275)	\$ (221)	\$ 247	\$ (163)

Refranchising net gains resulted from the refranchising of 1,435 units in 1999, 1,373 units in 1998 and 1,407 units in 1997. These gains included initial franchise fees of \$45 million, \$44 million and \$41 million in 1999, 1998 and 1997, respectively. See pages 25–26 for more details regarding our refranchising activities.

Impairment charges for stores that will continue to be used in the business were \$16 million in 1999 compared to \$25 million in 1998 reflecting fewer underperforming stores. In 1998,

related to continuing efforts to improve and standardize administrative and accounting systems.

## Worldwide Other (Income) Expense

	% B(W)		1998	% B(W) vs. 1997
	1999	vs. 1998		
Equity income from investments in unconsolidated affiliates	\$ (19)	6	\$ (18)	NM
Foreign exchange net loss (gain)	3	NM	(6)	NM
	\$ (16)	(31)	\$ (24)	NM

Other income declined \$8 million in 1999. Net foreign exchange losses were \$3 million in 1999 compared to net foreign exchange gains of \$6 million in 1998. This decline was due to foreign losses in 1999 versus gains in 1998 related to U.S. dollar denominated short-term investments in Canada.

In 1998, equity income from investments in our unconsolidated affiliates increased \$10 million. This increase was due primarily to lower amortization relating to the impact of the \$79 million joint venture investment impairment included in our 1997 fourth quarter charge and, to a lesser extent, the impact of new unit development primarily by our affiliate in the United Kingdom. Net foreign exchange gains were \$6 million in 1998 compared to net foreign exchange losses of \$16 million in 1997. This improvement was due primarily to non-recurring 1997 foreign exchange losses, predominantly in Thailand and the Netherlands, and to foreign exchange gains in 1998 primarily due to U.S. dollar denominated short-term investments in Canada.

	1999		1998		1997	
	Total	Excluding 1997 4th Qtr. Charge Adjustments	Total	Excluding 1997 4th Qtr. Charge Adjustments	Total	Excluding 4th Qtr. Charge
Refranchising net gains	\$ (422)	\$ (418)	\$ (279)	\$ (281)	\$ (112)	\$ (248)
Store closure net costs	13	22	(27)	29	248	35
Impairment charges for stores that will continue to be used in the business	16	16	25	25	111	50
Impairment charges for stores to be closed in the future	12	12	6	6	—	—
Facility actions net (gain) loss	\$ (381)	\$ (368)	\$ (275)	\$ (221)	\$ 247	\$ (163)

upon adoption of the SEC's interpretation of SFAS 121, we also began to perform impairment evaluations when we expect to actually close a store beyond the quarter in which our closure decision is made. This change resulted in additional impairment charges of \$12 million in 1999 and \$6 million in 1998. Under our prior accounting policy, these impairment charges would have been included in store closure costs. We believe the overall decrease in impairment in 1998 was significantly impacted by 1997 decisions included in our fourth quarter

charge to dispose of certain stores which may have otherwise been impaired in our evaluations, and improved performance in 1998, primarily at Pizza Hut in the U.S.

Our 1999 refranchising gains, store closure costs and impairment charges are not necessarily indicative of future results.

### Worldwide Operating Profit

	% B(W)		1998	% B(W) vs. 1997
	1999	vs. 1998		
U.S. ongoing				
operating profit <sup>(a)</sup>	\$ 813	10	\$ 740	23
International				
ongoing				
operating profit	265	39	191	11
Accounting changes	29	NM	—	—
Foreign exchange				
net (loss) gain	(3)	NM	6	NM
Ongoing unallocated and				
corporate expenses <sup>(b)</sup>	(194)	(14)	(169)	(93)
Facility actions				
net gain (loss)	381	38	275	NM
Unusual items	(51)	NM	(15)	NM
Reported operating				
profit	\$ 1,240	21	\$ 1,028	NM

(a) Excludes 1999 favorable accounting changes of approximately \$15 million.

(b) Excludes 1999 favorable accounting changes of approximately \$14 million.

The increases in U.S. and International ongoing operating profit for 1999 and 1998 are discussed fully on pages 31 and 33, respectively. Accounting changes, facility actions net gain (loss) and unusual items are discussed in Note 5.

Ongoing unallocated and corporate expenses increased \$25 million or 14% in 1999. The increase was driven by higher strategic and other corporate spending, system standardization investment and the absence of favorable cost recovery agreements from AmeriServe and PepsiCo that were terminated in 1998. These increases were partially offset by the absence of costs associated with relocating certain of our operations from Wichita, Kansas in 1998.

In 1998, ongoing unallocated and corporate expenses increased \$82 million or 93%. The increase was primarily due to spending on Year 2000 compliance and remediation efforts, costs to relocate our processing center from Wichita to other facilities and expenses incurred as an independent, publicly owned company, as well as, additional expenses related to the efforts to improve and standardize operating, administrative and accounting systems.

### Worldwide Interest Expense, Net

	1999	1998	1997
External debt	\$ 218	\$ 291	\$ 102
PepsiCo allocation	—	—	188
Interest expense	218	291	290
Interest income	(16)	(19)	(14)
Interest expense, net	\$ 202	\$ 272	\$ 276

Our net interest expense decreased approximately \$70 million in 1999. The decline was primarily due to the reduction of debt through use of after-tax cash proceeds from our refranchising activities and cash from operations.

In 1998, our net interest expense decreased approximately \$4 million. The decline was due to an increase in interest income, partially offset by a slight increase in interest expense. The increase in interest income was driven by higher average international investment balances. The slight increase in interest expense was primarily due to higher average outstanding debt balances.

Prior to the Spin-off in the fourth quarter of 1997, our operations were financed through operating cash flows, proceeds from refranchising activities and investment by and advances from PepsiCo. At the Spin-off date, we borrowed \$4.55 billion under a bank credit agreement to replace the financing previously provided by PepsiCo and, additionally, to fund a dividend to PepsiCo. See Notes 2 and 11. For periods prior to the Spin-off, our interest expense included PepsiCo's allocation of its interest expense (PepsiCo's weighted average interest rate applied to the average balance of investments by and advances from PepsiCo) and interest on our external debt, including capital leases. We believe such allocated interest expense is not indicative of the interest expense that we would have incurred as an independent, publicly owned company. Subsequent to the Spin-off date, our interest costs consist primarily of interest expense related to our bank credit agreement, unsecured notes and other external debt. Most of the other external debt existed at the Spin-off date.

### Worldwide Income Taxes

	1999	1998	1997
Reported			
Income taxes	\$ 411	\$ 311	\$ 76
Effective tax rate	39.5%	41.1%	NM
Ongoing <sup>(a)</sup>			
Income taxes	\$ 267	\$ 210	\$ 179
Effective tax rate	39.3%	42.3%	45.2%

(a) Excludes the effects of 1999 accounting changes, facility actions net gain (loss) and unusual items. See Note 5 for a discussion of these exclusions.

For periods prior to the Spin-off in 1997, income tax expense was calculated, to the extent possible, as if we filed income tax returns separate from PepsiCo.

The following reconciles the U.S. federal statutory tax rate to our ongoing effective tax rate:

	1999	1998	1997
U.S. federal statutory tax rate	35.0%	35.0%	35.0%
State income tax,			
net of federal tax benefit	2.3	2.8	3.9
Foreign and U.S. tax effects			
attributable to foreign operations	1.5	6.3	4.9
Adjustments relating to prior years	0.2	(3.3)	0.8
Other, net	0.3	1.5	0.6
Ongoing effective tax rate	39.3%	42.3%	45.2%

The 1999 ongoing effective tax rate decreased 3.0 points to 39.3%. The decrease in the ongoing effective tax rate was primarily due to a one-time favorable international benefit in Mexico. The recent pattern of profitability in Mexico and expectations of future profitability have allowed us to reverse a previous valuation allowance against deferred tax assets. This will allow us to reduce future cash tax payments in Mexico.

The 1998 ongoing effective tax rate decreased 2.9 points to 42.3%. The decrease in the 1998 ongoing effective tax rate was primarily due to favorable adjustments related to prior years.

The effective tax rate attributable to foreign operations varied from year-to-year but in each year was higher than the U.S. federal statutory tax rate. This was primarily due to foreign tax rate differentials, including foreign withholding tax paid without benefit of the related foreign tax credit for U.S. income tax purposes and losses of foreign operations for which no tax benefit could be currently recognized.

### Diluted Earnings Per Share

The components of diluted earnings per common share ("EPS") were as follows:

	Diluted <sup>(a)</sup> 1999	Basic 1999	Diluted <sup>(a)</sup> 1998	Basic 1998
Ongoing operating earnings	\$ 2.58	\$ 2.69	\$ 1.83	\$ 1.88
Accounting changes	0.11	0.12	—	—
Facility actions net gain <sup>(b)</sup>	1.41	1.47	1.03	1.06
Unusual items <sup>(c)</sup>	(0.18)	(0.19)	(0.02)	(0.02)
<b>Total</b>	<b>\$ 3.92</b>	<b>\$ 4.09</b>	<b>\$ 2.84</b>	<b>\$ 2.92</b>

(a) Based on 160 million shares in 1999 and 156 million shares in 1998 applicable to diluted earnings. See Note 4.

(b) Includes favorable adjustments to our 1997 fourth quarter charge of \$0.06 and \$0.21 per diluted share in 1999 and 1998, respectively.

(c) Includes favorable adjustments to our 1997 fourth quarter charge of \$0.07 and \$0.04 per diluted share in 1999 and 1998, respectively.

### U.S. Results of Operations

	1999	% B(W) vs. 1998	1998	% B(W) vs. 1997
System Sales Revenues	\$ 14,516	4	\$ 14,013	4
Company sales Franchise and license fees <sup>(1)</sup>	\$ 5,253	(13)	\$ 6,013	(14)
	495	16	426	13
<b>Total Revenues</b>	<b>\$ 5,748</b>	<b>(11)</b>	<b>\$ 6,439</b>	<b>(13)</b>
Company Restaurant Margin	\$ 825	1	\$ 819	—
% of sales	15.7%	2.1 ppts.	13.6%	1.9 ppts.
Ongoing Operating Profit <sup>(2)</sup>	\$ 813	10	\$ 740	23

(1) Excluding the special 1997 KFC renewal fees, 1998 increased 21% over 1997.

(2) Excludes 1999 accounting changes, facility actions net gain (loss) and unusual items.

### U.S. Restaurant Unit Activity

	Company	Franchisees	Licensees	Total
Balance at Dec. 27, 1997 <sup>(a)</sup>	7,794	9,512	3,167	20,473
New Builds & Acquisitions	75	338	508	921
Refranchising & Licensing	(1,219)	1,216	3	—
Closures	(418)	(204)	(403)	(1,025)
Balance at Dec. 26, 1998	6,232	10,862	3,275	20,369
New Builds & Acquisitions	155	432	539	1,126
Refranchising & Licensing	(1,170)	1,167	3	—
Closures	(230)	(248)	(593)	(1,071)
Other	(3)	(103)	(124)	(230)
Balance at Dec. 25, 1999	<b>4,984<sup>(b)</sup></b>	<b>12,110</b>	<b>3,100</b>	<b>20,194</b>
% of total	24.7%	60.0%	15.3%	100.0%

(a) A total of 114 units have been reclassified from the U.S. to International to reflect the transfer of management responsibility.

(b) Includes 36 Company units approved for closure, but not yet closed at December 25, 1999.

### U.S. System Sales and Revenues

**System sales** increased \$503 million or 4% in 1999. The improvement was driven by new unit development, led by Taco Bell franchisees and same store sales growth at our three U.S. concepts. These increases were partially offset by store closures, primarily at Pizza Hut and Taco Bell.

In 1998, system sales increased \$511 million or 4%. The increase was attributable to new unit development, primarily by franchisees and licensees of Taco Bell and, to a lesser extent, KFC, and positive same store sales growth at all three of our concepts. These increases were partially offset by the impact of store closures.

**Revenues** decreased \$691 million or 11% due to the expected decline in Company sales of \$760 million or 13% in 1999. The decline in Company sales was due to the portfolio effect. Excluding the portfolio effect, Company sales increased approximately \$305 million or 6%. This increase was primarily due to new unit development, favorable effective net pricing and volume increases led by Pizza Hut's first quarter new product introduction, "The Big New Yorker." Franchise and license fees increased \$69 million or 16% in 1999. The increase was driven by units acquired from us, new unit development and franchisee same store sales growth, primarily at Pizza Hut. These increases were partially offset by store closures.

We measure same store sales only for our U.S. Company restaurants. Same store sales at Pizza Hut increased 9% in 1999. The improvement was primarily driven by an increase in



transactions of over 5%, resulting from the launch of “The Big New Yorker.” The growth at Pizza Hut was also aided by effective net pricing of over 3%. Same store sales at KFC grew 2%. The increase was almost equally driven by effective net pricing and transaction growth. Transaction growth at KFC was primarily due to the fourth quarter launch of its new chicken sandwiches. This favorable impact was partially offset by lower check averages from these transactions and declines in other products. Same store sales at Taco Bell were flat as an increase in effective net pricing of approximately 4% was fully offset by transaction declines. In the fourth quarter, Taco Bell introduced a new hot, fried product, the Chalupa, reigniting transaction growth during that period.

In 1998, revenues decreased \$931 million or 13% due to the expected decline in Company sales of \$981 million or 14%. Excluding the effect of the Non-core Businesses, our Company sales decreased \$715 million or 11%. The decline in Company sales was driven by the portfolio effect. Excluding the impact of Non-core Businesses and portfolio effect, Company sales increased approximately \$331 million or 6%. This increase was primarily due to positive same store sales growth at all three of our operating companies. Franchise and license fees increased \$50 million or 13% in 1998. In 1997, we generated \$24 million of special KFC renewal fees. Substantially all of KFC’s franchisees renewed their franchise agreements, typically for 20 years, during 1997. As part of this special renewal program at KFC, certain participating franchisees also committed to attain over the next several years certain facility standards based on physical assessment of that franchisee’s restaurants. We believe these upgrades of the franchised facilities will ultimately result in higher system sales and, therefore, higher franchise fees. Excluding the special 1997 KFC renewal fees, 1998 franchise and license fees increased \$74 million or 21%. The increase was primarily driven by units acquired from us and new unit development, partially offset by the impact of store closures by franchisees and licensees.

In 1998, same store sales at Pizza Hut increased 6%. The improvement was primarily driven by effective net pricing of 4% aided by transaction increases of 2%. Same store sales at KFC grew 3%. This growth was due to transaction increases of 2% aided by effective net pricing of 1%. Same store sales at Taco Bell increased 3%. The improvement at Taco Bell was driven by transaction increases of 1% aided by effective net pricing of 2%.

#### U.S. Company Restaurant Margin

	1999	1998	1997
Company sales	100.0%	100.0%	100.0%
Food and paper	30.0	31.0	31.1
Payroll and employee benefits	29.8	30.4	30.5
Occupancy and other operating expenses	24.5	25.0	26.7
Restaurant margin	15.7%	13.6%	11.7%

Our restaurant margin as a percentage of sales increased approximately 210 basis points for 1999. Portfolio effect contributed approximately 45 basis points and accounting changes contributed nearly 25 basis points to our improvement. Excluding the portfolio effect and accounting changes, our restaurant margin grew approximately 140 basis points. The improvement in restaurant margin was primarily attributable to favorable effective net pricing. Labor cost increases, primarily driven by higher wage rates, were fully offset by lower food and paper costs as improved product cost management resulted in lower overall beverage and distribution costs. The improvement in our restaurant margin also included approximately 15 basis points from retroactive beverage rebates related to 1998 recognized in 1999. In addition, an increase in favorable insurance-related adjustments over 1998 contributed approximately 10 basis points to our improvement. These adjustments arose from improved casualty loss trends across all three of our U.S. operating companies. See Note 21 for additional information regarding our insurance-related adjustments. All of these improvements were partially offset by volume declines at Taco Bell and the unfavorable impact of the introduction of lower margin chicken sandwiches at KFC.

In 1998, our restaurant margin as a percentage of sales increased over 190 basis points. The portfolio effect contributed approximately 75 basis points and the suspension of depreciation and amortization relating to our 1997 fourth quarter charge contributed approximately 40 basis points. Excluding the portfolio effect and the benefit of the 1997 fourth quarter charge, our restaurant margin increased approximately 80 basis points. We benefited from favorable effective net pricing in excess of costs, primarily labor and commodity costs. Our labor increases were driven by higher wage rates, primarily the September 1997 minimum wage increase, an increase in the management complement at our Taco Bell restaurants and lower favorable insurance-related adjustments in 1998. Commodity cost increases, primarily cheese and produce, were partially offset by a decrease in other commodity costs. Our occupancy and other operating expenses were favorably impacted by higher favorable insurance-related adjustments in 1998 and the decreased store condition and quality initiative spending at Pizza Hut and Taco Bell. These favorable items were partially offset by increased store refurbishment expenses at KFC in 1998.

#### U.S. Ongoing Operating Profit

Ongoing operating profit increased \$73 million or 10% in 1999. The increase was due to our base restaurant margin improvement of 140 basis points and higher franchise fees primarily from new unit development. The favorable impact of these items was partially offset by the net negative impact of the portfolio effect. We have estimated the 1999 net negative impact due to the portfolio effect was approximately \$40 million or approximately 5% of our operating profit in 1998. Higher G&A, net of field G&A savings from our portfolio activities, also

unfavorably impacted ongoing operating profit. This increase in G&A was largely due to the biennial conferences at Pizza Hut and Taco Bell to support our corporate culture initiatives.

In 1998, ongoing operating profit increased approximately \$137 million or 23%. Excluding the effect of our Non-core Businesses, our ongoing operating profit increased approximately \$150 million or 26%. The increase was due to our base restaurant margin improvement of 80 basis points and reduced G&A expenses. Higher franchise and license fees were partially offset by the absence of the special 1997 KFC renewal fees. The impact due to the portfolio effect was insignificant. Ongoing operating profit included the benefits of our 1997 fourth quarter charge of approximately \$35 million, of which \$19 million related to the suspension of depreciation and amortization for stores included in the charge.

### International Restaurant Unit Activity

Balance at Dec. 27, 1997 <sup>(a)</sup>
New Builds & Acquisitions
Refranchising & Licensing
Closures
Balance at Dec. 26, 1998
New Builds & Acquisitions
Refranchising & Licensing
Closures
Balance at Dec. 25, 1999
% of Total

### International Results of Operations

	1999		1998	
	Amount	% B(W) vs. 1998	Amount	% B(W) vs. 1997
System Sales Revenues	<b>\$ 7,246</b>	<b>10</b>	<b>\$ 6,607</b>	(5)
Company sales	<b>\$ 1,846</b>	—	\$ 1,839	(13)
Franchise and license fees	<b>228</b>	<b>13</b>	201	—
Total Revenues	<b>\$ 2,074</b>	<b>2</b>	<b>\$ 2,040</b>	(12)
Company Restaurant Margin	<b>\$ 266</b>	<b>11</b>	<b>\$ 239</b>	(1)
% of sales	<b>14.4%</b>	<b>1.4 ppts.</b>	13.0%	1.6 ppts.
Ongoing Operating Profit <sup>(1)</sup>	<b>\$ 265</b>	<b>39</b>	<b>\$ 191</b>	11

(1) Excludes 1999 accounting changes, facility actions net gain (loss) and unusual items.

Company	Unconsolidated				Total
	Affiliates	Franchisees	Licensees		
2,323	1,090	5,585	241	9,239	
150	63	452	36	701	
(154)	(9)	86	77	—	
(154)	(24)	(335)	(33)	(546)	
2,165	1,120	5,788	321	9,394	
168	83	426	47	724	
(265)	(5)	276	(6)	—	
(71)	(20)	(186)	(53)	(330)	
<b>1,997<sup>(b)</sup></b>	<b>1,178</b>	<b>6,304</b>	<b>309</b>	<b>9,788</b>	
20.4%	12.0%	64.4%	3.2%	100.0%	

(a) A total of 114 units have been reclassified from the U.S. to International to reflect the transfer of management responsibility.

(b) Includes 1 Company unit approved for closure, but not yet closed at December 25, 1999.

### International System Sales and Revenues

**System Sales** increased \$639 million or 10% in 1999 largely driven by our strong performance in Asia. Excluding the favorable impact from foreign currency translation, system sales increased \$498 million or 8%. This was led by Asia, our largest region. System sales in Asia increased \$426 million or 19%. Excluding the favorable impact of foreign currency translation, system sales in Asia increased \$229 million or 10%. In 1999, the economy in Asia began to show signs of a steady recovery after the overall economic turmoil and weakening of local currencies against the U.S. dollar that began in late 1997. The increase in system sales in Asia was driven by new unit development and same store sales growth. Outside of Asia, the improvement was driven by new unit development, both by franchisees and us, and same store sales growth. New unit development was primarily in Mexico and the U.K. The increase in system sales was partially offset by store closures primarily by franchisees in Canada, Latin America and Japan.

In 1998, system sales decreased \$356 million or 5%. Excluding the negative impact of foreign currency translation, system sales increased \$360 million or 5%. The increase was driven by new unit development, primarily in Asia, partially offset by store closures in other countries/markets. System sales in Asia decreased \$254 million or 10% as a result of the economic turmoil. Excluding the unfavorable impact of foreign currency translation, system sales in Asia increased 8%.

**Revenues** increased \$34 million or 2% in 1999. Excluding the favorable impact of foreign currency translation, revenues increased \$29 million or 1%. Company sales increased less than 1% in 1999. New unit development, favorable effective net pricing and volume increases were largely offset by the portfolio effect. Excluding the portfolio effect, Company sales increased \$208 million or 13% in 1999 largely driven by our strong performance in Asia. Revenues in Asia increased \$139 million or 28%. Excluding the favorable impact of foreign currency translation, revenues in Asia increased \$115 million or 23% driven by new unit development and same store sales growth.

Franchise and license fees rose \$27 million or 13% in 1999. The increase in franchise and license fees was driven by new unit development, same store sales growth and units acquired from us. New unit development was primarily in Asia. These increases were partially offset by store closures.

In 1998, revenues decreased \$280 million or 12%. Excluding the negative impact of foreign currency translation, revenues decreased \$86 million or 4%. Company sales decreased \$279 million or 13% driven by the portfolio effect. Excluding the negative impact of foreign currency translation and the portfolio effect, Company sales increased \$180 million or 10%. The increase was driven by new unit development, primarily in Asia, and effective net pricing. Franchise and license fees decreased \$1 million or less than 1%. Excluding the negative impact of foreign currency translation, franchise and license fees increased \$21 million or 11%. The increase was driven by new unit development, primarily in Asia, and units acquired from us, partially offset by store closures by franchisees and licensees.

#### International Company Restaurant Margin

	1999	1998	1997
Company sales	100.0%	100.0%	100.0%
Food and paper	36.0	35.8	36.5
Payroll and employee benefits	21.0	22.6	22.7
Occupancy and other			
operating expenses	28.6	28.6	29.4
Restaurant margin	14.4%	13.0%	11.4%

Our restaurant margin as a percentage of sales increased approximately 140 basis points in 1999. Excluding the favorable impact of foreign currency translation, restaurant margins increased approximately 130 basis points. Portfolio effect contributed approximately 50 basis points. Excluding the portfolio effect, our restaurant margin grew approximately 80 basis points. The improvement in restaurant margin was driven by volume increases in China, Korea and Australia and favorable effective net pricing in excess of cost increases, primarily in the U.K., Puerto Rico and Korea. Our growth in 1999 was partially offset by volume decreases in Taiwan and Poland. In addition to the factors described above, margins benefited from improved cost management, primarily in China.

In 1998, our restaurant margin increased over 160 basis points. Excluding the negative impact of foreign currency translation, restaurant margin increased approximately 195 basis points. The increase was driven primarily by the suspension of depreciation and amortization relating to restaurants included in our 1997 fourth quarter charge, which contributed 110 basis points. The portfolio effect also contributed approximately 30 basis points to the improvement. The remaining margin improvement of approximately 55 basis points resulted from favorable effective net pricing in excess of costs in Mexico, Australia and Spain. Restaurant margin improvement was partially offset by volume declines in Asia, led by Korea. The economic turmoil throughout Asia resulted in an overall volume decline, even though we had volume increases in Mexico, Canada and Spain.

#### International Ongoing Operating Profit

Ongoing operating profit grew \$74 million or 39% in 1999. Excluding the favorable impact of foreign currency translation, ongoing operating profit increased \$69 million or 36%. The increase in operating profit was driven by our base margin improvement of approximately 80 basis points, higher franchise and license fees and a decline in G&A. Our ongoing operating profit benefited from the economic recovery in Asia. Operating profit in Asia increased \$55 million or 84%. Excluding the favorable impact of foreign currency translation, Asia operating profit increased \$46 million or 72%. Additionally, ongoing operating profit included benefits of approximately \$15 million from our 1998 fourth quarter decision to streamline our international infrastructure in Asia, Europe and Latin America and other actions.

In 1998, ongoing operating profit increased \$19 million or 11%. Excluding the negative impact of foreign currency translation, ongoing operating profit increased \$43 million or 25% in 1998. The increase was driven by our base margin improvement of 55 basis points and a decline in G&A. The favorable impact of these items was partially offset by the net negative impact of the portfolio effect, which was approximately \$10 million or approximately 6% of operating profit in 1997. Lower franchise and license fees, net of fees from units acquired from us, also unfavorably impacted ongoing operating profit. Ongoing operating profit in 1998 included benefits related to our 1997 fourth quarter charge of approximately \$29 million, of which \$14 million related to the suspension of depreciation and amortization for the stores included in the charge. These benefits were fully offset by the 30% decline in Asia operating profit and Year 2000 spending.

#### Consolidated Cash Flows

**Net cash provided by operating activities** decreased \$109 million to \$565 million in 1999. Net income before facility actions and all other non-cash charges increased \$12 million from \$780 million to \$792 million, despite the net decline of 1,400 Company restaurants. This decline was primarily due to our portfolio activities during the year. Portfolio activities also contributed to the decline of \$128 million in our operating working capital deficit due primarily to a reduction in accounts payable and other current liabilities. Our operating working capital deficit, which excludes cash, short-term investments and short-term borrowings, is typical of restaurant operations where the majority of sales are for cash while payment to suppliers for food and supply inventories carry longer payment terms, generally from 10–30 days. The decline in accounts payable was a result of the reduction in the number of our restaurants and timing in the payment of liabilities. Other current liabilities declined primarily due to lower vacation accruals due to the change in vacation policy (described in Note 5), lower casualty loss reserves based on our independent actuary's valuation, lower advertising accruals and lower accrued interest due to the reduction in debt. As expected, the refranchising of our restaurants and the related increase in franchised units have caused accounts receivable for franchise fees to increase.

In 1998, net cash provided by operating activities decreased \$136 million to \$674 million. Cash used for working capital was \$106 million for 1998 compared to cash provided by working capital of \$27 million in 1997. The 1998 use was primarily due to an increase in current deferred tax assets and reduced income taxes payable. Excluding net changes in working capital, net income before facility actions and all other non-cash charges was essentially unchanged despite the net decline of over 1,700 Company restaurants. The decline was driven by our portfolio activities.

**Cash provided by investing activities** increased \$220 million to \$522 million in 1999. The majority of the increase is due to higher gross refranchising proceeds and proceeds from the sale of international short-term investments in connection with a planned tax-efficient repatriation to the U.S.

We look at refranchising proceeds on an “after-tax” basis. We define after-tax proceeds as gross refranchising proceeds less the settlement of working capital liabilities related to the units refranchised, primarily accounts payable and property taxes, and payment of taxes on the gains. This use of proceeds reduces our normal working capital deficit as more fully discussed above. The after-tax proceeds are available to pay down debt or repurchase shares. The estimated after-tax proceeds from refranchising of \$683 million in 1999 increased approximately 13% compared to prior year. This increase is due to the increased number of units refranchised as well as the mix of units sold and the level of taxable gains from each refranchising.

In 1998, net cash provided by investing activities decreased \$164 million to \$302 million compared to \$466 million in 1997. The 1998 decrease was primarily due to the prior year sale of the Non-core Businesses partly offset by increased proceeds from refranchising and the sales of property, plant and equipment. Capital spending decreased by \$81 million or 15%.

**Net cash used for financing activities** was essentially unchanged at \$1.1 billion in 1999. Payments on our unsecured Term Loan Facility and our unsecured Revolving Credit Facility totaled \$1.0 billion.

In September 1999, the Board of Directors authorized the repurchase of up to \$350 million of the Company's outstanding Common Stock. Through December 25, 1999, 3.3 million shares were repurchased under this program at a cost of \$134 million. We have repurchased approximately 3.4 million additional shares for approximately \$125 million through February 25, 2000.

In 1998, net cash used for financing activities of \$1.1 billion decreased slightly compared to 1997. The 1998 use represents net debt repayments. During 1998, we issued unsecured notes resulting in proceeds of \$604 million. These proceeds were used to reduce existing borrowings under our unsecured Term Loan Facility and unsecured Revolving Credit Facility.

### Financing Activities

Our primary bank credit agreement, as amended in March 1999, is currently comprised of a senior, unsecured Term Loan Facility and a \$3 billion senior unsecured Revolving Credit Facility

(collectively referred to as the “Credit Facilities”) which mature on October 2, 2002. At December 25, 1999, we had approximately \$774 million outstanding under the Term Loan Facility and \$955 million outstanding under the Revolving Credit Facility. Amounts outstanding under our Term Loan Facility and Revolving Credit Facility are expected to fluctuate from time to time, but Term Loan Facility reductions cannot be reborrowed. At December 25, 1999, we had unused Revolving Credit Facility borrowings available aggregating \$1.9 billion, net of outstanding letters of credit of \$152 million. We believe that we will be able to replace or refinance our Credit Facilities with another form of borrowing including a new credit facility or publicly issued debt, depending on market conditions or terms available at that time. We currently believe we will be able to replace or refinance the Credit Facilities prior to the maturity date.

This substantial indebtedness subjects us to significant interest expense and principal repayment obligations, which are limited in the near term, to prepayment events as defined in the credit agreement. Interest on the Credit Facilities is based principally on the London Interbank Offered Rate (“LIBOR”) plus a variable margin as defined in the credit agreement. Therefore, our future borrowing costs may fluctuate depending upon the volatility in LIBOR. We currently mitigate a portion of our interest rate risk through the use of financial instruments. See Notes 11 and 13 and our market risk discussion for further discussions of our interest rate risk.

We anticipate that our 2000 combined cash flow from operating and refranchising activities will be lower than 1999 levels primarily because of our expectations of reduced refranchising activity. However, we believe it will be sufficient to support our expected capital spending and still allow us to make required debt repayments and buy back shares under our current stock repurchase program.

### Consolidated Financial Condition

**Assets** decreased \$570 million or 13% to \$4.0 billion at year-end 1999. This decrease is primarily attributable to the portfolio effect and a decrease in cash and short-term investments. The decrease in cash and short-term investments was primarily driven by initiatives which allowed us to repatriate \$210 million of cash to the U.S. from foreign countries at minimal tax cost. We continue to look for opportunities to tax efficiently repatriate cash generated from foreign operations.

**Liabilities** decreased \$1.2 billion or 21% to \$4.5 billion primarily due to net debt repayments.

Our operating working capital deficit declined 13% to \$832 million at year-end 1999 from \$960 million at year-end 1998, primarily reflecting the portfolio effect.

### Other Significant Known Events, Trends or Uncertainties Expected to Impact 2000 Ongoing Operating Income Comparisons with 1999

**Impact of AmeriServe Bankruptcy.** As described in Note 22, on January 31, 2000, AmeriServe filed for protection under Chapter 11 of the U.S. Bankruptcy Code. AmeriServe

has advised us that it intends to prepare and file with the Bankruptcy Court a plan of reorganization in the future.

TRICON, the purchasing cooperative for the TRICON system and key representatives of the TRICON franchise community are working closely together to proactively address the bankruptcy situation and develop appropriate contingency plans. It is our intention to take all actions reasonably necessary and prudent to ensure continued supply of restaurant products and equipment to the TRICON system, and to minimize any incremental costs or exposures related to the AmeriServe bankruptcy. The significant actions that we have taken to date are described below.

On February 2, 2000, we and another major AmeriServe customer agreed to provide a \$150 million interim “debtor-in-possession” revolving credit facility (the “Facility”) to AmeriServe. We initially committed to provide up to \$100 million under this Facility. However, we have reached an agreement in principle to assign \$30 million of our commitment to a third party, reducing our total commitment under the Facility to \$70 million. AmeriServe has advised us that it is actively seeking to arrange alternative debtor-in-possession financing to replace the Facility.

In addition to our participation in the Facility, to help ensure that our supply chain continues to remain open, we have begun to purchase (and take title to) supplies directly from suppliers (the “temporary direct purchase program”) for use in our restaurants, as well as for resale to our franchisees and licensees who previously purchased supplies from AmeriServe. AmeriServe has agreed, for the same fee in effect prior to the bankruptcy filing, to continue to be responsible for distributing the supplies to us and our participating franchisee and licensee restaurants as well as providing ordering, inventory, billing and collection services for us. To date, this arrangement has been effective in ensuring supplies to our restaurants, and we have not experienced any significant supply interruption.

Further, we have commenced contingency planning and believe that we can arrange with an alternative distributor or distributors to meet the needs of the TRICON restaurant system if AmeriServe is no longer able to adequately service our restaurants or if otherwise permitted by the Bankruptcy Court.

As in most bankruptcies involving a primary supplier or distributor, the AmeriServe bankruptcy poses certain risks and uncertainties to us, as well as to our franchisees that rely on AmeriServe to distribute products to their restaurants. The more significant of these risks and uncertainties are described below. Significant adverse developments in any of these risks or uncertainties could have a material adverse impact on our results of operations, cash flow or financial condition.

We expect to incur costs in connection with our temporary direct purchase program, including the cost of additional debt incurred to finance the inventory purchases and to carry the receivables arising from inventory sales. While we believe that adequate inventory control and collections systems are in place, we may also incur costs related to the possibility of inventory obsoles-

cence and uncollectible receivables from our franchisees. We expect to mitigate, if not fully offset, these costs through discounts granted by suppliers for prompt payments. We also expect to incur certain one-time unusual costs as a result of the AmeriServe bankruptcy, primarily consisting of professional fees.

We intend to continue to work with AmeriServe and our suppliers to meet our supply needs while AmeriServe seeks to reorganize. Due to the uncertainties surrounding AmeriServe's reorganization, we cannot predict the ultimate impact, if any, on our businesses. There can be no assurance that the Facility will be sufficient to meet AmeriServe's cash requirements or that we will be able to fully recover the amount advanced under the Facility. There can be no assurance that AmeriServe will be successful in arranging replacement debtor-in-possession financing on satisfactory terms, or that a plan of reorganization for AmeriServe will ultimately be confirmed, or if confirmed, what the plan will provide. Additionally, there can be no assurance that AmeriServe will be able to maintain our supply line indefinitely without additional financing or at our current contractual rates.

We currently have a multi-year contract with AmeriServe which is subject to the Bankruptcy Court procedures during the reorganization process. As stated above, we believe that we can arrange with an alternative distributor or distributors to meet the needs of the TRICON restaurant system if AmeriServe is no longer able to adequately service our restaurants or if otherwise permitted by the Bankruptcy Court. We could, however, experience some short-term delays due to the time required to qualify and contract with, and transition the business to, other distributors. There can be no assurance that the cost of these alternatives would be at the same rates we currently pay AmeriServe.

We believe that we may have a set-off or recoupment claim against amounts we owe AmeriServe under our distribution contract that would allow us to recover certain costs and damages that we have incurred (or may incur) as a result of AmeriServe's failure to perform its contractual obligations to our restaurants both prior to and after the bankruptcy filing. While we intend to assert this claim, there can be no assurance that we will be successful.

Without regard to the final outcome of the AmeriServe bankruptcy proceedings, it is our intention to take whatever steps are reasonably required to ensure continued supply of restaurant products and equipment to the TRICON system. To the extent we incur any ongoing incremental costs as a result of the AmeriServe bankruptcy or actions related thereto, we intend to mitigate those costs to the maximum extent possible through other reasonable management actions.

**Impact of New Ventures.** Consistent with our strategy to focus our capital on key international markets, we entered into agreements in the fourth quarter of 1999 to form new ventures during 2000 in Canada and Poland with our largest franchisees in those markets. We intend to contribute approximately 300 restaurants in Canada and 50 restaurants in Poland in exchange for an equity interest in each venture. These units represented approximately 18% of total International Company

units at December 25, 1999. These interests will be accounted for under the equity method. We have not yet determined the timing of the formation of these new ventures.

Upon formation of these ventures, we will recognize our share of the ventures' net income or loss as equity income from investments in unconsolidated affiliates. Currently, the results from these restaurants are being consolidated. The impact of these transactions on operating results will be similar to the portfolio effect of our franchising activities. These transactions will result in a decline in our Company sales, restaurant margin dollars and general and administrative expenses and an increase in franchise fees. In addition, because of our retained interest in these ventures, we will recognize our share of the ventures' net income or loss. Had these ventures been formed at the beginning of 1999, our 1999 International Company sales would have declined approximately 14% as compared to the slight increase reported in 1999. However, we estimate the overall impact on 1999 operating profit would have been favorable due to higher franchise fees and equity income.

**Change in Casualty Loss Estimates.** As described in Note 21, we have recorded favorable adjustments to our casualty loss reserves of \$30 million in 1999 (\$21 million in the first quarter and \$9 million in the fourth quarter), \$23 million in 1998 and \$18 million in 1997 primarily as a result of our independent actuary's changes in its estimate of casualty losses. The changes were related to previously recorded casualty loss estimates determined by our independent actuary for both the current and prior years in which we retained some risk of loss. We believe the favorable adjustments are a direct result of our recent investments in safety and security programs to better manage risk at the store level.

We will continue to make adjustments both based on our actuary's periodic valuations as well as whenever there are significant changes in the expected costs of settling large claims not contemplated by the actuary. Due to the inherent volatility of our actuarially-determined casualty loss estimates, it is reasonably possible that we will experience changes in estimated losses which could be material to our growth in net income in 2000. However, we currently expect the magnitude of such estimate changes will be less than those experienced in 1999. This expectation is primarily based on indications by our independent actuary that its current loss estimates are based more on the favorable actual loss trends we have achieved in the last few years than the more negative trends we experienced in earlier years. We believe that, since we record our reserves for casualty losses at a 75% confidence level, we have mitigated the negative impact of adverse development and/or volatility. At December 25, 1999, our reserves for casualty losses were \$142 million, compared to \$154 million at year-end 1998.

**Year 2000.** As previously disclosed, we developed and implemented an enterprise-wide plan to prepare our information technology (IT) systems and non-information technology systems with embedded technology applications (ET) for the

Year 2000 issue. We also took actions we believed would mitigate our Year 2000 risks related to our critical business partners including suppliers, banks, franchisees and other service providers (primarily data exchange partners). We have not experienced any significant disruptions of our operating or financial activities caused by a failure of our IT/ET systems or unexpected business problems resulting from Year 2000 issues. Given the absence of any significant problems to date, we do not expect Year 2000 issues to have a material adverse effect on TRICON's operations or financial results in 2000.

We currently expect our Year 2000 plan to cost approximately \$67 to \$68 million from inception of the planned actions in 1997 through 2000. We have incurred approximately \$65 million of Year 2000 costs from 1997 through December 25, 1999 of which approximately \$30 million was incurred during 1999. We expect to incur approximately \$2 to \$3 million to complete all Year 2000 problem resolution in 2000. These costs relate to additional validation of our IT/ET systems and resolution of any Year 2000 problems or issues that arise during the remainder of 2000. We have funded the costs related to our Year 2000 plan through cash flows from operations.

**Extra Week in 2000.** Our fiscal calendar results in a fifty-third week every five or six years. Fiscal year 2000 will include a fifty-third week in the fourth quarter. This additional week will have a favorable effect on our operating results for 2000.

**Euro Conversion.** On January 1, 1999, eleven of the fifteen member countries of the European Economic and Monetary Union ("EMU") adopted the Euro as a common legal currency and fixed conversion rates were established. From that date through no later than June 30, 2002, participating countries will maintain both legacy currencies and the Euro as legal tender. Beginning January 1, 2002, new Euro-denominated bills and coins will be issued, and a transition period of up to six months will begin during which legacy currencies will be removed from circulation.

We have Company and franchised businesses in the adopting member countries, which are preparing for the conversion. Expenditures associated with conversion efforts to date have been insignificant. We currently estimate that our spending over the ensuing three-year transition period will be approximately \$10 million, related to the conversion in the EMU member countries in which we operate stores. In our 1998 Form 10-K, we estimated that our spending over the period would be approximately \$16 million. This estimate was reduced in the fourth quarter of 1999 to reflect the franchising of certain equity markets and enhancements made to our existing point-of-sale ("P.O.S.") systems. Approximately 60% of these expenditures relate to capital expenditures for new P.O.S. and back-of-restaurant hardware and software to accommodate Euro-denominated transactions. We expect that adoption of the Euro by the U.K. would significantly increase this estimate due to the size of our businesses there relative to our aggregate businesses in the adopting member countries in which we operate.

The pace of ultimate consumer acceptance of and our competitors' responses to the Euro are currently unknown and may impact our existing plans. However, we know that, from a competitive perspective, we will be required to assess the impacts of product price transparency, potentially revise product bundling strategies and create Euro-friendly price points prior to 2002. We do not believe that these activities will have sustained adverse impacts on our businesses. Although the Euro does offer certain benefits to our treasury and procurement activities, these are not currently anticipated to be significant.

We currently anticipate that our suppliers and distributors will continue to invoice us in legacy currencies until late 2001. We expect to begin dual pricing in our restaurants in 2001. We expect to compensate employees in Euros beginning in 2002. We believe that the most critical activity regarding the conversion for our businesses is the completion of the rollout of Euro-ready point-of-sale equipment and software by the end of 2001. Our current plans should enable us to be Euro-compliant prior to the requirements for these changes. Any delays in our ability to complete our plans, or in the ability of our key suppliers to be Euro-compliant, could have a material adverse impact on our results of operations, financial condition or cash flows.

**Improvement in Effective Tax Rate.** As discussed on pages 29–30, we have achieved significant improvements in our effective tax rate (“ETR”) on ongoing operating profit in both 1999 and 1998 as a result of several tax planning initiatives and other events. In 1999, our ETR was 39.3%, an improvement of 300 basis points from 1998 and 590 basis points better than 1997.

We continue to pursue a variety of initiatives designed to further reduce our ETR. The most significant current initiative is to become eligible to claim foreign income tax credits against our U.S. income tax liability on foreign sourced income. When it becomes more likely than not that we will be able to claim the benefit of foreign tax credits, which is reasonably possible in 2000, it should result in a further improvement in our ETR.

#### Quantitative and Qualitative Disclosures About Market Risk of Financial Instruments

Our primary market risk exposure with regard to financial instruments is to changes in interest rates, principally in the United States. In addition, an immaterial portion of our debt and receivables are denominated in foreign currencies which exposes us to market risk associated with exchange rate movements. Historically, we have used derivative financial instruments on a limited basis to manage our exposure to foreign currency rate fluctuations since the market risk associated with our foreign currency denominated debt was not considered significant.

At December 25, 1999, a hypothetical 100 basis point increase in short-term interest rates would result in a reduction of \$12 million in annual pre-tax earnings. The estimated reduction is based upon the unhedged portion of our variable rate debt and assumes no change in the volume or composition of

debt at December 25, 1999. In addition, the fair value of our interest rate derivative contracts would increase approximately \$7 million in value to us, and the fair value of our unsecured Notes would decrease approximately \$28 million. Fair value was determined by discounting the projected cash flows.

#### New Accounting Pronouncement

See Note 2.

#### Cautionary Statements

From time to time, in both written reports and oral statements, we present “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The statements include those identified by such words as “may,” “will,” “expect,” “anticipate,” “believe,” “plan” and other similar terminology. These “forward-looking statements” reflect our current expectations and are based upon data available at the time of the statements. Actual results involve risks and uncertainties, including both those specific to the Company and those specific to the industry, and could differ materially from expectations.

Company risks and uncertainties include, but are not limited to, the limited experience of our management group in operating the Company as an independent, publicly owned business; potentially substantial tax contingencies related to the Spin-off, which, if they occur, require us to indemnify PepsiCo; our substantial debt leverage and the attendant potential restriction on our ability to borrow in the future, as well as the substantial interest expense and principal repayment obligations; potential unfavorable variances between estimated and actual liabilities including accruals for wage and hour litigation and the liabilities related to the sale of the Non-core Businesses; the ongoing business viability of our key distributor of restaurant products and equipment in the United States and our ability to ensure adequate supply of restaurant products and equipment in our stores; our ability to complete our conversion plans or the ability of our key suppliers to be Euro-compliant; our potential inability to identify qualified franchisees to purchase restaurants at prices we consider appropriate under our strategy to reduce the percentage of system units we operate; volatility of actuarially determined casualty loss estimates and adoption of new or changes in accounting policies and practices.

Industry risks and uncertainties include, but are not limited to, global and local business, economic and political conditions; legislation and governmental regulation; competition; success of operating initiatives and advertising and promotional efforts; volatility of commodity costs and increases in minimum wage and other operating costs; availability and cost of land and construction; consumer preferences, spending patterns and demographic trends; political or economic instability in local markets and currency exchange rates.

# consolidated statement of operations

## TRICON Global Restaurants, Inc. and Subsidiaries

Fiscal years ended December 25, 1999, December 26, 1998 and December 27, 1997

(in millions, except per share amounts)

	1999	1998	1997
<b>Revenues</b>			
Company sales	<b>\$ 7,099</b>	\$ 7,852	\$ 9,112
Franchise and license fees	<b>723</b>	627	578
	<b>7,822</b>	8,479	9,690
<b>Costs and Expenses, net</b>			
Company restaurants			
Food and paper	<b>2,238</b>	2,521	2,949
Payroll and employee benefits	<b>1,956</b>	2,243	2,614
Occupancy and other operating expenses	<b>1,814</b>	2,030	2,491
	<b>6,008</b>	6,794	8,054
General and administrative expenses	<b>920</b>	941	956
Other (income) expense	<b>(16)</b>	(24)	8
Facility actions net (gain) loss	<b>(381)</b>	(275)	247
Unusual items	<b>51</b>	15	184
Total costs and expenses, net	<b>6,582</b>	7,451	9,449
<b>Operating Profit</b>	<b>1,240</b>	1,028	241
Interest expense, net	<b>202</b>	272	276
<b>Income (Loss) Before Income Taxes</b>	<b>1,038</b>	756	(35)
<b>Income Tax Provision</b>	<b>411</b>	311	76
<b>Net Income (Loss)</b>	<b>\$ 627</b>	\$ 445	\$ (111)
Basic Earnings Per Common Share	<b>\$ 4.09</b>	\$ 2.92	
Diluted Earnings Per Common Share	<b>\$ 3.92</b>	\$ 2.84	

See accompanying Notes to Consolidated Financial Statements.



# consolidated statement of cash flows

## TRICON Global Restaurants, Inc. and Subsidiaries

Fiscal years ended December 25, 1999, December 26, 1998 and December 27, 1997

(in millions)	1999	1998	1997
<b>Cash Flows — Operating Activities</b>			
Net income (loss)	\$ 627	\$ 445	\$ (111)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	386	417	536
Facility actions net (gain) loss	(381)	(275)	247
Unusual items	45	15	184
Other liabilities and deferred credits	65	58	—
Deferred income taxes	(16)	3	(138)
Other non-cash charges and credits, net	66	117	65
Changes in operating working capital, excluding effects of acquisitions and dispositions:			
Accounts and notes receivable	(28)	(8)	(22)
Inventories	6	4	3
Prepaid expenses and other current assets	(13)	(20)	—
Accounts payable and other current liabilities	(215)	10	3
Income taxes payable	23	(92)	43
Net change in operating working capital	(227)	(106)	27
<b>Net Cash Provided by Operating Activities</b>	<b>565</b>	<b>674</b>	<b>810</b>
<b>Cash Flows — Investing Activities</b>			
Capital spending	(470)	(460)	(541)
Refranchising of restaurants	916	784	770
Acquisition of restaurants	(6)	—	—
Sales of Non-core Businesses	—	—	186
Sales of property, plant and equipment	51	58	40
Other, net	31	(80)	11
<b>Net Cash Provided by Investing Activities</b>	<b>522</b>	<b>302</b>	<b>466</b>
<b>Cash Flows — Financing Activities</b>			
Proceeds from Notes	—	604	—
Revolving Credit Facility activity, by original maturity			
More than three months — proceeds	—	400	500
More than three months — payments	—	(900)	—
Three months or less, net	(860)	(120)	1,935
Proceeds from long-term debt	4	4	2,000
Payments of long-term debt	(180)	(1,068)	(65)
Short-term borrowings — three months or less, net	21	(53)	83
Decrease in investments by and advances from PepsiCo	—	—	(3,281)
Dividend to PepsiCo	—	—	(2,369)
Repurchase shares of common stock	(134)	—	—
Other, net	30	13	59
<b>Net Cash Used for Financing Activities</b>	<b>(1,119)</b>	<b>(1,120)</b>	<b>(1,138)</b>
<b>Effect of Exchange Rate Changes on Cash and Cash Equivalents</b>	<b>—</b>	<b>(3)</b>	<b>(7)</b>
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	<b>(32)</b>	<b>(147)</b>	<b>131</b>
<b>Cash and Cash Equivalents — Beginning of Year</b>	<b>121</b>	<b>268</b>	<b>137</b>
<b>Cash and Cash Equivalents — End of Year</b>	<b>\$ 89</b>	<b>\$ 121</b>	<b>\$ 268</b>
<b>Supplemental Cash Flow Information</b>			
Interest paid	\$ 212	\$ 303	\$ 64
Income taxes paid	340	310	210

See accompanying Notes to Consolidated Financial Statements.

# consolidated balance sheet

## TRICON Global Restaurants, Inc. and Subsidiaries

December 25, 1999 and December 26, 1998

(in millions)

	1999	1998
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 89	\$ 121
Short-term investments, at cost	48	87
Accounts and notes receivable, less allowance: \$13 in 1999 and \$17 in 1998	161	155
Inventories	61	68
Prepaid expenses and other current assets	68	57
Deferred income tax assets	59	137
<b>Total Current Assets</b>	<b>486</b>	<b>625</b>
<b>Property, Plant and Equipment, net</b>	<b>2,531</b>	<b>2,896</b>
<b>Intangible Assets, net</b>	<b>527</b>	<b>651</b>
<b>Investments in Unconsolidated Affiliates</b>	<b>170</b>	<b>159</b>
<b>Other Assets</b>	<b>247</b>	<b>200</b>
<b>Total Assets</b>	<b>\$ 3,961</b>	<b>\$ 4,531</b>
<b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>		
<b>Current Liabilities</b>		
Accounts payable and other current liabilities	\$ 1,085	\$ 1,283
Income taxes payable	96	94
Short-term borrowings	117	96
<b>Total Current Liabilities</b>	<b>1,298</b>	<b>1,473</b>
<b>Long-term Debt</b>	<b>2,391</b>	<b>3,436</b>
<b>Other Liabilities and Deferred Credits</b>	<b>825</b>	<b>720</b>
<b>Deferred Income Taxes</b>	<b>7</b>	<b>65</b>
<b>Total Liabilities</b>	<b>4,521</b>	<b>5,694</b>
<b>Shareholders' Deficit</b>		
Preferred stock, no par value, 250 shares authorized; no shares issued	—	—
Common stock, no par value, 750 shares authorized; 151 and 153 shares issued in 1999 and 1998, respectively	1,264	1,305
Accumulated deficit	(1,691)	(2,318)
Accumulated other comprehensive income	(133)	(150)
<b>Total Shareholders' Deficit</b>	<b>(560)</b>	<b>(1,163)</b>
<b>Total Liabilities and Shareholders' Deficit</b>	<b>\$ 3,961</b>	<b>\$ 4,531</b>

See accompanying Notes to Consolidated Financial Statements.

# consolidated statement of shareholders' (deficit) equity and comprehensive income

## TRICON Global Restaurants, Inc. and Subsidiaries

Fiscal years ended December 25, 1999, December 26, 1998 and December 27, 1997

(in millions)

	Issued Common Stock		Accumulated Deficit	Investments by and Advances from PepsiCo	Accumulated Other Comprehensive Income	Total
	Shares	Amount				
Balance at December 28, 1996				\$ 4,268	\$ (29)	\$ 4,239
Net income prior to Spin-off				283		283
Net loss after Spin-off			(394)			(394)
Foreign currency translation adjustment					(101)	(101)
Minimum pension liability adjustment (includes tax of \$2 million)					2	<u>2</u>
Comprehensive Income (Loss)						(210)
Net investments by and advances from PepsiCo				(1,152)		(1,152)
Spin-off dividend and partial repayment of advances			(2,369)	(2,131)		(4,500)
Issuance of shares of common stock, no par value, in connection with the Spin-off	152					—
Contribution to capital of remaining unpaid advances		1,268		(1,268)		—
Stock option exercises		3				<u>3</u>
Balance at December 27, 1997	152	\$ 1,271	\$ (2,763)	\$ —	\$ (128)	\$ (1,620)
Net income			445			445
Foreign currency translation adjustment					(20)	(20)
Minimum pension liability adjustment (includes tax of \$1 million)					(2)	<u>(2)</u>
Comprehensive Income						423
Adjustment to opening equity related to net advances from PepsiCo		12				12
Stock option exercises (includes tax benefits of \$3 million)	1	22				<u>22</u>
Balance at December 26, 1998	153	\$ 1,305	\$ (2,318)	\$ —	\$ (150)	\$ (1,163)
Net income			<b>627</b>			<b>627</b>
Foreign currency translation adjustment					<b>15</b>	<b>15</b>
Minimum pension liability adjustment (includes tax of \$1 million)					<b>2</b>	<u><b>2</b></u>
Comprehensive Income						<b>644</b>
Adjustment to opening equity related to net advances from PepsiCo		<b>7</b>				<b>7</b>
Repurchase of shares of common stock	<b>(3)</b>	<b>(134)</b>				<b>(134)</b>
Stock option exercises (includes tax benefits of \$14 million)	<b>1</b>	<b>39</b>				<u><b>39</b></u>
Compensation-related events		<b>47</b>				<u><b>47</b></u>
<b>Balance at December 25, 1999</b>	<b>151</b>	<b>\$1,264</b>	<b>\$ (1,691)</b>	<b>\$ —</b>	<b>\$ (133)</b>	<b>\$ (560)</b>

See accompanying Notes to Consolidated Financial Statements.

# notes to consolidated financial statements

(tabular amounts in millions, except share data)

## note 1

### Description of Business

TRICON Global Restaurants, Inc. and Subsidiaries (collectively referred to as “TRICON” or the “Company”) is the world’s largest quick service restaurant company based on the number of system units, with almost 30,000 units in 104 countries and territories. References to TRICON throughout these Consolidated Financial Statements are made using the first person notations of “we” or “us.” Our worldwide businesses, KFC, Pizza Hut and Taco Bell (“Core Business(es)”), include the operations, development and franchising or licensing of a system of both traditional and non-traditional quick service restaurant units. Our traditional restaurants feature dine-in, carryout and, in some instances, drive-thru or delivery service. Non-traditional units include express units and kiosks which have a more limited menu and operate in non-traditional locations like airports, gas and convenience stores, stadiums, amusement parks and colleges, where a full-scale traditional outlet would not be practical or efficient. Each Core Business has proprietary menu items and emphasizes the preparation of food with high quality ingredients as well as unique recipes and special seasonings to provide appealing, tasty and attractive food at competitive prices. Approximately 33% of our system units are located outside the U.S. In late 1994, we determined that each Core Business system should be rebalanced toward a higher percentage of total system units operated by franchisees and that Company underperforming units should be closed. Since that time, we have refranchised 5,138 units and closed 2,119 units through December 25, 1999. Our overall Company ownership percentage of total system units was 23% at December 25, 1999, a decline of 5 percentage points from year-end 1998 and 11 percentage points from year-end 1997. Our target Company ownership is approximately 20%.

We also previously operated other non-core businesses disposed of in 1997, which included California Pizza Kitchen, Chevys Mexican Restaurant, D’Angelo’s Sandwich Shops, East Side Mario’s and Hot ’n Now (collectively, the “Non-core Businesses”).

## note 2

### Summary of Significant Accounting Policies

Our preparation of the accompanying Consolidated Financial Statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts

of revenues and expenses during the reporting period. Actual results could differ from our estimates.

### Principles of Consolidation and Basis of Preparation.

TRICON was created as an independent, publicly owned company on October 6, 1997 (the “Spin-off Date”) via a tax-free distribution by our former parent, PepsiCo, Inc. (“PepsiCo”), of our Common Stock (the “Distribution” or “Spin-off”) to its shareholders. The accompanying Consolidated Financial Statements present our financial position, results of operations and cash flows as if we had been an independent, publicly owned company for all prior periods presented. Intercompany accounts and transactions have been eliminated. Investments in unconsolidated affiliates in which we exercise significant influence but do not control are accounted for by the equity method. Our share of the net income or loss of those unconsolidated affiliates and net foreign exchange gains or losses are included in other (income) expense. The Consolidated Financial Statements prior to the Spin-off Date represent the combined worldwide operations of our Core Businesses and Non-core Businesses disposed of in 1997. To facilitate this presentation, PepsiCo made certain allocations of its previously unallocated interest and general and administrative expenses as well as pro forma computations, to the extent possible, of separate income tax provisions for its restaurant segment.

PepsiCo based its interest allocations on its weighted-average interest rate applied to the average annual balance of investments by and advances from PepsiCo and its allocations of general and administrative expenses on our revenue as a percent of PepsiCo’s total revenue. We believe that the bases of allocation of interest expense and general and administrative expenses were reasonable based on the facts and circumstances available at the date of their allocation, however, these allocations are not indicative of amounts that we would have incurred as an independent, publicly owned company. Our 1997 results included \$188 million of interest allocations and \$37 million of general and administrative allocations from PepsiCo. PepsiCo used its weighted-average interest rate of 6.1% to calculate the interest allocation for 1997 through the Spin-off Date. PepsiCo managed its tax position on a consolidated basis, which took into account the results of all of its businesses. For this reason, our historical effective tax rates prior to 1998 are not indicative of our future tax rates.

In addition, our capital structure changed in 1997 as a result of the Distribution and bears little relationship to the average net outstanding investments by and advances from PepsiCo

prior to the Spin-off. In connection with the Spin-off, we borrowed \$4.55 billion to fund a dividend and repayments to PepsiCo, which exceeded the net aggregate balance owed at the Spin-off Date by \$1.1 billion.

**Segment Disclosures.** Effective December 28, 1997, we adopted SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS 131"). Operating segments, as defined by SFAS 131, are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. This Statement allows aggregation of similar operating segments into a single operating segment if the businesses are considered similar under the criteria of SFAS 131. We identify our operating segments based on management responsibility within the U.S. and International. For purposes of applying SFAS 131, we consider our three U.S. Core Business operating segments to be similar and therefore have aggregated them into a single reportable operating segment.

**Internal Development Costs and Abandoned Site Costs.** We capitalize direct internal payroll and payroll related costs and direct external costs associated with the acquisition of a site to be developed as a Company unit and the construction of a unit on that site. Only those site-specific costs incurred subsequent to the time that the site acquisition is considered probable are capitalized. We consider acquisition probable upon final site approval. If we subsequently make a determination that a site for which internal development costs have been capitalized will not be acquired or developed, the previously capitalized costs are expensed at this date and included in general and administrative expenses.

**Fiscal Year.** Our fiscal year ends on the last Saturday in December and, as a result, a fifty-third week is added every five or six years. Fiscal years 1999, 1998 and 1997 comprised 52 weeks. Fiscal year 2000 will include a fifty-third week. Each of the first three quarters of each fiscal year consists of 12 weeks and the fourth quarter consists of 16 or 17 weeks. Our subsidiaries operate on similar fiscal calendars with period end dates suited to their businesses. Period end dates are within one week of TRICON's period end date with the exception of our international businesses, which close one period or month earlier to facilitate consolidated reporting.

**Direct Marketing Costs.** We report substantially all of our direct marketing costs in occupancy and other operating expenses in the Consolidated Statement of Operations, which include costs of advertising and other marketing activities. We charge direct marketing costs to expense ratably in relation to revenues over the year in which incurred. Direct marketing costs deferred at year-end consist of media and related ad production costs. We expense these costs when the media or ad is first used. Deferred advertising expense, classified as prepaid expenses in the Consolidated Balance Sheet, was

\$3 million in 1999 and \$4 million in 1998. Our advertising expenses were \$385 million, \$435 million and \$517 million in 1999, 1998 and 1997, respectively. The decline in our advertising expense is a direct result of substantially fewer Company stores as a result of our major refranchising program.

**Research and Development Expenses.** Research and development expenses, which we expense as incurred, were \$24 million in 1999 and \$21 million in both 1998 and 1997.

**Stock-Based Employee Compensation.** We measure stock-based employee compensation cost for financial statement purposes in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and its related interpretations and include pro forma information in Note 15 as required by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). Accordingly, we measure compensation cost for the stock option grants to our employees as the excess of the average market price of our Common Stock at the grant date over the amount the employee must pay for the stock. Our policy is to generally grant stock options at the average market price of the underlying Common Stock at the date of grant.

**Earnings (Loss) Per Common Share.** In the accompanying Consolidated Statement of Operations, we have omitted loss per share information for 1997 as our capital structure as an independent, publicly owned company did not exist for the entire year.

**Derivative Instruments.** From time to time, we utilize interest rate swaps, collars and forward rate agreements to hedge our exposure to fluctuations in variable interest rates.

We recognize the interest differential to be paid or received on interest rate swap and forward rate agreements as an adjustment to interest expense as the differential occurs. We recognize the interest differential to be paid or received on an interest rate collar as an adjustment to interest expense only if the interest rate falls below or exceeds the contractual collared range. We reflect the recognized interest differential not yet settled in cash in the accompanying Consolidated Balance Sheet as a current receivable or payable. If we were to terminate an interest rate swap, collar or forward rate position, any gain or loss realized upon termination would be deferred and amortized to interest expense over the remaining term of the underlying debt instrument it was intended to modify or would be recognized immediately if the underlying debt instrument was settled prior to maturity.

We recognize foreign exchange gains and losses on forward contracts that are designated and effective as hedges of foreign currency receivables each period as the differential occurs. This is fully offset by the corresponding gain or loss recognized in income on the currency translation of the receivable, as both amounts are based upon the same exchange rates. We

reflect the recognized foreign currency differential not yet settled in cash on the accompanying Consolidated Balance Sheet each period as a current receivable or payable. If a foreign currency forward contract was to be terminated prior to maturity, the gain or loss recognized upon termination would be immediately recognized into income.

We defer gains and losses on futures contracts that are designated and effective as hedges of future commodity purchases and include them in the cost of the related raw materials when purchased. Changes in the value of futures contracts that we use to hedge commodity purchases are highly correlated to the changes in the value of the purchased commodity. If the degree of correlation between the futures contracts and the purchase contracts were to diminish such that the two were no longer considered highly correlated, we would recognize in income subsequent changes in the value of the futures contracts.

**Cash and Cash Equivalents.** Cash equivalents represent funds we have temporarily invested (with original maturities not exceeding three months) as part of managing our day-to-day operating cash receipts and disbursements.

**Inventories.** We value our inventories at the lower of cost (computed on the first-in, first-out method) or net realizable value.

**Property, Plant and Equipment.** We state property, plant and equipment (“PP&E”) at cost less accumulated depreciation and amortization, impairment writedowns and valuation allowances. We calculate depreciation and amortization on a straight-line basis over the estimated useful lives of the assets as follows: 5 to 25 years for buildings and improvements, 3 to 20 years for machinery and equipment and 3 to 7 years for capitalized software costs. We suspend depreciation and amortization on assets related to restaurants that are held for disposal. Our depreciation and amortization expense was \$345 million, \$372 million and \$460 million in 1999, 1998 and 1997, respectively.

**Intangible Assets.** Intangible assets include both identifiable intangibles and goodwill arising from the allocation of purchase prices of businesses acquired. Where appropriate, the intangibles are allocated to the individual store level at the time of acquisition. We base amounts assigned to identifiable intangibles on independent appraisals or internal estimates. Goodwill represents the residual purchase price after allocation to all identifiable net assets. Our intangible assets are stated at historical allocated cost less accumulated amortization, impairment writedowns and valuation allowances. We amortize intangible assets on a straight-line basis as follows: up to 20 years for reacquired franchise rights, 3 to 34 years for trademarks and other identifiable intangibles and up to

20 years for goodwill. As discussed further below, we suspend amortization on intangible assets allocated to restaurants that are held for disposal. Our amortization expense was \$44 million, \$52 million and \$70 million in 1999, 1998 and 1997, respectively.

**Franchise and License Fees.** We execute franchise or license agreements covering each point of distribution which provide the terms of our arrangement with the franchisee or licensee. Our franchise and certain license agreements generally require the franchisee or licensee to pay an initial, non-refundable fee. Our agreements also require continuing fees based upon a percentage of sales. Subject to our approval and payment of a renewal fee, a franchisee may generally renew its agreement upon its expiration. Our direct costs of the sales and servicing of franchise and license agreements are charged to general and administrative expense as incurred.

We recognize initial fees as revenue when we have performed substantially all initial services required by the franchising or licensing agreement, which is generally upon opening of a store. We recognize continuing fees as earned with an appropriate provision for estimated uncollectible amounts. We recognize renewal fees in earnings when a renewal agreement becomes effective. We include initial fees collected upon the sale of a restaurant to a franchisee in refranchising gains (losses).

**Refranchising Gains (Losses).** Refranchising gains (losses) include the gains or losses from the sales of our restaurants to new and existing franchisees and the related initial franchise fees reduced by direct administrative costs of refranchising. We recognize gains on restaurant refranchisings when the sale transaction closes, the franchisee has a minimum amount of the purchase price in at-risk equity and we are satisfied that the franchisee can meet its financial obligations. Otherwise, we defer refranchising gains until those criteria have been met. In executing our refranchising initiatives, we most often offer groups of restaurants. We only consider the stores in the group “held for disposal” where the group is expected to be sold at a loss. We recognize estimated losses on restaurants to be refranchised and suspend depreciation and amortization when: (1) we make a decision to refranchise stores; (2) the estimated fair value less costs to sell is less than the carrying amount of the stores; and (3) the stores can be immediately removed from operations. For groups of restaurants expected to be sold at a gain, we typically do not suspend depreciation and amortization until the sale is probable. For practical purposes, we treat the closing date as the point at which the sale is probable. When we make a decision to retain a store previously held for refranchising, we revalue the store at the lower of its net book value at our original disposal decision date less normal depreciation during the period held for disposal or its

current fair market value. This value becomes the store's new cost basis. We charge (or credit) any difference between the store's carrying amount and its new cost to refranchising gains (losses). When we make a decision to close a store previously held for refranchising, we reverse any previously recognized refranchising loss and then record the store closure costs as described below.

**Store Closure Costs.** Effective for closure decisions made on or subsequent to April 23, 1998, we recognize store closure costs when we have closed the restaurant within the same quarter our decision is made. Store closure costs include the cost of writing-down (impairing) the carrying amount of a restaurant's assets to estimated fair market value less costs of disposal. Additionally, we record a liability for the net present value of any remaining operating lease obligations after the expected closure date, net of estimated sublease income, if any, at the date the closure is considered probable.

**Impairment of Long-Lived Assets to be Held and Used in the Business.** We review our long-lived assets, including any allocated intangible assets, related to each restaurant to be held and used in the business semi-annually for impairment, or whenever events or changes in circumstances indicate that the carrying amount of a restaurant may not be recoverable. We evaluate restaurants using a "two-year history of operating losses" as our primary indicator of potential impairment. Based on the best information available, we write down an impaired restaurant to its estimated fair market value, which becomes its new cost basis. We generally measure estimated fair market value by discounting estimated future cash flows. In addition, after April 23, 1998, when we decide to close a store beyond the quarter in which the closure decision is made, it is reviewed for impairment and depreciable lives are adjusted. The impairment evaluation is based on the estimated cash flows from continuing use until the expected disposal date plus the expected terminal value.

Considerable management judgment is necessary to estimate future cash flows. Accordingly, actual results could vary significantly from our estimates.

**Impairment of Investments in Unconsolidated Affiliates and Enterprise-Level Goodwill.** Our methodology for determining and measuring impairment of our investments in unconsolidated affiliates and enterprise-level goodwill is similar to the methodology we use for our restaurants except (a) the recognition test for an investment in an unconsolidated affiliate compares the carrying amount of our investment to a forecast of our share of the unconsolidated affiliate's undiscounted cash flows including interest and taxes instead of undiscounted cash flows before interest and taxes used for our restaurants and (b) enterprise-level goodwill is

generally evaluated at a country level instead of by individual restaurant. Also, we record impairment charges related to our investments in unconsolidated affiliates whenever other circumstances indicate that a decrease in the value of an investment has occurred which is other than temporary.

Considerable management judgment is necessary to estimate future cash flows. Accordingly, actual results could vary significantly from our estimates.

**New Accounting Pronouncement Not Yet Adopted.** In June 1998, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133 establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset the related change in fair value on the hedged item in the consolidated statement of operations, and requires that a company must formally document, designate and assess the effectiveness of transactions that receive hedge accounting.

In June 1999, the FASB amended SFAS 133 to extend the required adoption date from fiscal years beginning after June 15, 1999 to fiscal years beginning after June 15, 2000. The amendment was in response to issues identified by FASB constituents regarding implementation difficulties. A company may implement SFAS 133 as of the beginning of any fiscal quarter after issuance (that is, fiscal quarters beginning June 16, 1998 and thereafter). SFAS 133 cannot be applied retroactively. When adopted, SFAS 133 must be applied to (a) derivative instruments and (b) certain derivative instruments embedded in hybrid contracts that were issued, acquired or substantively modified after December 31, 1998 (and, at the company's election, before January 1, 1999).

We have not yet quantified the effects of adopting SFAS 133 on our financial statements or determined the timing or method of our adoption of SFAS 133. However, the adoption of SFAS 133 could increase volatility in our earnings and other comprehensive income.

**Reclassifications.** We have reclassified certain items in the accompanying Consolidated Financial Statements for prior periods to be comparable with the classification we adopted for the fiscal year ended December 25, 1999. These reclassifications had no effect on previously reported net income or loss.

### note 3 Comprehensive Income

Accumulated Other Comprehensive Income includes:

	1999	1998	1997
Foreign currency translation adjustment arising during the period	\$ 15	\$ (21)	\$ (90)
Less:			
Foreign currency translation adjustment included in net income (loss)	—	1	(11)
Net foreign currency translation adjustment	<u>\$ 15</u>	<u>\$ (20)</u>	<u>\$ (101)</u>

Accumulated Other Comprehensive Income consisted of the following components as of December 25, 1999 and December 26, 1998:

	1999	1998
Foreign currency translation adjustment	\$ (133)	\$ (148)
Minimum pension liability adjustment	—	(2)
Total accumulated other comprehensive income	<u>\$ (133)</u>	<u>\$ (150)</u>

### note 4 Earnings Per Common Share ("EPS")

	1999	1998
Net income	<u>\$ 627</u>	\$ 445
Basic EPS:		
Weighted-average common shares outstanding	<u>153</u>	153
Basic EPS	<u>\$ 4.09</u>	\$ 2.92
Diluted EPS:		
Weighted-average common shares outstanding	153	153
Shares assumed issued on exercise of dilutive share equivalents	24	20
Shares assumed purchased with proceeds of dilutive share equivalents	<u>(17)</u>	<u>(17)</u>
Shares applicable to diluted earnings	<u>160</u>	156
Diluted EPS	<u>\$ 3.92</u>	\$ 2.84

Unexercised employee stock options to purchase approximately 2.5 million and 1 million shares of our Common Stock for the years ended December 25, 1999 and December 26, 1998, respectively, were not included in the computation of diluted EPS because their exercise prices were greater than the average market price of our Common Stock during the year.

We have omitted EPS data for the year ended December 27, 1997 since we were not an independent, publicly owned company with a capital structure of our own for the entire year.

### Items Affecting Comparability of Net Income (Loss)

**Accounting Changes.** In 1998 and 1999, we adopted several accounting and human resource policy changes (collectively, the "accounting changes") that impacted our 1999 operating profit. These changes, which we believe are material in the aggregate, fall into three categories:

- required changes in Generally Accepted Accounting Principles ("GAAP"),
- discretionary methodology changes implemented to more accurately measure certain liabilities and
- policy changes driven by our human resource and accounting standardization programs.

**Required Changes in GAAP.** Effective December 27, 1998, we adopted Statement of Position 98-1 ("SOP 98-1"), "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." SOP 98-1 identifies the characteristics of internal-use software and specifies that once the preliminary project stage is complete, direct external costs, certain direct internal payroll and payroll-related costs and interest costs incurred during the development of computer software for internal use should be capitalized and amortized. Previously, we expensed all software development and procurement costs as incurred. In 1999, we capitalized approximately \$13 million of internal software development costs and third party software costs that we would have previously expensed. As of December 25, 1999, no interest costs were capitalized due to the insignificance of amounts. The majority of the software being developed is not yet ready for its intended use. The amortization of assets that became ready for their intended use in 1999 was immaterial.

In addition, we adopted Emerging Issues Task Force Issue No. 97-11 ("EITF 97-11"), "Accounting for Internal Costs Relating to Real Estate Property Acquisitions," upon its issuance in March 1998. EITF 97-11 limits the capitalization of internal real estate acquisition costs to those site-specific costs incurred subsequent to the time that the real estate

### note 5



acquisition is probable. We consider acquisition of the property probable upon final site approval. In the first quarter of 1999, we also made a discretionary policy change limiting the types of costs eligible for capitalization to those direct cost types described as capitalizable under SOP 98-1. Prior to the adoption of EITF 97-11, all pre-acquisition real estate activities were considered capitalizable. This change unfavorably impacted our 1999 operating profit by approximately \$3 million.

To conform to the Securities and Exchange Commission's April 23, 1998 letter interpretation of Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," our store closure accounting policy was changed in 1998. Effective for closure decisions made on or subsequent to April 23, 1998, we recognize store closure costs when we have closed the restaurant within the same quarter the closure decision is made. When we decide to close a restaurant beyond the quarter in which the closure decision is made, it is reviewed for impairment. The impairment evaluation is based on the estimated cash flows from continuing use until the expected date of disposal plus the expected terminal value. If the restaurant is not fully impaired, we continue to depreciate the assets over their estimated remaining useful life. Prior to April 23, 1998, we recognized store closure costs and generally suspended depreciation and amortization when we decided to close a restaurant within the next twelve months. This change resulted in additional depreciation and amortization of approximately \$3 million through April 23, 1999.

**Discretionary Methodology Changes.** In 1999, the methodology used by our independent actuary was refined and enhanced to provide a more reliable estimate of the self-insured portion of our current and prior years' ultimate loss projections related to workers' compensation, general liability and automobile liability insurance programs (collectively "casualty loss(es)"). Our prior practice was to apply a fixed factor to increase our independent actuary's ultimate loss projections which was at the 51% confidence level for each year to approximate our targeted 75% confidence level. Confidence level means the likelihood that our actual casualty losses will be equal to or below those estimates. Based on our independent actuary's opinion, our prior practice produced a very conservative confidence factor at a level higher than our target of 75%. Our actuary now provides an actuarial estimate at our targeted 75% confidence level in the aggregate for all self-insured years. The change in methodology resulted in a one-time increase in our 1999 operating profit of over \$8 million.

At the end of 1998, we changed our method of determining the pension discount rate to better reflect the assumed investment strategies we would most likely use to invest any short-term cash surpluses. Accounting for pensions requires us to develop an assumed interest rate on securities with

which the pension liabilities could be effectively settled. In estimating this discount rate, we look at rates of return on high-quality corporate fixed income securities currently available and expected to be available during the period to maturity of the pension benefits. As it is impractical to find an investment portfolio which exactly matches the estimated payment stream of the pension benefits, we often have projected short-term cash surpluses. Previously, we assumed that all short-term cash surpluses would be invested in U.S. government securities. Our new methodology assumes that our investment strategies would be equally divided between U.S. government securities and high-quality corporate fixed income securities. The pension discount methodology change resulted in a one-time increase in our 1999 operating profit of approximately \$6 million.

**Human Resource and Accounting Standardization Programs.** In the first quarter of 1999, we began the standardization of our U.S. personnel practices. At the end of 1999, our vacation policies were conformed to a calendar-year based, earn-as-you-go, use-or-lose policy. The change provided a one-time favorable increase in our 1999 operating profit of approximately \$7 million. Other accounting policy standardization among our three U.S. Core Businesses provided a one-time favorable increase in our 1999 operating profit of approximately \$1 million.

The impact of the above described accounting changes is summarized below:

	<b>1999 Impact</b>
GAAP	\$ 7
Methodology	14
Standardization	8
Total	<u>\$ 29</u>
These changes impacted our results as follows:	
Restaurant margin	\$ 11
General and administrative expenses	18
Operating Profit	<u>\$ 29</u>
U.S.	\$ 15
International	—
Unallocated	14
Total	<u>\$ 29</u>
After-tax	<u>\$ 18</u>
Per diluted share	<u>\$ 0.11</u>

**1997 Fourth Quarter Charge.** In the fourth quarter of 1997, we recorded a \$530 million unusual charge (\$425 million after-tax). The charge included estimates for (1) costs of closing stores, primarily at Pizza Hut and internationally;

(2) reduction to fair market value, less costs to sell, of the carrying amounts of certain restaurants we intended to rebrand; (3) impairment of certain restaurants intended to be used in the business; (4) impairment of certain investments in unconsolidated affiliates to be retained; and (5) costs of related personnel reductions. Of the \$530 million charge, approximately \$401 million related to asset writedowns and approximately \$129 million related to liabilities, primarily occupancy-related costs and, to a much lesser extent, severance. The liabilities were expected to be settled from cash flows provided by operations. Through December 25, 1999, the amounts used apply only to the actions covered by the charge.

The components of the 1997 fourth quarter charge are detailed below:

	U.S.	International	Worldwide
Store closure costs	\$ 141	\$ 72	\$ 213
Refranchising losses	77	59	136
Impairment charges	12	49	61
Total facility actions net loss	230	180	410
Impairment of investments in unconsolidated affiliates	—	79	79
Severance and other	18	23	41
Total unusual items	18	102	120
Total fourth quarter charges	\$ 248	\$ 282	\$ 530
Total fourth quarter charges, after-tax	\$ 176	\$ 249	\$ 425

During 1999 and 1998, we continued to re-evaluate our prior estimates of the fair market value of units to be rebranded or closed and other liabilities arising from the charge. In 1999, we recorded favorable adjustments of \$13 million (\$10 million after-tax) and \$11 million (\$10 million after-tax) included in facility actions net gain and unusual items, respectively. These adjustments relate to lower-than-expected losses from stores disposed of, decisions to retain stores originally expected to be disposed of and changes in estimated costs. In 1998, favorable adjustments of \$54 million (\$33 million after-tax) and \$11 million (\$7 million after-tax) were included in facility actions net gain and unusual items, respectively. These adjustments primarily related to decisions to retain certain stores originally expected to be disposed of, lower-than-expected losses from stores disposed of and favorable lease settlements with certain lessors related to stores closed.

Our operating profit includes benefits from the suspension of depreciation and amortization of approximately \$12 million (\$7 million after-tax) and \$33 million (\$21 million after-tax) in 1999 and 1998, respectively, for stores held for disposal. The relatively short-term benefits from depreciation and amortization suspension related to stores that were operating at the

end of the respective periods ceased when the stores were rebranded, closed or a subsequent decision was made to retain the stores.

Although we originally expected to rebrand or close all 1,392 units included in the original charge by year-end 1998, the disposal of 531 units was delayed. In 1999, we disposed of 326 units, and decisions were made to retain 195 units originally expected to be disposed of in 1999.

Below is a summary of activity through 1999 related to the units covered by the 1997 fourth quarter charge:

	Units Expected to be Closed	Refranchised	Total Units Remaining
Units at December 27, 1997	740	652	1,392
Units disposed of	(426)	(320)	(746)
Units retained	(88)	(20)	(108)
Change in method of disposal	(109)	109	—
Other	6	(13)	(7)
Units at December 26, 1998	123	408	531
Units disposed of	(79)	(247)	(326)
Units retained	(29)	(166)	(195)
Change in method of disposal	(21)	21	—
Other	6	(16)	(10)
Units at December 25, 1999	—	—	—

Below is a summary of the 1999 and 1998 activity related to our asset valuation allowances and liabilities recognized as a result of the 1997 fourth quarter charge:

	Asset Valuation Allowances	Liabilities	Total
Balance at			
December 27, 1997	\$ 261	\$ 129	\$ 390
Amounts used	(131)	(54)	(185)
(Income) expense impacts:			
Completed transactions	(27)	(7)	(34)
Decision changes	(22)	(17)	(39)
Estimate changes	15	(7)	8
Other	1	—	1
Balance at			
December 26, 1998	\$ 97	\$ 44	\$ 141
Amounts used	(87)	(32)	(119)
(Income) expense impacts:			
Completed transactions	(5)	—	(5)
Decision changes	1	(3)	(2)
Estimate changes	(7)	(9)	(16)
Other	1	—	1
Balance at			
December 25, 1999	\$ —	\$ —	\$ —

**Facility Actions Net (Gain) Loss.** Facility actions net (gain) loss consists of three components:

- Gains and losses on sales of our restaurants to new and existing franchisees,
- Costs of closing our underperforming stores and
- Impairment charges both for restaurants we intend to continue to use in the business and, since April 23, 1998, restaurants we intend to close beyond the quarter in which the closure decision is made.

The components of facility actions net (gain) loss for 1999, 1998 and 1997 were as follows:

	1999		1998		1997	
	Total	(Excluding 1997 4th Qtr. Charge Adjustments)	Total	(Excluding 1997 4th Qtr. Charge Adjustments)	Total	(Excluding 1997 4th Qtr. Charge)
<b>U.S.</b>						
Refranchising net gains <sup>(a)</sup>	\$ (405)	\$ (396)	\$ (275)	\$ (249)	\$ (67)	\$ (144)
Store closure net costs	5	15	(9)	27	154	13
Impairment charges for stores that will continue to be used in the business	6	6	23	23	59	47
Impairment charges for stores to be closed in the future	9	9	5	5	—	—
Facility actions net (gain) loss	<b>(385)</b>	<b>(366)</b>	(256)	(194)	146	(84)
<b>International</b>						
Refranchising net gains <sup>(a)</sup>	(17)	(22)	(4)	(32)	(45)	(104)
Store closure net costs	8	7	(18)	2	94	22
Impairment charges for stores that will continue to be used in the business	10	10	2	2	52	3
Impairment charges for stores to be closed in the future	3	3	1	1	—	—
Facility actions net (gain) loss	<b>4</b>	<b>(2)</b>	(19)	(27)	101	(79)
<b>Worldwide</b>						
Refranchising net gains <sup>(a)</sup>	(422)	(418)	(279)	(281)	(112)	(248)
Store closure net costs	13	22	(27)	29	248	35
Impairment charges for stores that will continue to be used in the business <sup>(b)</sup>	16	16	25	25	111	50
Impairment charges for stores to be closed in the future <sup>(b)</sup>	12	12	6	6	—	—
Facility actions net (gain) loss	<b>\$ (381)</b>	<b>\$ (368)</b>	\$ (275)	\$ (221)	\$ 247	\$ (163)
Facility actions net (gain) loss, after-tax	<b>\$ (226)</b>	<b>\$ (216)</b>	\$ (162)	\$ (129)	\$ 163	\$ (137)

<sup>(a)</sup> Includes initial franchise fees in the U.S. of \$38 million in 1999 and \$39 million in both 1998 and 1997, and in International of \$7 million, \$5 million and \$2 million in 1999, 1998 and 1997, respectively. See Note 6.

<sup>(b)</sup> Impairment charges for 1999 and 1998 were recorded against the following asset categories:

	1999	1998
Property, plant and equipment	\$ 25	\$ 25
Intangible assets:		
Goodwill	1	4
Reacquired franchise rights	2	2
Total impairment	<b>\$ 28</b>	<b>\$ 31</b>

The following table displays a summary of the 1999 and 1998 activity related to all stores disposed of or held for disposal including the stores covered by the fourth quarter 1997 charge. We believe that the remaining carrying amounts are adequate to complete our disposal actions.

	Asset Valuation Allowances	Liabilities
Carrying amount at		
December 27, 1997	\$ 291	\$ 115
Amounts used	(148)	(36)
(Income) expense impact:		
New decisions	16	5
Estimate/decision changes	(33)	(8)
Other	1	1
Carrying amount at		
December 26, 1998	127	77
Amounts used	(100)	(36)
(Income) expense impact:		
New decisions	9	15
Estimate/decision changes	(20)	15
Other	4	—
Carrying amount at		
December 25, 1999	<b>\$ 20</b>	<b>\$ 71</b>

The carrying values of assets held for disposal (which include stores, our idle processing facility in Wichita, Kansas and a minority interest investment in a non-core business in 1998) by reportable operating segment as of December 25, 1999 and December 26, 1998 were as follows:

	1999	1998
U.S.	<b>\$ 40</b>	\$ 111
International	—	46
Total	<b>\$ 40</b>	\$ 157

We anticipate that all assets held for disposal at December 25, 1999 will be disposed of during 2000.

The results of operations for stores held for disposal or disposed of in 1999, 1998 and 1997 were as follows:

	1999	1998	1997
Stores held for disposal or disposed of in 1999:			
Sales	<b>\$ 734</b>	\$ 1,271	\$ 1,155
Restaurant margin	<b>76</b>	147	114
Stores disposed of in 1998 and 1997:			
Sales	<b>\$ —</b>	\$ 637	\$ 1,779
Restaurant margin	—	55	132

The loss of restaurant margin from the disposal of these stores is mitigated in income before taxes by the increased franchise fees for stores franchised, lower general and administrative expenses and reduced interest costs primarily resulting from

the reduction of debt by the after-tax cash proceeds from our franchising activities. The margin reported above includes the benefit from the suspension of depreciation and amortization of approximately \$9 million (\$8 million in the U.S. and \$1 million in International), \$32 million (\$24 million in the U.S. and \$8 million in International) and \$17 million in the U.S. in 1999, 1998 and 1997, respectively, on assets held for disposal.

#### Unusual Items

	1999	1998	1997
U.S.	<b>\$ 48</b>	\$ 11	\$ 85
International	<b>3</b>	4	99
Worldwide	<b>\$ 51</b>	\$ 15	\$ 184
After-tax	<b>\$ 29</b>	\$ 3	\$ 165

On January 31, 2000, AmeriServe Food Distribution, Inc. ("AmeriServe"), our primary U.S. distributor, filed for protection under Chapter 11 of the U.S. Bankruptcy Code. As a result of the bankruptcy, we wrote off approximately \$41 million of amounts owed to us by AmeriServe, including a \$15 million unsecured loan. See Note 22. In addition to the AmeriServe write-off, unusual items included the following in 1999: (1) an increase in the estimated costs of settlement of certain wage and hour litigation and associated defense and other costs incurred, as more fully described in Note 21; (2) favorable adjustments to our 1997 fourth quarter charge related to lower actual costs; (3) the writedown to estimated fair market value less cost to sell of our idle Wichita processing facility; (4) costs associated with the pending formation of international unconsolidated affiliates in Canada and Poland; (5) the impairment of enterprise-level goodwill in one of our international businesses; and (6) additional severance and other exit costs related to 1998 strategic decisions to streamline the infrastructure of our international businesses. The estimated fair market value of our idle Wichita processing facility was determined by using the estimated selling price based primarily on an evaluation by a qualified third party.

Unusual items in 1998 included: (1) an increase in the estimated costs of settlement of certain wage and hour litigation and associated defense and other costs incurred; (2) severance and other exit costs related to 1998 strategic decisions to streamline the infrastructure of our international businesses; (3) favorable adjustments to our 1997 fourth quarter charge related to anticipated actions that were not taken, primarily severance; (4) the writedown to estimated fair market value less costs to sell of our minority interest in a privately held non-core business, previously carried at cost; and (5) reversals of certain valuation allowances and lease liabilities relating to better-than-expected proceeds from the sale of properties and settlement of lease liabilities associated with properties retained upon the sale of a Non-core Business.

Unusual items in 1997 included: (1) \$120 million (\$125 million after-tax) of unusual asset impairment and severance

charges included in our 1997 fourth quarter charge described above; (2) charges to further reduce the carrying amounts of the Non-core Businesses held for disposal to estimated market value, less costs to sell; and (3) charges relating to the estimated costs of settlement of certain wage and hour litigation and the associated defense and other costs incurred.

## note 6 Franchise and License Fees

	1999	1998	1997
Initial fees, including renewal fees	\$ 71	\$ 67	\$ 86
Initial franchise fees included in refranchising gains	(45)	(44)	(41)
	26	23	45
Continuing fees	697	604	533
	<u>\$ 723</u>	<u>\$ 627</u>	<u>\$ 578</u>

Initial fees in 1997 include \$24 million of special KFC renewal fees.

## note 7 Other (Income) Expense

	1999	1998	1997
Equity income from investments in unconsolidated affiliates	\$ (19)	\$ (18)	\$ (8)
Foreign exchange net loss (gain)	3	(6)	16
	<u>\$ (16)</u>	<u>\$ (24)</u>	<u>\$ 8</u>

## note 8 Property, Plant and Equipment, net

	1999	1998
Land	\$ 572	\$ 707
Buildings and improvements	2,553	2,861
Capital leases, primarily buildings	102	124
Machinery and equipment	1,598	1,795
	4,825	5,487
Accumulated depreciation and amortization	(2,279)	(2,491)
Disposal valuation allowances	(15)	(100)
	<u>\$ 2,531</u>	<u>\$ 2,896</u>

## Intangible Assets, net

	1999	1998
Reacquired franchise rights	\$ 326	\$ 418
Trademarks and other identifiable intangibles	124	123
Goodwill	77	110
	<u>\$ 527</u>	<u>\$ 651</u>

In determining the above amounts, we have subtracted accumulated amortization of \$456 million for 1999 and \$473 million for 1998. We have also subtracted disposal valuation allowances of \$18 million for 1998.

## Accounts Payable and Other Current Liabilities

	1999	1998
Accounts payable	\$ 375	\$ 476
Accrued compensation and benefits	281	310
Other accrued taxes	85	98
Other current liabilities	344	399
	<u>\$ 1,085</u>	<u>\$ 1,283</u>

## Short-term Borrowings and Long-term Debt

	1999	1998
<b>Short-term Borrowings</b>		
Current maturities of long-term debt	\$ 47	\$ 46
Other	70	50
	<u>\$ 117</u>	<u>\$ 96</u>

### Long-term Debt

Senior, unsecured Term Loan Facility, due October 2002	\$ 774	\$ 926
Senior, unsecured Revolving Credit Facility, expires October 2002	955	1,815
Senior, Unsecured Notes, due May 2005 (7.45%)	352	352
Senior, Unsecured Notes, due May 2008 (7.65%)	251	251
Capital lease obligations (see Note 12)	97	117
Other, due through 2010 (6% – 11%)	9	21
	<u>2,438</u>	<u>3,482</u>
Less current maturities of long-term debt	(47)	(46)
	<u>\$ 2,391</u>	<u>\$ 3,436</u>

## note 9

## note 10

## note 11

Our primary bank credit agreement, as amended in March 1999 and February 2000, is currently comprised of a senior, unsecured Term Loan Facility and a \$3 billion senior unsecured Revolving Credit Facility (collectively referred to as the "Credit Facilities") which mature on October 2, 2002. Our U.S. Core Businesses have guaranteed the Credit Facilities. Amounts borrowed under the Term Loan Facility that we repay may not be reborrowed.

The Credit Facilities are subject to various covenants including financial covenants relating to maintenance of specific leverage and fixed charge coverage ratios. In addition, the Credit Facilities contain affirmative and negative covenants including, among other things, limitations on certain additional indebtedness including guarantees of indebtedness, cash dividends, aggregate non-U.S. investment and certain other transactions, as defined in the agreement. Since October 6, 1997, we have complied with all covenants governing the Credit Facilities. The Credit Facilities contain mandatory prepayment terms for certain capital market transactions and refranchising of restaurants as defined in the agreement.

The amended Credit Facilities, under which at amendment we voluntarily reduced our maximum borrowing under the Revolving Credit Facility by \$250 million, gives us additional flexibility with respect to acquisitions and other permitted investments and the repurchase of Common Stock or payment of dividends. We deferred the Credit Facilities amendment costs of approximately \$2.6 million. These costs are being amortized to interest expense over the remaining life of the Credit Facilities. Additionally, an insignificant amount of our previously deferred original Credit Facilities costs was written off in the second quarter of 1999 as a result of this amendment.

In addition, on February 25, 2000, we entered into an agreement to amend certain terms of our Credit Facilities. This amendment will give us additional flexibility with respect to permitted liens, restricted payments, other permitted investments and transferring assets to foreign subsidiaries. We deferred the Credit Facilities amendment costs of approximately \$2 million. These costs will be amortized into interest expense over the remaining life of the Credit Facilities.

Interest on amounts borrowed is payable at least quarterly at rates which are variable, based principally on the London Interbank Offered Rate ("LIBOR") plus a variable margin factor as defined in the credit agreement. At December 25, 1999 and December 26, 1998, the weighted average interest rate on our variable rate debt was 6.6% and 6.2%, respectively, which includes the effects of associated interest rate swaps and

collars. See Note 13 for a discussion of our use of derivative instruments, our management of inherent credit risk and fair value information related to debt and interest rate swaps.

At December 25, 1999, we had unused borrowings available under the Revolving Credit Facility of \$1.9 billion, net of outstanding letters of credit of \$152 million. Under the terms of the Revolving Credit Facility, we may borrow up to \$3.0 billion until maturity less outstanding letters of credit. We pay a facility fee on the Revolving Credit Facility. The variable margin factor and facility fee rate is determined based on the more favorable of our leverage ratio or third-party senior debt ratings as defined in the agreement. Facility fees accrued at December 25, 1999 and December 26, 1998 were \$1.1 million and \$1.7 million, respectively.

The initial borrowings of \$4.55 billion under the Credit Facilities at inception in October 1997 were primarily used to fund a \$4.5 billion Spin-off related payment to PepsiCo. We used the remaining \$50 million of the proceeds to provide cash collateral securing certain obligations previously secured by PepsiCo, to pay fees and expenses related to the Spin-off and the establishment of the Credit Facilities and for general corporate purposes.

In 1997, we filed with the Securities and Exchange Commission a shelf registration statement with respect to offerings of up to \$2 billion of senior unsecured debt. In May 1998, we issued \$350 million 7.45% Unsecured Notes due May 15, 2005 and \$250 million 7.65% Unsecured Notes due May 15, 2008 (collectively referred to as the "Notes"). We used the proceeds, net of issuance costs, to reduce existing borrowings under the Credit Facilities. We carry the Notes net of related discounts, which are being amortized over the life of the Notes. The unamortized discount for both issues was approximately \$1.0 million at December 25, 1999 and \$1.1 million at December 26, 1998. The amortization during 1999 and 1998 was not significant. Interest is payable May 15 and November 15 and commenced on November 15, 1998. In anticipation of the issuance of the Notes, we entered into \$600 million in treasury locks (the "Locks") to reduce interest rate sensitivity in pricing of the Notes. Concurrent with the issuance of the Notes, the Locks were settled at a gain, which is being amortized to interest expense over the life of the Notes. The effective interest rate on the 2005 Notes and the 2008 Notes is 7.6% and 7.8%, respectively.

Interest expense on the short-term borrowings and long-term debt was \$218 million, \$291 million and \$290 million in 1999, 1998 and 1997, respectively. Interest expense in 1997 included the PepsiCo interest allocation of \$188 million.

## note 12

### Leases

The annual maturities of long-term debt through 2004 and thereafter, excluding capital lease obligations, are 2000 – \$37 million; 2001 – \$3 million; 2002 – \$1.7 billion; 2003 – \$.7 million; 2004 – \$352 million and \$252 million thereafter.

We have non-cancelable commitments under both capital and long-term operating leases, primarily for our restaurants. Capital and operating lease commitments expire at various dates through 2087 and, in many cases, provide for rent escalations and renewal options. Most leases require us to pay related executory costs, which include property taxes, maintenance and insurance.

Future minimum commitments and sublease receivables under non-cancelable leases are set forth below:

	Commitments		Sublease Receivables	
	Capital	Operating	Direct Financing	Operating
2000	\$ 17	\$ 190	\$ 2	\$ 13
2001	16	160	2	12
2002	15	142	2	10
2003	15	123	1	9
2004	13	109	1	7
Thereafter	112	617	11	41
	<u>\$ 188</u>	<u>\$ 1,341</u>	<u>\$ 19</u>	<u>\$ 92</u>

At year-end 1999, the present value of minimum payments under capital leases was \$97 million, after deducting \$91 million representing imputed interest.

The details of rental expense and income are set forth below:

	1999	1998	1997
Rental expense			
Minimum	<b>\$ 263</b>	\$ 308	\$ 341
Contingent	<b>28</b>	25	30
	<u><b>\$ 291</b></u>	<u>\$ 333</u>	<u>\$ 371</u>
Minimum rental income	<u><b>\$ 8</b></u>	<u>\$ 18</u>	<u>\$ 19</u>

Contingent rentals are based on sales levels in excess of stipulated amounts contained in the lease agreements.

## note 13

### Financial Instruments

**Derivative Instruments.** Our policy prohibits the use of derivative instruments for trading purposes, and we have procedures in place to monitor and control their use. Our use of derivative instruments has included interest rate swaps, collars and forward rate agreements. In addition, we utilize on a limited basis foreign currency forward contracts and commodity futures contracts. Our interest rate and foreign currency derivative contracts are entered

into with financial institutions and our commodity futures contracts are traded on national exchanges.

We enter into interest rate swaps, collars, and forward rate agreements with the objective of reducing our exposure to interest rate risk. We entered into interest rate swap and forward rate agreements to convert a portion of our variable rate bank debt to fixed rate. Reset dates and the floating rate indices on the swaps and forward rate agreements match those of the underlying bank debt. Accordingly, any market risk or opportunity associated with the swaps and forward rate agreements is offset by the opposite market impact on the related debt. At December 25, 1999 and December 26, 1998, we had outstanding interest rate swaps with notional amounts of \$800 million and \$1.2 billion, respectively. Under the contracts, we agree with other parties to exchange, at specified intervals, the difference between variable rate and fixed rate amounts calculated on a notional principal amount. At both December 25, 1999 and December 26, 1998, our average pay rate was 5.9%. Our payables under the related swaps aggregated \$0.4 million and \$1.6 million at December 25, 1999 and December 26, 1998, respectively. The swaps mature at various dates through 2001.

During 1999 and 1998, we entered into interest rate collars to reduce interest rate sensitivity on a portion of our variable rate bank debt. Interest rate collars effectively lock in a range of interest rates by establishing a cap and floor. Reset dates and the floating index on the collars match those of the underlying bank debt. If interest rates remain within the collared cap and floor, no payments are made. If rates rise above the cap level, we receive a payment. If rates fall below the floor level, we make a payment. At December 25, 1999, we did not have any outstanding interest rate collars. At December 26, 1998, we had outstanding interest rate collars of \$700 million, and our average pay rate was 5.4%. Under the contracts, we agreed with other parties to exchange, as required, the difference between the effective LIBOR rate and the cap or floor rate if the effective LIBOR rates fall outside the collared range.

We enter into foreign currency exchange contracts with the objective of reducing our exposure to earnings and cash flow volatility associated with foreign currency fluctuations. In 1999, we entered into forward contracts to hedge our exposure related to certain foreign currency receivables. The notional amount and maturity dates of the contracts match those of the underlying receivables. Accordingly, any market risk or opportunity associated with these contracts is offset by the opposite market impact on the related receivables.

Our credit risk from the interest rate swap, collar and forward rate agreements and foreign exchange contracts is dependent both on the movement in interest and currency rates and possibility of non-payment by counterparties. We mitigate credit risk by entering into these agreements with high-quality

counterparties, netting swap and forward rate payments within contracts and limiting payments associated with the collars to differences outside the collared range.

Open commodity future contracts and deferred gains and losses at year-end 1999 and 1998, as well as gains and losses recognized as part of cost of sales in 1999, 1998 and 1997, were not significant.

**Fair Value.** Excluding the financial instruments included in the table below, the carrying amounts of our other financial instruments approximate fair value.

The carrying amounts and fair values of TRICON's financial instruments are as follows:

	1999		1998	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Debt				
Short-term borrowings and long-term debt, excluding capital leases	\$ 2,411	\$ 2,377	\$ 3,415	\$ 3,431
Debt-related derivative instruments				
Open contracts in an (asset) liability position	—	(3)	2	17
Debt, excluding capital leases	\$ 2,411	\$ 2,374	\$ 3,417	\$ 3,448
Guarantees	\$ —	\$ 27	\$ —	\$ 24

We estimated the fair value of debt, debt-related derivative instruments and guarantees using market quotes and calculations based on market rates. See Note 2 for recently issued accounting pronouncements relating to financial instruments.

## note 14

### Pension Plans and Postretirement Medical Benefits

We sponsor noncontributory defined benefit pension plans covering substantially all full-time U.S.

salaried employees and certain hourly employees and non-contributory defined benefit pension plans covering certain international employees. In addition, we provide postretirement health care benefits to eligible retired employees and their dependents, principally in the U.S. Salaried retirees who have 10 years of service and attain age 55 are eligible to participate in the postretirement benefit plans; since 1994, these plans have included retiree cost sharing provisions. We base benefits generally on years of service and compensation or stated amounts for each year of service.

The components of net periodic benefit cost are set forth below:

	Pension Benefits		
	1999	1998	1997
Service cost	\$ 20	\$ 21	\$ 18
Interest cost	22	20	17
Expected return on plan assets	(24)	(21)	(19)
Amortization of prior service cost	1	—	—
Amortization of transition (asset) obligation	—	(2)	(4)
Recognized actuarial loss	—	2	1
Net periodic benefit cost	\$ 19	\$ 20	\$ 13
Additional loss recognized due to:			
Curtailement	\$ 4	\$ —	\$ —
Special termination benefits	—	3	2
	Postretirement Medical Benefits		
	1999	1998	1997
Service cost	\$ 2	\$ 2	\$ 2
Interest cost	3	3	2
Amortization of prior service cost	(2)	(2)	(2)
Net periodic benefit cost	\$ 3	\$ 3	\$ 2
Additional (gain) loss recognized due to:			
Curtailement	\$ (1)	\$ (3)	\$ —
Special termination benefits	—	1	—

Prior service costs are amortized on a straight-line basis over the average remaining service period of employees expected to receive benefits.



	Pension Benefits		Postretirement Medical Benefits	
	1999	1998	1999	1998
<b>Change in benefit obligation</b>				
Benefit obligation at beginning of year	\$ 315	\$ 286	\$ 38	\$ 38
Service cost	20	21	2	2
Interest cost	22	20	3	3
Plan amendments	6	—	—	—
Curtailment gain	(5)	—	(1)	(3)
Special termination benefits	—	1	—	1
Benefits and expenses paid	(24)	(13)	(2)	(2)
Actuarial (gain) loss	(19)	—	5	(1)
Benefit obligation at end of year	<u>315</u>	<u>315</u>	<u>45</u>	<u>38</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	259	270	—	—
Actual return on plan assets	51	1	—	—
Employer contributions	5	1	—	—
Benefits paid	(23)	(11)	—	—
Administrative expenses	(2)	(2)	—	—
Fair value of plan assets at end of year	<u>290</u>	<u>259</u>	<u>—</u>	<u>—</u>
<b>Reconciliation of funded status</b>				
Funded status	(25)	(56)	(45)	(38)
Unrecognized actuarial (gain) loss	(35)	11	3	(2)
Unrecognized prior service costs	7	2	(2)	(4)
Net amount recognized at year-end	<u>\$ (53)</u>	<u>\$ (43)</u>	<u>\$ (44)</u>	<u>\$ (44)</u>
<b>Amounts recognized in the statement of financial position consist of:</b>				
Accrued benefit liability	\$ (53)	\$ (46)	\$ (44)	\$ (44)
Accumulated other comprehensive income	—	3	—	—
Net amount recognized at year-end	<u>\$ (53)</u>	<u>\$ (43)</u>	<u>\$ (44)</u>	<u>\$ (44)</u>
Other comprehensive income attributable to change in additional minimum liability recognition	\$ (3)	\$ 3		
<b>Additional year-end information for pension plans with benefit obligations in excess of plan assets:</b>				
Benefit obligation	\$ 315	\$ 315		
Fair value of plan assets	290	259		
<b>Additional year-end information for pension plans with accumulated benefit obligations in excess of plan assets:</b>				
Projected benefit obligation	\$ 31	\$ 46		
Accumulated benefit obligation	12	29		
Fair value of plan assets	—	15		

The assumptions used to compute the information above are set forth below:

	Pension Benefits		Postretirement Medical Benefits	
	1999	1998	1999	1998
Discount rate — projected benefit obligation	7.8%	6.8%	7.6%	7.0%
Expected long-term rate of return on plan assets	10.0%	10.0%	—	—
Rate of compensation increase	5.5%	4.5%	5.5%	4.5%

We have assumed the annual increase in cost of postretirement medical benefits was 6.5% in 1999 and will be 6.0% in 2000. We are assuming the rate will decrease 0.5% to an ultimate rate of 5.5% in the year 2001 and remain at that level thereafter. There is a cap on our medical liability for certain retirees, which is expected to be reached between the years 2001–2004; at that point our cost for a retiree will not increase.

Assumed health care cost trend rates have a significant effect on the amounts reported for our postretirement health care plans. The effects of a one percentage point increase or decrease in the assumed health care cost trend rates on post-retirement benefit obligations are \$2.3 million and

\$2.5 million, respectively. The effects of a one percentage point increase or decrease in the assumed health care cost trend rates on total service and interest cost components are not significant.

At the end of 1998, we changed the method for determining our pension and postretirement medical benefit discount rate to better reflect the assumed investment strategies we would most likely use to invest any short-term cash surpluses. See Note 5.

## note 15

### Employee Stock-Based Compensation

At year-end 1999, we had four stock option plans in effect: the TRICON Global Restaurants, Inc. Long-Term Incentive Plan ("1999 LTIP"), the 1997 Long-Term Incentive Plan ("1997 LTIP"), the TRICON Global Restaurants, Inc. Restaurant General Manager Stock Option Plan ("YUMBUCKS") and the TRICON Global Restaurants, Inc. SharePower Plan ("SharePower").

We may grant options to purchase up to 7.6 million and 22.5 million shares of stock under the 1999 LTIP and 1997 LTIP, respectively, at a price equal to or greater than the average market price of the stock on the date of grant. New options we grant can have varying vesting provisions and exercise periods. Previously granted options vest in periods ranging from immediate to 2006 and expire ten to fourteen years after grant. Potential awards to employees and non-employee directors under the 1999 LTIP include stock options, incentive stock options, stock appreciation rights, restricted stock, stock units, restricted stock units, performance shares and performance units. Potential awards to employees and non-employee directors under the 1997 LTIP include stock options, incentive stock options, stock appreciation rights, restricted stock and performance restricted stock units. We have issued only stock options and performance restricted stock units under the 1997 LTIP and have yet to grant any awards under the 1999 LTIP.

We may grant options to purchase up to 7.5 million shares of stock under YUMBUCKS at a price equal to or greater than the average market price of the stock on the date of grant. YUMBUCKS options granted have a four year vesting period and expire ten years after grant. We do not anticipate that any further SharePower grants will be made although options previously granted could be outstanding through 2006.

At the Spin-off Date, we converted certain of the unvested options to purchase PepsiCo stock that were held by our

employees to TRICON stock options under either the 1997 LTIP or the SharePower. We converted the options at amounts and exercise prices that maintained the amount of unrealized stock appreciation that existed immediately prior to the Spin-off. The vesting dates and exercise periods of the options were not affected by the conversion. Based on their original PepsiCo grant date, our converted options vest in periods ranging from one to ten years and expire ten to fifteen years after grant.

Had we determined compensation cost for all TRICON option grants to employees and non-employee directors consistent with SFAS 123, our net income (loss) and basic and diluted earnings per Common Share would have been reduced (increased) to the pro forma amounts indicated below:

	1999	1998	1997
Net Income (Loss)			
As reported	<b>\$ 627</b>	\$ 445	\$ (111)
Pro forma	<b>597</b>	425	(112)
Basic Earnings			
per Common Share			
As reported	<b>\$ 4.09</b>	\$ 2.92	
Pro forma	<b>3.90</b>	2.79	
Diluted Earnings			
per Common Share			
As reported	<b>\$ 3.92</b>	\$ 2.84	
Pro forma	<b>3.73</b>	2.72	

SFAS 123 pro forma loss per Common Share data for 1997 is not meaningful as we were not an independent, publicly owned company with a capital structure of our own for the entire year.

The effects of applying SFAS 123 in the pro forma disclosures are not likely to be representative of the effects on pro forma net income for future years because variables such as the number of option grants, exercises and stock price volatility included in these disclosures may not be indicative of future activity.

We estimated the fair value of each option grant made during 1999, 1998 and 1997 subsequent to the Spin-off as of the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	1999	1998	1997
Risk-free interest rate	<b>4.9%</b>	5.5%	5.8%
Expected life (years)	<b>6.0</b>	6.0	6.6
Expected volatility	<b>29.7%</b>	28.8%	27.5%
Expected dividend yield	<b>0.0%</b>	0.0%	0.0%

A summary of the status of all options granted to employees and non-employee directors as of December 25, 1999, December 26, 1998 and December 27, 1997, and changes during the years then ended is presented below (tabular options in thousands):

	<b>December 25, 1999</b>		December 26, 1998		December 27, 1997	
	<b>Options</b>	<b>Wtd. Avg. Exercise Price</b>	Options	Wtd. Avg. Exercise Price	Options	Wtd. Avg. Exercise Price
Outstanding at beginning of year	<b>22,699</b>	<b>\$ 26.16</b>	15,245	\$ 23.03	—	\$ —
Conversion of PepsiCo options	—	—	—	—	13,951	21.48
Granted at price equal to average market price	<b>5,709</b>	<b>49.07</b>	12,084	29.37	872	32.95
Granted at price greater than average market price	—	—	—	—	1,334	31.63
Exercised	<b>(1,273)</b>	<b>19.51</b>	(962)	18.93	(112)	24.80
Forfeited	<b>(2,969)</b>	<b>31.94</b>	(3,668)	25.60	(800)	20.84
Outstanding at end of year	<b>24,166</b>	<b>\$ 31.18</b>	22,699	\$ 26.16	15,245	\$ 23.03
Exercisable at end of year	<b>3,665</b>	<b>\$ 22.44</b>	3,006	\$ 21.16	1,251	\$ 23.84
Weighted average of fair value of options granted	<b>\$ 19.20</b>		<b>\$ 11.65</b>		<b>\$ 13.37</b>	

The following table summarizes information about stock options outstanding and exercisable at December 25, 1999 (tabular options in thousands):

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
\$ 0.01–17.80	1,932	4.91	\$ 15.22	1,582	\$ 14.67
22.02–29.40	11,874	7.11	25.60	1,279	26.11
30.41–34.47	4,642	8.26	31.77	773	31.46
35.13–46.97	5,078	9.18	44.50	30	42.05
72.75	640	9.27	72.75	1	72.75
	<u>24,166</u>			<u>3,665</u>	

In November 1997, we granted two awards of performance restricted stock units of TRICON's Common Stock to our CEO. The awards were made under the 1997 LTIP and may be paid in Common Stock of TRICON or cash at the discretion of the Board of Directors. Payments of the awards of \$2.7 million and \$3.6 million are contingent upon the CEO's continued employment through January 25, 2001 and 2006, respectively, and our attainment of certain pre-established earnings thresholds, as defined. We expense these awards over the performance periods stipulated above; the amount included in earnings for both 1999 and 1998 was \$1.3 million and the amount for 1997 was insignificant.

During 1999, modifications of certain 1997 LTIP and Share-Power options held by terminated employees were made.

These modifications resulted in additional compensation expense of \$5.0 million in 1999 with a corresponding increase in our Common Stock account.

## note 16

### Other Compensation and Benefit Programs

We sponsor two deferred compensation benefit programs, the Executive Income Deferral Program and the Restaurant Deferred Compensation Plan (the "EID Plan"

and the "RDC Plan," respectively) for eligible employees and non-employee directors. These plans allow participants to defer receipt of all or a portion of their annual salary and incentive compensation. As defined by the benefit programs, we credit the amounts deferred with earnings based on certain investment options selected by the participants.

In late 1997, we introduced a new investment option for the EID Plan allowing participants to defer certain incentive compensation into the purchase of phantom shares of our Common Stock at a 25% discount from the average market price at the date of deferral (the "Discount Stock Account"). Participants bear the risk of forfeiture of both the discount and any amounts deferred if they voluntarily separate from employment during the two year vesting period. We expense the intrinsic value of the discount over the vesting period.

We are phasing in certain program changes to the EID Plan during 1999 and 2000. These changes include limiting investment options, primarily to phantom shares of our Common Stock, and requiring the distribution of investments in the TRICON Common Stock investment options to be paid in shares of our Common Stock. Due to these changes, in 1998 we agreed to credit to their accounts a one time premium on

January 1, 2000 to participants with an account balance as of December 31, 1999. The premium credited totaled approximately \$3 million and was equal to 10% of the participant's account balance as of December 31, 1999, excluding investments in the discounted TRICON Common Stock investment option discussed above and 1999 deferrals.

Prior to January 1, 1999, we recognized as compensation expense all investment appreciation or depreciation within the EID Plan. Subsequent to January 1, 1999, we no longer recognize as compensation expense the appreciation or depreciation, if any, attributable to investments in the Discount Stock Account since investments in the Discount Stock Account can only be settled in shares of our Common Stock. For 1998, we expensed \$9 million related to appreciation attributable to investments in the Discount Stock Account. We also reduced our liabilities by \$21 million related to investments in the Discount Stock Account and increased the Common Stock Account by the same amount at January 1, 1999.

For periods subsequent to January 1, 2000, we will no longer recognize as compensation expense the appreciation or depreciation, if any, attributable to investments in any phantom shares of our Common Stock in the EID Plan since these investments can only be settled in shares of our Common Stock. For 1999, we recorded a benefit of \$3 million related to depreciation of investments impacted by the January 2000 plan amendment.

Our obligations under the EID Plan as of the end of 1999 and 1998 were \$50 million and \$59 million, respectively. We recognized compensation expense of \$6 million in 1999 and \$20 million in 1998, including the estimated premium payment, and \$9 million in 1997 for the EID Plan.

Investment options in the RDC Plan consist of phantom shares of various mutual funds and TRICON Common Stock. During 1998, RDC participants also became eligible to purchase phantom shares of our Common Stock under YUMSOP as defined below. We recognize compensation expense for the appreciation or depreciation, if any, attributable to all investments in the RDC Plan as well as for our matching contribution. Our obligations under the RDC program as of the end of 1999 and 1998 were \$6 million and \$7 million, respectively. We recognized compensation expense of \$1 million in 1999, 1998 and 1997 for the RDC Plan.

We sponsor a contributory plan to provide retirement benefits under the provision of Section 401(k) of the Internal Revenue Code ("401(k) Plan") for eligible full-time U.S. salaried and certain hourly employees. Participants may elect to contribute up to 15% of their eligible compensation on a pre-tax basis. We are not required to make contributions to the Plan. In 1998, a Stock Ownership Program ("YUMSOP") was added to the TRICON Common Stock investment option. Under YUMSOP, we

make a partial discretionary matching contribution equal to a predetermined percentage of each participant's contribution to the TRICON Common Stock Fund. We determine our percentage match at the beginning of each year based on the immediate prior year performance of our Core Businesses. We recognized as compensation expense our total matching contribution of \$4 million and \$1 million in 1999 and 1998, respectively.

#### Shareholders' Rights Plan

On July 21, 1998, our Board of Directors declared a dividend distribution of one right for each share of Common Stock outstanding as of August 3, 1998 (the "Record Date"). Each right initially entitles the registered holder to purchase a unit consisting of one one-thousandth of a share (a "Unit") of Series A Junior Participating Preferred Stock, without par value, at a purchase price of \$130 per Unit, subject to adjustment. The rights, which do not have voting rights, will become exercisable for our Common Stock ten business days following a public announcement that a person or group has acquired, or has commenced or intends to commence a tender offer for, 15% or more, or 20% or more if such person or group owned 10% or more on the adoption date of this plan, of our Common Stock. In the event the rights become exercisable for Common Stock, each right will entitle its holder (other than the Acquiring Person as defined in the Agreement) to purchase, at the right's then-current exercise price, TRICON Common Stock having a value of twice the exercise price of the right. In the event the rights become exercisable for Common Stock and thereafter we are acquired in a merger or other business combination, each right will entitle its holder to purchase, at the right's then-current exercise price, common stock of the acquiring company having a value of twice the exercise price of the right.

We can redeem the rights in their entirety, prior to becoming exercisable, at \$0.01 per right under certain specified conditions. The rights expire on July 21, 2008, unless we extend that date or we have earlier redeemed or exchanged the rights as provided in the Agreement.

This description of the rights is qualified in its entirety by reference to the Rights Agreement between TRICON and BankBoston, N.A., as Rights Agent, dated as of July 21, 1998 (including the exhibits thereto).

#### Share Repurchases

On September 23, 1999, we announced that our Board of Directors authorized the repurchase of up to \$350 million of our outstanding Common Stock. As of December 25, 1999, we have purchased 3.3 million shares for \$134 million at an average price per share of \$40.

note 17

note 18

## note 19

### Income Taxes

The details of our income tax provision are set forth below:

	1999	1998	1997
Current:			
Federal	\$ 342	\$ 231	\$ 106
Foreign	46	55	77
State	39	22	31
	<u>427</u>	<u>308</u>	<u>214</u>
Deferred:			
Federal	(18)	(2)	(66)
Foreign	17	10	(59)
State	(15)	(5)	(13)
	<u>(16)</u>	<u>3</u>	<u>(138)</u>
	<u>\$ 411</u>	<u>\$ 311</u>	<u>\$ 76</u>

The 1998 and 1997 deferred state tax benefits included net operating loss carryovers of \$1 million that were utilized in 1999. Taxes payable were reduced by \$14 million, \$3 million and less than \$1 million in 1999, 1998 and 1997, respectively, as a result of stock option exercises. In addition, goodwill and other intangibles were reduced by \$22 million in 1999 as a result of the settlement of a disputed claim with the Internal Revenue Service relating to the deductibility of the amortization of reacquired franchise rights and other intangibles. Finally, the valuation allowance as of the beginning of 1999 that related to deferred tax assets in certain foreign countries was reduced by \$13 million as a result of establishing a pattern of profitability.

Our U.S. and foreign income (loss) before income taxes are set forth below:

	1999	1998	1997
U.S.	\$ 782	\$ 542	\$ 13
Foreign	256	214	(48)
	<u>\$1,038</u>	<u>\$ 756</u>	<u>\$ (35)</u>

Our 1999 and 1998 reconciliation of income taxes calculated at the U.S. federal tax statutory rate to our effective tax rate is set forth below:

	1999	1998
U.S. federal statutory rate	35.0%	35.0%
State income tax, net of federal tax benefit	3.0	2.7
Foreign and U.S. tax effects attributable to foreign operations	1.7	4.4
Effect of unusual items	(0.5)	(0.6)
Adjustments relating to prior years	0.2	(2.1)
Other, net	0.1	1.6
Effective income tax rate	<u>39.5%</u>	<u>41.1%</u>

In 1997, our reconciliation of income taxes calculated at the U.S. federal tax statutory rate was computed on a dollar basis, as a reconciliation on a percentage basis is not meaningful due to our pre-tax loss.

	1997
Income taxes computed at the U.S. federal statutory rate of 35%	\$ (12)
State income tax, net of federal tax benefit	18
Foreign and U.S. tax effects attributable to foreign operations	24
Effect of unusual items	79
Adjustments relating to prior years	3
Other, net	(36)
Income tax provision	<u>\$ 76</u>
Effective income tax rate	<u>(217.1%)</u>

The details of our 1999 and 1998 deferred tax liabilities (assets) are set forth below:

	1999	1998
Intangible assets and property, plant and equipment	\$ 170	\$ 243
Other	25	8
Gross deferred tax liabilities	<u>\$ 195</u>	<u>\$ 251</u>
Net operating loss and tax credit carryforwards	\$ (140)	\$ (107)
Employee benefits	(91)	(58)
Self-insured casualty claims	(38)	(46)
Stores held for disposal	(12)	(62)
Various liabilities and other	(178)	(183)
Gross deferred tax assets	(459)	(456)
Deferred tax assets		
valuation allowance	173	133
Net deferred tax assets	(286)	(323)
Net deferred tax (asset) liability	<u>\$ (91)</u>	<u>\$ (72)</u>

Included in:		
Deferred income tax assets	\$ (59)	\$ (137)
Other assets	(51)	—
Accounts payable and other current liabilities	12	—
Deferred income taxes	7	65
	<u>\$ (91)</u>	<u>\$ (72)</u>

Our valuation allowance related to deferred tax assets increased by \$40 million in 1999 primarily due to additions related to current and prior year operating losses and temporary differences in a number of foreign and state jurisdictions.

A determination of the unrecognized deferred tax liability for temporary differences related to our investments in foreign subsidiaries and investments in foreign unconsolidated affiliates that are essentially permanent in duration is not practicable.

We have available net operating loss and tax credit carryforwards totaling \$837 million at year-end 1999 to reduce future tax of TRICON and certain subsidiaries. The carryforwards are related to a number of foreign and state jurisdictions. Of these carryforwards, \$51 million expire in 2000 and \$725 million expire at various times between 2001 and 2019. The remaining \$61 million of carryforwards do not expire.

## note 20 Reportable Operating Segments

We are engaged principally in developing, operating, franchising or licensing the worldwide KFC, Pizza Hut and Taco Bell concepts. We also previously operated the Non-core Businesses, all of which were sold in 1997 prior to the Spin-off.

KFC, Pizza Hut and Taco Bell operate throughout the U.S. and 84, 87 and 14 countries and territories outside the U.S., respectively. Principal international markets include Australia, Canada, China, Japan and the U.K. At year-end 1999, we had 10 investments in unconsolidated affiliates outside the U.S. which operate KFC and/or Pizza Hut restaurants, the most significant of which are operating in Japan and the U.K.

As disclosed in Note 2, we identify our operating segments based on management responsibility within the U.S. and International. For purposes of applying SFAS 131, we consider our three U.S. Core Business operating segments to be similar and therefore have aggregated them into a single reportable operating segment. Other than the U.S., no individual country represented 10% or more of our total revenues, profits or assets.

	Revenues		
	1999	1998	1997
United States	\$ 5,748	\$ 6,439	\$ 7,370 <sup>(a)</sup>
International	2,074	2,040	2,320
	<b>\$ 7,822</b>	<b>\$ 8,479</b>	<b>\$ 9,690</b>
	Operating Profit; Interest Expense, Net; and Income Before Income Taxes		
	1999	1998	1997
United States	\$ 828	\$ 740	\$ 603 <sup>(a)</sup>
International <sup>(b)</sup>	265	191	172
Foreign exchange gain (loss)	(3)	6	(16)
Unallocated and corporate expenses	(180)	(169)	(87) <sup>(c)</sup>
Facility actions net gain (loss) <sup>(d)</sup>	381	275	(247)
Unusual items <sup>(d)</sup>	(51)	(15)	(184)
Total Operating Profit	1,240	1,028	241
Interest expense, net	202	272	276 <sup>(c)</sup>
Income (loss) before income taxes	<b>\$ 1,038</b>	<b>\$ 756</b>	<b>\$ (35)</b>

	Depreciation and Amortization		
	1999	1998	1997
United States	\$ 266	\$ 300	\$ 388
International	110	104	143
Corporate	10	13	5
	<b>\$ 386</b>	<b>\$ 417</b>	<b>\$ 536</b>

	Capital Spending		
	1999	1998	1997
United States	\$ 315	\$ 305	\$ 381
International	139	150	157
Corporate	16	5	3
	<b>\$ 470</b>	<b>\$ 460</b>	<b>\$ 541</b>

	Identifiable Assets	
	1999	1998
United States	\$ 2,478	\$ 2,942
International <sup>(e)</sup>	1,367	1,447
Corporate <sup>(f)</sup>	116	142
	<b>\$ 3,961</b>	<b>\$ 4,531</b>

	Long-Lived Assets	
	1999	1998
United States <sup>(g)</sup>	\$ 2,143	\$ 2,616
International <sup>(g)</sup>	874	895
Corporate <sup>(g)</sup>	41	36
	<b>\$ 3,058</b>	<b>\$ 3,547</b>

(a) Results from the United States in 1997 included the Non-core Businesses disposed of in 1997. Excluding unusual disposal charges, the Non-core Businesses contributed the following:

	1997
Revenues	\$ 268
Operating profit	13
Interest expense, net	3
Income before income taxes	10

(b) Includes equity income of unconsolidated affiliates of \$22 million, \$18 million and \$8 million in 1999, 1998 and 1997, respectively.

(c) Includes amounts allocated by PepsiCo prior to the Spin-off of \$37 million in 1997 related to general and administrative expenses and \$188 million in 1997 related to interest expense.

(d) See Note 5 for a discussion by reportable operating segment of facility actions net gain (loss) and unusual items.

(e) Includes investment in unconsolidated affiliates of \$170 million and \$159 million for 1999 and 1998, respectively.

(f) Includes restricted cash, capitalized debt issuance costs, advances to our voluntary employees' beneficiary association trust, leasehold improvements in certain of our office facilities and non-core assets held for sale.

(g) Includes PP&E, net and Intangible Assets, net.

See Note 5 for additional operating segment disclosures related to impairment, suspension of depreciation and amortization and the carrying amount of assets held for disposal.

## note 21

### Commitments and Contingencies

The 1997 financial data we reported above is materially consistent with restaurant segment information previously reported by PepsiCo. We made adjustments to these amounts primarily to remove the impact of the restaurant distribution business previously included by PepsiCo in its restaurant segment, and to include the investment in and our equity income of unconsolidated affiliates within the international segment. We made this change to align our reporting with the way we internally review and make decisions regarding our international business.

**Contingent Liabilities.** We were directly or indirectly contingently liable in the amounts of \$386 million and \$327 million at year-end 1999 and 1998, respectively, for certain lease assignments and guarantees. In connection with these contingent liabilities, after the Spin-off Date, we were required to maintain cash collateral balances at certain institutions of approximately \$30 million, which is included in Other Assets in the accompanying Consolidated Balance Sheet. At year-end 1999, \$311 million represented contingent liabilities to lessors as a result of assigning our interest in and obligations under real estate leases as a condition to the refranchising of Company restaurants. The \$311 million represented the present value of the minimum payments of the assigned leases, excluding any renewal option periods, discounted at our pre-tax cost of debt. On a nominal basis, the contingent liability resulting from the assigned leases was \$485 million. The balance of the contingent liabilities primarily reflected guarantees to support financial arrangements of certain unconsolidated affiliates and other restaurant franchisees.

**Casualty Loss Programs and Estimates.** To mitigate the cost of our exposures for certain casualty losses as defined in Note 5, we make annual decisions to either retain the risks of loss up to certain per occurrence or maximum loss limits negotiated with our insurance carriers or to fully insure those risks. Since the Spin-off, we have elected to retain the risks subject to insured limitations. In addition, we also purchased insurance in 1998 to limit the cost of our retained risks for the years 1994 to 1996.

Effective August 16, 1999, we made changes to our U.S. and portions of our International property and casualty loss programs which we believe will reduce our annual property and casualty costs. Under the new program, we bundled our risks for casualty losses, property losses and various other insurable risks into one risk pool with a single large retention limit. Based on our historical casualty loss experience over the past ten

years, we believe that the combination of the annual risk of loss that we retained and the lower insurance premium costs under the new program should be less than the average total costs incurred under the old program. However, since all of these risks have been pooled and there are no per occurrence limits for individual claims, it is possible that we may experience increased volatility in property and casualty losses on a quarter to quarter basis. This would occur if an individual large loss is incurred either early in a program year or when the latest actuarial projection of losses for a program year is significantly below our aggregate loss retention. A large loss is defined as a loss in excess of \$2 million which was our predominate per occurrence casualty loss limit under our previous insurance program.

Under both our old and new programs, we have determined our retained liabilities for casualty losses, including reported and incurred but not reported claims, based on information provided by our independent actuary. Effective August 16, 1999, property losses are also included in our actuary's valuation. Prior to that date, property losses were based on our internal estimates.

We have our actuary perform valuations two times a year. However, given the complexities of the Spin-off, we had only one 1998 valuation, based on information through June 30, 1998, which we received and recognized in the fourth quarter of that year. In the first and fourth quarters of 1999, we received a valuation from the actuary based on information through December 31, 1998 and June 30, 1999, respectively. As a result, we have a timing difference in our actuarial adjustments, from recognizing the entire 1998 adjustment in the fourth quarter of 1998 to recognizing adjustment in both the first quarter and fourth quarter of 1999. We expect that, beginning in 2000, valuations will be received and required adjustments will be made in the second and fourth quarters of each year.

We have recorded favorable adjustments to our casualty loss reserves of \$30 million in 1999 (\$21 million in the first quarter and \$9 million in the fourth quarter), \$23 million in 1998 and \$18 million in 1997 primarily as a result of our independent actuary's changes in its estimated losses. The changes were related to previously recorded casualty loss estimates determined by our independent actuary for both the current and prior years in which we retained some risk of loss. The 1999 adjustments resulted primarily from improved loss trends related to our 1998 casualty losses across all three of our U.S. operating companies. We believe the favorable adjustments are a direct result of our recent investments in safety and security

programs to better manage risk at the store level. In addition, the favorable insurance adjustments in 1998 included the benefit of the insurance transaction discussed above.

We will continue to make adjustments both based on our actuary's periodic valuations as well as whenever there are significant changes in the expected costs of settling large claims not contemplated by the actuary. Due to the inherent volatility of our actuarially determined casualty loss estimates, it is reasonably possible that we will experience changes in estimated losses which could be material to our growth in net income in 2000. We believe that, since we record our reserves for casualty losses at a 75% confidence level, we have mitigated the negative impact of adverse development and/or volatility. At December 25, 1999, our reserves for casualty losses were \$142 million, compared to \$154 million at year-end 1998.

**Change of Control Severance Agreements.** In July 1998, we entered into severance agreements with certain key executives which are triggered by a termination, under certain conditions, of the executive following a change in control of the Company, as defined in the agreements. Once triggered, the affected executives would receive twice the amount of their annual base salary and their annual incentive in a lump sum, outplacement services and a tax gross-up for any excise taxes. The agreements expire December 31, 2000. Since the timing of any payments under these agreements cannot be anticipated, the amounts are not estimable. However, these payments, if made, could be substantial. In connection with the execution of these agreements, the Compensation Committee of our Board of Directors has authorized amendment of the deferred and incentive compensation plans and, following a change in control, an establishment of rabbi trusts which will be used to provide payouts under these deferred compensation plans following a change in control.

**Wage and Hour Litigation.** We are subject to various claims and contingencies related to lawsuits, taxes, environmental and other matters arising out of the normal course of business. Like some other large retail employers, Pizza Hut and Taco Bell recently have been faced in a few states with allegations of purported class-wide wage and hour violations.

On May 11, 1998, a purported class action lawsuit against Pizza Hut, Inc., and one of its franchisees, PacPizza, LLC, enti-

tled *Aguardo, et al. v. Pizza Hut, Inc., et al.* ("*Aguardo*"), was filed in the Superior Court of the State of California of the County of San Francisco. The lawsuit was filed by three former Pizza Hut restaurant general managers purporting to represent approximately 1,300 current and former California restaurant general managers of Pizza Hut and PacPizza. The lawsuit alleges violations of state wage and hour laws involving unpaid overtime wages and vacation pay and seeks an unspecified amount in damages. On January 12, 2000, the Court certified a class of approximately 1,300 current and former restaurant general managers. This lawsuit is in the early discovery phase.

On October 2, 1996, a class action lawsuit against Taco Bell Corp., entitled *Mynaf, et al. v. Taco Bell Corp.* ("*Mynaf*"), was filed in the Superior Court of the State of California of the County of Santa Clara. The lawsuit was filed by two former restaurant general managers and two former assistant restaurant general managers purporting to represent all current and former Taco Bell restaurant general managers and assistant restaurant general managers in California. The lawsuit alleges violations of California wage and hour laws involving unpaid overtime wages. The complaint also includes an unfair business practices claim. The four named plaintiffs claim individual damages ranging from \$10,000 to \$100,000 each. On September 17, 1998, the court certified a class of approximately 3,000 current and former assistant restaurant general managers and restaurant general managers. Taco Bell petitioned the appellate court to review the trial court's certification order. The petition was denied on December 31, 1998. Taco Bell then filed a petition for review with the California Supreme Court, and the petition was subsequently denied. Class notices were mailed on August 31, 1999 to over 3,400 class members. Discovery has commenced, and a trial date has been set for July 10, 2000.

On August 29, 1997, a class action lawsuit against Taco Bell Corp., entitled *Bravo, et al. v. Taco Bell Corp.* ("*Bravo*"), was filed in the Circuit Court of the State of Oregon of the County of Multnomah. The lawsuit was filed by two former Taco Bell shift managers purporting to represent approximately 17,000 current and former hourly employees statewide. The lawsuit alleges violations of state wage and hour laws, principally involving unpaid wages including overtime, and rest and meal period violations, and seeks an unspecified amount in damages. Under Oregon class action procedures, Taco Bell was allowed



an opportunity to “cure” the unpaid wage and hour allegations by opening a claims process to all putative class members prior to certification of the class. In this cure process, Taco Bell has currently paid out less than \$1 million. On January 26, 1999, the Court certified a class of all current and former shift managers and crew members who claim one or more of the alleged violations. The lawsuit is in the discovery and pre-trial motions phase. A trial date of November 2, 1999 was set. However, on November 1, 1999, the Court issued a proposed order postponing the trial and establishing a pre-trial claims process. The final order regarding the claims process was entered on January 14, 2000. Taco Bell moved for certification of an immediate appeal of the Court-ordered claims process and requested a stay of the proceedings. This motion was denied on February 8, 2000, and Taco Bell intends to appeal this decision to the Supreme Court of Oregon. A Court-approved notice and claim form was mailed to approximately 14,500 class members on January 31, 2000.

We have provided for the estimated costs of the *Aguardo*, *Mynaf* and *Bravo* litigations, based on a projection of eligible claims (including claims filed to date, where applicable), the cost of each eligible claim and the estimated legal fees incurred by plaintiffs. Although the outcome of these lawsuits cannot be determined at this time, we believe the ultimate cost of these cases in excess of the amounts already provided will not be material to our annual results of operations, financial condition or cash flows.

On February 10, 1995, a class action lawsuit, entitled *Ryder, et al. v. Taco Bell Corp.* (“*Ryder*”), was filed in the Superior Court of the State of Washington for King County on behalf of approximately 16,000 current and former Taco Bell employees claiming unpaid wages resulting from alleged uniform, rest and meal period violations and unpaid overtime. In April 1996, the Court certified the class for purposes of injunctive relief and a finding on the issue of liability. The trial was held during the first quarter of 1997 and resulted in a liability finding. In August 1997, the Court certified the class for purposes of damages as well. Prior to the damages phase of the trial, the parties reached a court-approved settlement process in April 1998. The settlement process is substantially complete, with less than 50 claims left to be resolved. We have provided for the estimated cost of settling these remaining claims.

**Obligations to PepsiCo After Spin-off.** At the Spin-off, we entered into separation and other related agreements (the “Separation Agreement”), governing the Spin-off transaction and our subsequent relationship with PepsiCo. These agreements provide certain indemnities to PepsiCo. In addition, prior to the Spin-off, our U.S. Core Businesses each entered into a multi-year agreement with Pepsi-Cola Company, a wholly owned subsidiary of PepsiCo, regarding the purchase of beverage products. Prior to the Spin-off and PepsiCo’s sale to AmeriServe of PFS, our primary U.S. food and supplies distributor, our Core Businesses signed a multi-year distribution agreement with PFS. Neither contract is for quantities expected to exceed normal usage.

The Separation Agreement provided for, among other things, our assumption of all liabilities relating to the restaurant businesses, inclusive of the Non-core Businesses, and our indemnification of PepsiCo with respect to these liabilities. We have included our best estimates of these liabilities in the accompanying Consolidated Financial Statements. Subsequent to Spin-off, claims have been made by certain Non-core Business franchisees and a purchaser of one of the businesses. Certain of these claims have been settled, and we are disputing the validity of the remaining claims; however, we believe that any settlement of these claims at amounts in excess of previously recorded liabilities is not likely to have a material adverse effect on our results of operations, financial condition or cash flows.

In addition, we have indemnified PepsiCo for any costs or losses it incurs with respect to all letters of credit, guarantees and contingent liabilities relating to our businesses under which PepsiCo remains liable. As of December 25, 1999, PepsiCo remains liable for approximately \$200 million related to these contingencies. This obligation ends at the time they are released, terminated or replaced by a qualified letter of credit. We have not been required to make any payments under this indemnity.

Under the separation agreements, PepsiCo maintains full control and absolute discretion with regard to any combined or consolidated tax filings for periods through the Spin-off Date. PepsiCo also maintains full control and absolute discretion regarding any common tax audit issues. Although PepsiCo has contractually agreed to, in good faith, use its best efforts to set-

tle all joint interests in any common audit issue on a basis consistent with prior practice, there can be no assurance that determinations made by PepsiCo would be the same as we would reach, acting on our own behalf. Through December 25, 1999, there have not been any determinations made by PepsiCo where we would have reached a different determination.

We have agreed to certain restrictions on future actions to help ensure that the Spin-off maintains its tax-free status. Restrictions include, among other things, limitations on our liquidation, merger or consolidation with another company, certain issuances and redemptions of our Common Stock, our granting of stock options and our sale, refranchising, distribution or other disposition of assets. If we fail to abide by these restrictions or to obtain waivers from PepsiCo and, as a result, the Spin-off fails to qualify as a tax-free reorganization, we will be obligated to indemnify PepsiCo for any resulting tax liability which could be substantial. No payments under these indemnities have been required. Additionally, under the terms of the tax separation agreement, PepsiCo is entitled to the federal income tax benefits related to the exercise after the Spin-off of vested PepsiCo options held by our employees. We incur the payroll taxes related to the exercise of these options.

## note 22

### Subsequent Event

We and our franchisees and licensees are dependent on frequent replenishment of the food ingredients and paper supplies required by our restaurants. We and a large number of our franchisees and licensees are under multi-year contracts to use AmeriServe to purchase and make deliveries of most of these supplies.

On January 31, 2000, AmeriServe filed for protection under Chapter 11 of the U.S. Bankruptcy Code. We had approximately \$43 million of receivables from AmeriServe at December 25, 1999. While it is possible that we may recover a portion of these receivables, the amount of the recovery is not currently estimable. We have written off our January 31, 2000 receivable balance of approximately \$41 million, which represents the year-end balance less settlements in the ordinary course of business between December 26, 1999 and the date of bankruptcy.

On February 2, 2000, we and another major AmeriServe customer agreed to provide a \$150 million interim revolving credit facility (the "Facility") to AmeriServe. We initially committed to provide up to \$100 million under this Facility. However, we have reached an agreement in principle to assign \$30 million of our commitment to a third party, reducing our total commitment under the Facility to \$70 million. The Facility represents post-bankruptcy "debtor-in-possession" financing which enjoys preference over pre-bankruptcy unsecured creditors. The interest rate is prime plus 4%.

To help ensure that our supply chain continues to remain open, we have begun to purchase (and take title to) supplies directly from suppliers (the "temporary direct purchase program") for use in our restaurants as well as for resale to our franchisees and licensees who previously purchased supplies from AmeriServe. AmeriServe has agreed, for the same fee in effect prior to the bankruptcy filings, to continue to be responsible for distributing the supplies to us and our participating franchisee and licensee restaurants as well as providing ordering, inventory, billing and collection services for us.

	1999				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Revenues:					
Company sales	\$ 1,662	\$ 1,723	\$ 1,639	\$ 2,075	\$ 7,099
Franchise and license fees	151	163	173	236	723
Total revenues	1,813	1,886	1,812	2,311	7,822
Total costs and expenses	1,577	1,537	1,435	2,033	6,582
Operating profit	236	349	377	278	1,240
Net income	106	179	197	145	627
Diluted earnings per common share	0.66	1.10	1.23	0.93	3.92
Operating profit (loss) attributable to:					
Accounting changes	10	6	5	8	29
Facility actions net gain	34	133	144	70	381
Unusual items	—	(4)	(3)	(44)	(51)
Net income (loss) attributable to:					
Accounting changes	6	4	3	5	18
Facility actions net gain	19	80	84	43	226
Unusual items	—	(2)	(3)	(24)	(29)
	1998				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Revenues:					
Company sales	\$ 1,790	\$ 1,867	\$ 1,869	\$ 2,326	\$ 7,852
Franchise and license fees	132	140	152	203	627
Total revenues	1,922	2,007	2,021	2,529	8,479
Total costs and expenses	1,754	1,745	1,742	2,210	7,451
Operating profit	168	262	279	319	1,028
Net income	54	112	128	151	445
Diluted earnings per common share	0.35	0.72	0.82	0.95	2.84
Operating profit (loss) attributable to:					
Facility actions net gain	29	73	54	119	275
Unusual items	—	—	5	(20)	(15)
Net income (loss) attributable to:					
Facility actions net gain	16	42	34	70	162
Unusual items	—	—	3	(6)	(3)

See Note 5 for details of 1999 accounting changes, facility actions net gain (loss) and unusual items.

## management's responsibility for financial statements

### To Our Shareholders:

We are responsible for the preparation, integrity and fair presentation of the Consolidated Financial Statements, related notes and other information included in this annual report. The financial statements were prepared in accordance with generally accepted accounting principles and include certain amounts based upon our estimates and assumptions, as required. Other financial information presented in the annual report is derived from the financial statements.

We maintain a system of internal control over financial reporting, designed to provide reasonable assurance as to the reliability of the financial statements, as well as to safeguard assets from unauthorized use or disposition. The system is supported by formal policies and procedures, including an active Code of Conduct program intended to ensure employees adhere to the highest standards of personal and professional integrity. Our internal audit function monitors and reports on the adequacy of and compliance with the internal control system, and appropriate actions are taken to address significant control deficiencies and other opportunities for improving the system as they are identified.

The financial statements have been audited and reported on by our independent auditors, KPMG LLP, who were given free access to all financial records and related data, including minutes of the meetings of the Board of Directors and Committees of the Board. We believe that management representations made to the independent auditors were valid and appropriate.

The Audit Committee of the Board of Directors, which is composed solely of outside directors, provides oversight to our financial reporting process and our controls to safeguard assets through periodic meetings with our independent auditors, internal auditors and management. Both our independent auditors and internal auditors have free access to the Audit Committee.

Although no cost-effective internal control system will preclude all errors and irregularities, we believe our controls as of December 25, 1999 provide reasonable assurance that our assets are reasonably safeguarded.



David J. Deno  
Chief Financial Officer

## report of independent auditors

### The Board of Directors

#### TRICON Global Restaurants, Inc.:

We have audited the accompanying consolidated balance sheet of TRICON Global Restaurants, Inc. and Subsidiaries ("TRICON") as of December 25, 1999 and December 26, 1998, and the related consolidated statements of operations, cash flows and shareholders' (deficit) equity and comprehensive income for each of the years in the three-year period ended December 25, 1999. These consolidated financial statements are the responsibility of TRICON's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of TRICON as of December 25, 1999 and December 26, 1998, and the results of its operations and its cash flows for each of the years in the three-year period ended December 25, 1999, in conformity with generally accepted accounting principles.



KPMG LLP  
Louisville, Kentucky  
February 8, 2000, except as to  
Note 11, which is as of  
February 25, 2000

## selected financial data

### TRICON Global Restaurants, Inc. and Subsidiaries

(in millions, except per share and unit amounts)

	Fiscal Year Ended				
	1999	1998	1997	1996	1995
<b>Summary of Operations:</b>					
System sales (rounded) <sup>(1)</sup>					
U.S.	\$ 14,500	\$ 14,000	\$ 13,500	\$ 13,400	\$ 13,200
International	7,300	6,600	7,000	6,900	6,500
Total	<b>21,800</b>	20,600	20,500	20,300	19,700
Revenues					
Company sales	7,099	7,852	9,112	9,738	9,813
Franchise and license fees	723	627	578	494	437
Total	<b>7,822</b>	8,479	9,690	10,232	10,250
Facility actions net gain (loss) <sup>(2)</sup>	381	275	(247)	37	(402)
Unusual items <sup>(3)</sup>	(51)	(15)	(184)	(246)	—
Operating profit	<b>1,240</b>	1,028	241	372	252
Interest expense, net	202	272	276	300	355
Income (loss) before income taxes <sup>(2)(3)</sup>	<b>1,038</b>	756	(35)	72	(103)
Net income (loss) <sup>(2)(3)</sup>	<b>627</b>	445	(111)	(53)	(132)
Basic earnings per common share <sup>(4)</sup>	<b>4.09</b>	2.92	N/A	N/A	N/A
Diluted earnings per common share <sup>(4)</sup>	<b>3.92</b>	2.84	N/A	N/A	N/A
<b>Cash Flow Data:</b>					
Provided by operating activities	\$ 565	\$ 674	\$ 810	\$ 713	\$ 813
Capital spending	470	460	541	620	701
Refranchising of restaurants	916	784	770	355	165
<b>Balance Sheet:</b>					
Total assets	\$ 3,961	\$ 4,531	\$ 5,114	\$ 6,520	\$ 6,908
Operating working capital deficit	(832)	(960)	(1,073)	(915)	(925)
Long-term debt	2,391	3,436	4,551	231	260
Total debt	2,508	3,532	4,675	290	404
Investments by and advances from PepsiCo	—	—	—	4,266	4,604
<b>Other Data:</b>					
Number of stores at year-end <sup>(1)</sup>					
Company	6,981	8,397	10,117	11,876	12,540
Unconsolidated Affiliates	1,178	1,120	1,090	1,007	926
Franchisees	18,414	16,650	15,097	13,066	11,901
Licensees	3,409	3,596	3,408	3,147	2,527
System	<b>29,982</b>	29,763	29,712	29,096	27,894
U.S. Company same store sales growth <sup>(1)</sup>					
KFC	2%	3%	2%	6%	7%
Pizza Hut	9%	6%	(1)%	(4)%	4%
Taco Bell	—	3%	2%	(2)%	(4)%
Blended	4%	4%	1%	N/A	N/A
Shares outstanding at year-end (in millions)	151	153	152	N/A	N/A
Market price per share at year-end	\$ 37 <sup>15/16</sup>	\$ 47 <sup>5/8</sup>	\$ 28 <sup>5/16</sup>	N/A	N/A

N/A — Not Applicable.

TRICON Global Restaurants, Inc. and Subsidiaries ("TRICON") became an independent, publicly owned company on October 6, 1997 through the spin-off of the restaurant operations of its former parent, PepsiCo, Inc., to its shareholders. The historical consolidated financial data for 1997 and the prior years above were prepared as if we had been an independent, publicly owned company for all periods presented. The selected financial data should be read in conjunction with the Consolidated Financial Statements and the Notes thereto.

(1) Excludes Non-core Businesses.

(2) Includes \$13 million (\$10 million after-tax) and \$54 million (\$33 million after-tax) of favorable adjustments to our 1997 fourth quarter charge in 1999 and 1998, respectively, \$410 million (\$300 million after-tax) related to our fourth quarter charge in 1997 and \$457 million (\$324 million after-tax) related to the early adoption of Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment Of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" in 1995.

(3) Includes \$11 million (\$10 million after-tax) and \$11 million (\$7 million after-tax) of favorable adjustments to our 1997 fourth quarter charge in 1999 and 1998, respectively. 1997 includes \$120 million (\$125 million after-tax) related to our 1997 fourth quarter charge and an additional \$54 million (\$34 million after-tax) related to the 1997 disposal of the Non-core Businesses. 1996 includes \$246 million (\$189 million after-tax) writedown of our Non-core Businesses. See Note 5 to the Consolidated Financial Statements.

(4) EPS data has been omitted for 1997 and prior years as our capital structure as an independent, publicly owned company did not exist for those years.

## shareholder information

**Annual Meeting** The Annual Meeting of Shareholders will be at Tricon's headquarters, Louisville, KY at 9:00 a.m. (EDT), Thursday, May 18, 2000. Proxies for the meeting will be solicited by an independent proxy solicitor. This Annual Report is not part of the proxy solicitation.

## inquiries regarding your stock holdings

**Registered Shareholders** (shares held by you in your name) should address communications concerning statements, dividend payments, address changes, lost certificates and other administrative matters to:

Tricon Global Restaurants, Inc.  
c/o Boston Equiserve, L.P.  
P.O. Box 8038  
Boston, MA 02266-8038  
Telephone: (800) 439-4986  
www.equiserve.com

or

Mary Dossett  
Shareholder Analyst  
Tricon Global Restaurants, Inc.  
1441 Gardiner Lane, Louisville, KY 40213  
Telephone: (888) 2yummyum  
email: mary.dossett@tricon-yum.com  
Internet: www.triconglobal.com

In all correspondence or telephone inquires, please mention Tricon, your name as printed on your statement or stock certificate, your social security number, your address and telephone number.

**Beneficial Shareholders** (shares held in the name of your bank or broker) should direct communications on all administrative matters to your stockbroker.

## Tricon YUMBUCKS and SHAREPOWER PARTICIPANTS

(employees with YUMBUCKS shares or SharePower options) should address all questions regarding your account, outstanding options or shares received through option exercises to:

Merrill Lynch/SharePower  
Stock Option Plan Services  
P.O. Box 30446  
New Brunswick, NJ 08989-0446  
Telephone: (800) 637-2432 (U.S., Puerto Rico and Canada)  
(732) 560-9444 (all other locations)

In all correspondence, please provide your account number (for U.S. citizens, this is your social security number), your address, your telephone number and mention either Tricon YUMBUCKS or SharePower. For telephone inquiries, please have a copy of your most recent statement available.

## Employee Benefit Plan Participants

Capital Stock Purchase Plan	(888) 875-4015
SaveUp (formerly 401(k) or Long-term Savings)	(888) 875-4015
Tricon Savings Center	(617) 847-1013
P.O. Box 1389	(outside U.S.)
Boston, MA 02104-1389	

Please have a copy of your most recent statement available when calling. Press \*0 for a customer service representative and give the representative the name of the Plan.

## shareholder services

**Optional Cash Investment** A brochure explaining this convenient plan is available from our transfer agent:

Boston Equiserve, L.P.  
P.O. Box 8038  
Boston, MA 02266-8038 (888) 439-4986  
www.equiserve.com

**Low-Cost Investment Plan** Investors may purchase their initial share of stock through NAIC's Low-Cost Investment Plan. For details contact:

National Association of Investors Corporation (NAIC)  
711 West Thirteen Mile Road  
Madison Heights, MI 48071  
(877) ASK-NAIC (275-6242)  
www.betterinvesting.com



**Financial and Other Information** Earnings and other financial results, corporate news, and company information are now available on Tricon's Website: www.triconglobal.com

Copies of Tricon's SEC Form 8-K, 10-K and 10-Q reports and quarterly earnings releases are available free of charge. Contact Tricon's Shareholder Relations at (888) 2YUMMYUM or email mary.dossett@tricon-yum.com

Securities analysts, portfolio managers, representatives of financial institutions and other individuals with questions regarding Tricon's performance are invited to contact:

Lynn A. Tyson  
Vice President, Investor Relations  
Tricon Global Restaurants, Inc.  
1441 Gardiner Lane  
Louisville, KY 40213  
Telephone: (502) 874-8617

## Independent Auditors

KPMG LLP  
400 West Market Street, Suite 2600  
Louisville, KY 40202  
Telephone: (502) 587-0535

## capital stock information

**Stock Trading Symbol** — YUM



The New York Stock Exchange is the principal market for Tricon Common Stock.

**Shareholders** At year-end 1999, there were approximately 156,000 shareholders of record.

**Dividend Policy** Tricon does not currently pay dividends, nor does it anticipate doing so in the near future.

Tricon's Annual Report contains many of the valuable trademarks owned and used by Tricon and subsidiaries and affiliates in the United States and internationally.

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Chief Operating Officer  
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Chief Operating Officer  
KFC USA
- Michael S. Rawlings** 45  
President and  
Chief Concept Officer  
Pizza Hut USA
- Peter C. Waller** 45  
President and  
Chief Concept Officer  
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