



KFC



DEAR SHAREHOLDERS,

THE YEAR 2006 HAS BEEN A CHALLENGING BUT REWARDING ONE FOR QSR BRANDS BHD (QSR). THE UNCERTAINTIES AND DISTRACTIONS, DUE TO THE BOARDROOM TUSSLES THAT PLAGUED THE COMPANY OVER THE PAST FEW YEARS, HAVE ALREADY BEEN BURIED IN OUR CORPORATE HISTORY NOW THAT KULIM (MALAYSIA) BERHAD (KULIM) IS ENTRENCHED AS QSR'S MAJORITY SHAREHOLDER.

Corporate Statement

QSR is now set for a new take-off with a freshly defined corporate destiny that demands our total focus on strengthening the relationship with our customers. The company is ideally placed with its wide network of outlets to yield greater efficiencies, deliver value to customers, develop and enrich the careers of our people and execute our strategy to add sustainable value to the business for our stakeholders.

It is my pleasure, on behalf of the Board of Directors (the Board), to present to you the Corporate Statement of QSR for the financial year ended 31 December 2006.

QSR Brands Bhd

Holdings (Malaysia) Bhd



from left to right:

Jamaludin bin Md Ali
Managing Director

Tan Sri Dato' Muhammad Ali bin Hashim
Chairman

Ahamad bin Mohamad
Deputy Chairman

END OF SHAREHOLDER TUSSLE

The new entrepreneurial leadership at the helm of QSR has settled in quickly to work closely with the management teams at QSR and KFC Holdings (Malaysia) Bhd (KFCH) who have led these international franchises and our home-grown label Ayamas and Rasamas, so successfully, in Malaysia, Singapore and Brunei. Eight new Directors were appointed to the Board at the Extraordinary General Meeting held on 7 June 2006. Later in the year on 29 August 2006 at QSR's third Annual General Meeting the position of the new QSR directors was again reaffirmed.

With Kulim now firmly in control with a 56.8% stake in QSR, we can refocus and concentrate on the fundamentals of the company's operations in order to derive the best performance from our outlets and maximise long term returns for our shareholders. Our powerful brands have become part of our urban and emerging lifestyle and we will continue investing in strong branding strategies including promotional activities, public relations and advertising to strengthen our businesses and add value to these profitable and resilient assets.

OPERATING ENVIRONMENT

The Malaysian economy maintained a steady growth of 5.9% in 2006, against 5.3% in the previous year, with oil and high-tech exports continuing to fuel economic expansion throughout the year. The increase in the price of petroleum contributed to inflation rising slightly to 3.9% in 2006 from 3% in 2005.

The Ninth Malaysian Plan laid out an agenda to shape growth for 2006 - 2010 and as the allocations for capital spending began to be disbursed consumer confidence was lifted, encouraging more spending at our restaurants. Per capita income increased from RM18,040 in 2005 to RM19,740 in 2006 providing more scope for discretionary spending by our customers.

The Singapore economy posted a healthy growth of 7.9% which helped contribute to a marked improvement by our Pizza Hut results in the city-state.

The Malaysian Government's decision to reduce the subsidies on petrol and diesel in February increased the cost of transportation and an outbreak of Avian Flu early in the year setback the poultry trade and made a small but temporary dent in restaurant sales.

The new leadership at the helm of the Board of Directors has motivated the professional Management team to redouble efforts towards the twin goals of customer satisfaction and brand loyalty. The new and refreshing corporate climate has also inspired a robust team spirit among our employees, eager to dedicate their best efforts to reach new heights in enhancing shareholder value. A synergistic convergence between the KFCH and Ayamas businesses will facilitate the implementation of common best practices across the franchises and strengthen our hand in procurement, pricing and in the labour market.

POSITIVE PROGRESS

Despite adverse market conditions at the start of 2006, QSR made positive progress and delivered excellent results. Revenue grew by 11.0% to RM428.5 million in 2006, while profit before taxation (PBT) grew by 237.9% to RM65.8 million. These results mark QSR's best performance to date.

The year's financial highlights include:

- 11.0% increase in revenue to RM428.5 million by the Pizza Hut Restaurant Segment in Malaysia and Singapore, mainly due to the continuing strategy of network expansion and effective Pizza Hut marketing programmes.
- An increase in operating profit, before the share of the results of associate KFCH, by 14.2% to RM36.6 million (excluding a provision of RM6.5 million relating to expenses for the Mandatory General Offer (MGO) exercise for KFCH).
- The share of results in KFCH increased from a loss of RM10.7 million in 2005 to a positive contribution of RM35.7 million (the loss in the prior year was owing to KFCH taking a one-off charge of RM118.2 million due largely to impairment losses on properties).
- A 237.9% increase in year-on-year profitability, an exceptional percentage increase owing to associate KFCH making a positive contribution in the current year.

On the downside, KFCH's Integrated Poultry Segment experienced a 9.2% slide in external sales due to the Avian Flu and the rationalisation of its Ayamas distribution channels.

Borrowings increased from RM155.7 million to RM207.4 million to fund the expansion of QSR's holding in KFCH, which the Board views as a strategic corporate initiative which will further enhance corporate stability, add long term value and maximise shareholder benefits and value. The 192% increase in Group gearing (net of cash and bank balances) from 0.13 times in 2005 to 0.38 times as at end December 2006 is well within manageable and prudent limits.

STRATEGIC INITIATIVES

2006's revenue and profitability improvements came about as a result of the following strategic initiatives:

- A commitment to management and customer service improvement by a series of quality enhancement initiatives focusing on key areas such as customer service, management and employee excellence, and asset and product improvement.
- Effective marketing campaigns, innovative product launches, product variants and extended promotions on innovative higher margin products – all of which helped drive same store sales growth as well as improved throughput and a rising ticket average.
- The continuation of the image Enhancement Dine-In (EDI) exercise at Pizza Hut which is a major revamp of menu selection and uniforms to redesigning of interiors and exteriors, to create an upgraded or “enhanced” dine-in experience.
- Delivery Initiatives to facilitate customer access to home delivery throughout the country with the one easy-to-remember phone number: 1-300-88-2525, processed by our nationwide call centre.
- Making the Pizza Hut experience available to more customers by the expansion of the number of outlets in Malaysia and Singapore where 20 new Pizza Hut restaurants (2 relocations) were opened in 2006 and a further 20 were remodeled. The total number of stores rose to 151 in Malaysia and 38 in Singapore.
- Restaurant expansion at KFC in Malaysia and Singapore with 37 new KFC restaurants (14 relocations) opened. A further 43 existing premises were remodeled. By the end of 2006, the number of KFC outlets had grown to 375 in Malaysia and was unchanged at 68 in Singapore as good locations are scarce.
- Scouting for new locations for restaurants continues to reveal demand in both urban centres and in rural Malaysia.
- Stronger governance and transparency via the activation of Board and Management Committees and stringent checks and balances.
- Mitigation of the Avian Flu impact by offering a trusted and cost effective non-chicken variant alternative (i.e. the Fish Sandwich).
- Implementation of an Avian Flu crisis management plan for KFCH involving increased bio-security measures, adaptation of YUM!'s guidelines plus the assurance of a highly secure supply chain with adequate contingency plans in place.





Branding and mall expansion have formed the cornerstone of Malaysia's retail sector constantly developing to satisfy an increasingly sophisticated market who enjoy the air-conditioned comforts of an all-in-one shopping and dining experience. We make it imperative for our brands to be present at these high traffic locations and our outlets inside these venues are always busy as families take to the malls for a day of shopping and dining. An influx of foreign vehicles on the roads in 2006 joining home-grown marquees helped encourage mobility and dining out.

DIVIDENDS

At QSR we remain committed to building our brand into a profitable enterprise which provides strong earnings for our shareholders. For 2006, the Board is proposing a total dividend of 9 sen per share (comprising an interim dividend of 3 sen and a final dividend of 6 sen) in comparison to 7 sen in 2005.

REWARDED FOR EXCELLENCE

2006 was a banner year for the Malaysian operations as Pizza Hut Malaysia garnered recognition at the Yum! Marketing Awards, Malaysian Media Awards 2006, Best Use of Television/Cinema Awards and the Asia Pacific Regional Champs Challenge, with a host of awards.

At the Yum! Marketing awards, the Best New Product award was given to Pizza Hut Malaysia for the launch of Cheesy Bites Pizza. Shaped like a giant sunflower surrounded by 24 bite-sized "petals", Cheesy Bites broke all sales records and achieved over 10% same store sales growth and 3% transaction growth: another successful launch by Pizza Hut Malaysia.

Pizza Hut Malaysia also won Gold at the Malaysian Media Awards 2006 for the Best Use of Television or Cinema in advertising for the television commercial entitled "Pizza Hut Top of the Hour" used to advertise the Pizza Hut Delivery Service.



At the Asia Pacific Regional CHAMPS Challenge countries compete for awards under the CHAMPS categories. CHAMPS is the guide by which staff of Pizza Hut and KFC run the restaurants, serve the customers and work together. CHAMPS stands for Cleanliness, Hospitality, Accuracy of Order, Maintenance of Facility, Product Quality and Speed of Service. Malaysian individual crew won the Novelty Award for Best Hospitality, and Best of the Best Awards for Best Production, Best Service and Best Manager.

The Malaysian team also won the Yum! Champion Club 2006 presented to individuals considered the best of the best, considered good enough to join the rank of champions. It is an appreciation of their efforts to help raise the brand to greater heights.

On 27 July 2006, the Prime Minister, YAB Datuk Seri Abdullah Ahmad Badawi, presented KFC Malaysia with the inaugural Consumer-friendly Award 2006 on the occasion of the National Consumer Day Celebrations 2006 held at Stadium Putra, Bukit Jalil. This prestigious national award bears testament to our consistent efforts at winning over our customers by providing them the best possible services and quality products.

The KFC Malaysia team was yet again the recipient of the YUM! Best Overall Marketing Excellence Award for the second year in a row. The award is fitting recognition of this excellent team's consistent efforts in helping build the KFC brand through world class execution of innovative strategies.



CORPORATE SOCIAL RESPONSIBILITY

In line with the Company's philosophy of Corporate Social Responsibility, our people are encouraged to "make a difference" especially in the lives of the needy and less fortunate. Toward this end, the year in review proved to be a fulfilling one thanks to the efforts and participation of our staff in initiating programmes of community relations.

The Group's participation in the semi reality program "Tijarah Ramadhan" made a difference in the lives of two individuals in hardship. The beneficiaries received financial aid for a year at RM300 and RM200 per month respectively, and both received a load of groceries and RM700 shopping money to celebrate Hari Raya.

40 Orphans from Persatuan Anak-Anak Yatim dan Ibu Tunggal Jalan Klang Lama enjoyed a super treat on an outing to the charity screening of Superman Returns.

At the Tabung Penyayang cheque presentation ceremony on 17th May 2006, KFCH presented cheques totaling RM25,000 to five Klang Valley Children's Charities: Persatuan Orang-Orang Cacat Pendengaran Malaysia, Pusat Jagaan Titian Kasih, Rumah Charis, Samaritan Home, Rumah Anak Kesayangan and the National Cancer Council. The money, drawn from our children's fund Tabung Penyayang KFC, represents the Group's ongoing commitment to being a caring corporate citizen.

At the Live! "Cartoonival" Premiere at Plenary Hall KLCC on June 6th, children from Persekutuan Orang-Orang Pekak Malaysia, Pusat Jagaan Titian Kasih, Rumah Charis, Samaritan Home and Rumah Anak Kesayangan were guests. The youngsters were excited to see a first-time stage performance featuring characters from four original Cartoon Networks series, including Dexter's Laboratory, Power Puff Girls, Foster's Home for Imaginary friends and Hi Hi Puffy Ami Yumi!



Two evening functions for the breaking of fast at charitable organisations were also held. The first, Majlis Berbuka Puasa Anak-Anak Yatim, for inmates from Sekolah Kebangsaan Sg Lui, Hulu Langat on 11th October 2006 and the second Berbuka Puasa with orphans of Darul Hanan, Pasir Gudang on 15th October 2006 in conjunction with the largest simultaneous pizza delivery, when altogether 110 charities, 7,168 inmates and orphans and a staggering 1,827 pizzas were delivered.

In conjunction with the KFC PERSADA grand opening on 18th November 2006, KFCH presented a cheque totaling RM25,000 to 6 homes in Johor Bahru. They were Persatuan Kanak-Kanak Spastik Johor, Taman Sinar Harapan Jubli, Tabung Pengurusan Darul Hanan, Persatuan Bagi Kanak-Kanak Kerencanaan Akal Johor and Pusat Perlindungan Kanak-Kanak Johor Bahru.

Across the causeway, following KFC Singapore's opening of the first Deaf operated restaurant in Toa Payoh in 2003, and the second one in 2005 at the KFC Community Club, we continued support for the deaf through the Ambassador for the Deaf program to raise awareness of the deaf community. Coverage of the deaf community was carried in Chit Chat, our quarterly Chick Club magazine, the KFC website, in-store communications and by participation in Christmas Carolling Signing. KFC was given top honours for our effort with two awards presented to us in 2006, Friend of the Deaf and the President's Social Service Award.

MANDATORY GENERAL OFFER (MGO)

The world renowned KFC franchise with its unparalleled global brand recognition status, devoted customer base and prospect for exponential growth has been and will always be the jewel in our corporate crown. The most significant and exciting initiative at QSR this year has been the strategic move to bring our associate company KFCH, owners of Malaysia's premier restaurant chain, further under the ambit of the company.

In order to achieve this objective, on 12 September 2006, QSR acquired 10,000,000 ordinary shares of RM1.00 each in KFCH, representing a 5.04% interest in KFCH at the price of RM4.94 per share. As such, QSR's cumulative direct and indirect equity interest in KFCH increased from 32.83% to 37.88% which triggered an MGO under Section 6 of the Malaysian Code of Take-overs and Mergers 1998.

As at 2nd March 2007, QSR had acquired an additional 9.94 million share through the open market which further increased its holding in KFCH from 37.88% to 42.89%.



As this report goes to press, the MGO has just closed and acceptances have fallen short of the 50% of the voting shares required by QSR and parties acting in concert with us. Accordingly the offer has lapsed as at 23 April 2007. The Board respects the decision of those shareholders who resolved to hold on to their shares and pledges to redouble efforts to support the profitable growth of KFCH for the benefit of all shareholders.

PROSPECTS

The global economy in 2007 is expected to moderate given the impact of higher oil prices, increasing inflationary pressure, higher interest rates and greater uncertainties due to geopolitical tensions. Therefore the world economy is expected to grow at the slightly slower rate of 4.7% in 2007 compared with 4.9% in 2006 while global trade may slow to 7.5% compared to 9.6% in 2006. These developments are expected to result in the still very satisfactory, yet rather slower, growth of economies in the region including China, Thailand and India.

However the Malaysian economy is expected to grow by 6% in 2007 due to the continuous expansion of the capital, manufacturing and service sectors. This balanced expansion will be supported by further recovery in investment and improved economic resilience and productivity. Singapore's economic growth is expected to moderate in 2007 to 4.5% from 7.9% in 2006.

We anticipate a positive business outlook for QSR in 2007. We are optimistic that the constant review and effective execution of our strategic initiatives will further create value and growth. However, we are also conscious of the challenges posed to KFCH's poultry farm by concerns over the continuing strength of the prices of imported raw materials such as corn and soya bean meal that have been on the uptrend since 2006 and are taking measures to address this.

GROWTH STRATEGY

The synergy gained from our brands has added to the dynamism in QSR and contributed to the company having achieved impressive growth. In 2007, all three main brands plan to expand their number of outlets or distribution points and increase market share overall, thereby contributing significantly towards profitability.

Higher customer satisfaction and a better level of service will come together to contribute to synergies of performance, helping to ensure the Group's winning track record next year.

There are several fundamental factors that will help us achieve our goals. Firstly, moving forward, shareholders can anticipate the new, dynamic corporate climate to be further translated into value enhancement now that Kulim is in control of QSR. The added plus factor is the continued strong support from YUM! Brands Inc. We also have in place strong, powerful brands, a matured system, experienced and highly motivated personnel and reliable and efficient processes that will help us accelerate forward.

The increase in QSR's equity interest in KFCH to 43.39% (as at 30 April 2007) will enable QSR shareholders to enjoy greater long-term participation in a growing and successful franchise. We are satisfied with QSR's substantial holding in KFCH and we have every intention to build on this very strong foundation going forward to realise the maximum potential in the KFCH business.

The Yum! Awards set the specific standards for operations and customer service at Pizza Hut and KFC and we target at least 70% of all our restaurants to achieve 100% CHAMPS rating. CHAMPS is the guide by which staff of Pizza Hut and KFC operate the restaurants, serve the customers and work together.

To ensure we realise the full potential of the opportunities before us, several key business initiatives will be implemented under the ambit of QSR's Strategic Business Plan 2007 - 2009, as endorsed by the Board. These include studying the opportunities for entering new markets with existing brands as well as exploring the potential for new brands and food-related acquisitions.

QSR's vision is to be the leading integrated food services group in the ASEAN region delivering consistent quality products and excellent customer-focussed service. Going forward, our mission for QSR is to maximise profitability, improve shareholder value and deliver sustainable growth year after year.

QSR's large network of entrepreneurial businesses, unique vertically integrated business model through KFCH, and strong cash flow generation from the restaurant businesses and market expansion, too, should hold us in good stead. Moreover, we envisage strong economic expansion and new township development heralding hypermarket and shopping complex expansion, and in turn, will offer tremendous new opportunities for us.

We have also put in place bold, creative strategies to turn around KFCH's Kedai Ayamas and Rasa Ayamas outlets. The first initiatives taken were to re-brand "Rasa Ayamas" into "Rasamas" and to reposition the outlets as dine-in restaurants. These initiatives underscore the new restaurant-oriented approach of this business segment and were directed towards making the brand more relevant to consumers. We will also explore the viability of opening poultry processing facilities in geographically diverse locations to ensure our businesses in those areas are self-sufficient.



Further downstream at KFCH, we will take measures to introduce more layered product offerings that focus on value for customers. We will continue to drive through new products like the Fish Burger, Zinger Maxx and Cheezy Meltz, among others. Our products can no longer be considered occasion-driven purchases as we have implemented a pricing strategy that makes them affordable to the masses.

Pizza Hut plans to open a minimum of 16 new restaurants in Malaysia and Singapore in 2007. KFCH will continue to grow market share through opening a minimum of 16 new restaurants each year and remodelling up to 10%. We will also explore the potential for expanding operations into small towns, recognising the trend of a wider population segment that hunger for iconic lifestyle foods that our brands offer. Our recent success in this segment shows that our brand equity has grown by leaps and bounds in the marketplace.

At the same time, QSR will continue to derive better cost efficiencies across all functions and to improve on the productivity of the restaurants and manufacturing operations. The strengthening of the Malaysian Ringgit against the United States Dollar has helped us offset some of our imported raw material costs.

We are confident that as we put these strong fundamentals into place, we will accelerate forward to realise leadership status in terms of consistent value creation, strengthening our brands and astute operational excellence.

The Board of Directors believe in high standards of corporate governance and are committed to making sure that effective self-regulatory corporate practices exist to protect the interest of the shareholders and to maximise long term shareholder value. These measures, driven by a clear Group vision, mission and cohesive set of strategies, are closely monitored by a dedicated and undistracted Board that is focussed on delivering sustainable value. Stringent standards of governance have been put in place through the appointment of Board Committees and the institution of risk management processes that are serviced by a strengthened and empowered internal audit division.





We remain fully committed to compliance with the standards of conduct as established by the Malaysian Code on Corporate Governance (2000). It is the policy of this Board to manage the affairs of QSR in accordance with those principals and best practices.

MANAGING BY KPI's

The Company has initiated a performance driven culture using key performance indicators (KPIs) as a management tool to measure achievement and to form the criteria for recognising, promoting and rewarding employees. We are confident this initiative will enhance motivation and increase our momentum in the fast paced restaurant sector.

With the shift in corporate leadership and as part of a corporate climate renewal exercise, we have also internalised and strengthened the interface between everyone in a leadership position involving, especially, all Restaurant Managers in the process. The key instrument adopted, among others, is the Group-wide annual interactive session labeled "Pedoman".

What these sessions have achieved to-date is to institutionalise open dialogue and a fully transparent interface involving all senior Management members as well as the Chairman himself. Pedoman exercise that is performed periodically is aimed at strengthening corporate cultural bonding. It gives a new, powerful meaning to the focus on 'people first' principle that has been so much a part of our past tradition.

Pedoman is seen to have had the desired impact of continuously reinforcing the glue that bonds our people at all levels. It is aimed principally at managing a seamless leadership transition.

More importantly, moving forward, Pedoman is a powerful tool to overcome any disadvantages of size now that the companies are shifting into higher gear of business growth and corporate expansion. Sizable corporate entities tend to be afflicted by the negative impact from bureaucracy and hierarchy that often stifle dynamism and undermine creativity and entrepreneurship in the process.



Pedoman real value is finally to be realised in the enhancement of trust and faith all around. Sustainable trust and faith in one another, after all, are among the most fundamental elements in delivering success in today's environment of rapid, constant, and often unremitting change.

We are confident that these initiatives will go a long way in both driving and sustaining a performance-driven culture in our organisation.

APPRECIATION

We wish to thank Yum! Brands Inc. for their confidence in our stewardship of their Pizza Hut and KFC Brands in Malaysia, Singapore and Brunei and look forward to implementing the extensive marketing campaigns planned for 2007.

On behalf of the Board, we thank most sincerely all our staff for their loyalty and support during the past year. We have no doubt that we can rely on their continuing commitment to meet the challenges that lie ahead.

We would also like to thank our financiers, our partners, the many Government bodies that we deal with, and last but not least our customers.

May we also take this opportunity to thank our fellow board members for their valuable insights and thoughtful advice.

Tan Sri Dato' Muhammad Ali bin Hashim
Chairman

Ahamad bin Mohamad
Deputy Chairman

Jamaludin bin Md Ali
Managing Director