

Yum China (YUMC US / 9987HK)

1Q23 performance indicates more improvements ahead

- A recovering economy revives the consumer market and the Group's revenue growth in 1Q23; higher revenue growth is expected in FY23E
- Higher margin in 1Q23 led to a 189% YoY jump in net profit (to shareholders of the Company) and a 200% YoY increase in basic EPS; we expect the trend of higher profit growth to continue in FY23 as sales growth recovers and operating efficiency increases
- Maintain **BUY**; TP represents 35.26x/28.87x 23E/24E P/E, or 4.33x/3.82x 23E/24E P/B

Better growth outlook for FY23E. In 1Q23 revenue grew 9.3% YoY vs. 4.3% YoY in 1Q22, revenue of KFC and Pizza Hut grew 9.0 YoY and 9.1% YoY (vs. 10.1% YoY and 1.1% YoY in 1Q22), and non-company-owned stores saw higher sales growth as demonstrated in 17% YoY growth in system sales. The higher revenue growth in 1Q23 was mainly due to improved product offerings, removal of COVID-19-related restrictions, and a reviving consumer market. We expect the consumer market to continue to recover as the economy improves, aiding revenue growth in the Group. We project, in FY23E, revenue growth to be 21.1% YoY, with revenue of KFC and Pizza Hut increasing 19.9% YoY and 12.7% YoY; net new store opening is expected to be ~1.28k, and store counts of KFC and Pizza Hut is expected to grow by 9.4% YoY and 8.2% YoY to ~9.9k and ~3.1k

Higher profit level growth to push up margins. 1Q23 restaurant margin and OPM both increased substantially to 20.3% and 15.0% from 13.8% and 7.5% in 1Q22. The restaurant margins and OPM of KFC and Pizza Hut also rose, with the former showing greater increase. 1Q23 NPM (to shareholders of the Company) rose to 9.9% and net profit (to shareholders of the Company) jumped 189.0% YoY. The Group's higher margin was mainly due to temporary relief from government and landlord, the continuous effort in improving operating efficiency, and sales leveraging. As the economy improves, the Group would reap more benefits from higher operational efficiency and economies of scale. However, we believe risks of cost inflation persist in areas of raw material and labor. Our projections of restaurant margin, OPM, and NPM (to shareholders of the Company) are maintained at 15.8%, 11.2%, 7.4% for FY23E.

Maintain BUY; TP at US\$ 72.7/HK\$570.3. 1Q23 results show resilience and strength of the Group's business. Its current targets for net new store opening (1,100-1,300) and capex (US\$ 700mn-900mn) are the same as the ones announced in 4Q22 results. Maintain **BUY**. Our TP is raised mainly due to the lower number of shares resulted from the Group's share repurchase program. Current TP represents 35.26x/28.87x 23E/24E P/E, or 4.33x/3.82x 23E/24E P/B.

Risk factors: 1) Macroeconomic risk; 2) Regulatory/policy risk; 3) Operational risk; 4) Inflation risk; 5) Concentration risk; 6) Seasonality risk; 7) Non-GAAP financial metrics; 8) Fluctuations in EPS growth.

Results and Valuation

FY ended Dec 31	FY21A	FY22E	FY23E	FY24E	FY25E
Revenue (US\$ mn)	9,853	9,569	11,589	13,008	14,489
Chg (% YoY)	19.2	(2.9)	21.1	12.2	11.4
Net profit (US\$ mn) ⁽¹⁾	990	442	861	1,052	1,218
Chg (% YoY)	26.3	(55.4)	94.9	22.1	15.8
EPS (US\$)	2.34	1.05	2.06	2.52	2.91
Chg (% YoY)	16.4	(55.1)	96.2	22.1	15.8
BVPS (US\$)	16.72	15.40	16.79	19.00	21.42
Chg (% YoY)	5.1	(7.9)	9.1	13.1	12.7
P/E (x) – US	26.41	58.86	29.99	24.56	21.20
P/E (x) – HK	27.25	60.72	30.94	25.34	21.87
P/B (x) – US	3.70	4.01	3.68	3.25	2.89
P/B (x) – HK	3.81	4.14	3.80	3.36	2.98
ROAA (%)	8.5	3.8	7.2	8.0	8.5
ROAE (%)	14.9	6.5	12.8	14.1	14.4
DPS (US\$)	0.48	0.48	0.49	0.48	0.48
Yield (%) – US	0.8	0.8	0.8	0.8	0.8
Yield (%) – HK	0.8	0.8	0.8	0.8	0.8

Source(s): The Group, ABCI Securities estimates

Company Report

May 5, 2023

Rating (US): BUY
Rating (HK): BUY
TP (US): US\$ 72.7
TP (HK): HK\$ 570.3

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Price (US/HK)	US\$ 61.8/HK\$ 500.5
Est. price return (US/HK)	17.56%/13.95%
Est. dividend yield (US/HK)	0.8%/0.8%
Est. total return (US/HK)	18.36%/14.75%
Previous Rating & TP (US/HK)	BUY; US\$ 72.3/HK\$ 567.5
Previous Report Date	Feb 9, 2022

Source(s): Bloomberg, ABCI Securities estimate

Key Data

52Wk H/L (US\$) (US shr)	64.7/36.05
52Wk H/L (HK\$) (HK shr)	514.5/290
Total issued shares (mn)	418
Issued US shr (mn)	377
Issued HK shr (mn)	42
US-shr market cap (US\$ mn)	23,270
H-shr market cap (HK\$ mn)	20,976
3-mth avg daily turnover (US\$ mn) (US shr)	102.8
3-mth avg daily turnover (HK\$ mn) (HK shr)	140.4
Major shareholder(s) (%):	
Blackrock	14.05

Source(s): Bloomberg, ABCI Securities

Price performance – US (%)

	Absolute	Relative*
1-mth	(1.2)	(0.5)
3-mth	5.1	7.0
6-mth	23.7	16.0

*Relative to S&P 500 Index

Source(s): Bloomberg, ABCI Securities

Price performance – HK (%)

	Absolute	Relative*
1-mth	1.3	2.9
3-mth	8.5	16.4
6-mth	26.4	3.0

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Note:

- 1) refers to net profit to shareholders of the Company ;
2) US\$/HK\$= 7.8500; 3) Market data as of May 4, 2023

Exhibit 1: Changes in assumptions and valuations

Exhibit 1: Changes in assumptions and valuations					
As of Dec 31	Current report		Previous report		Rationale
	FY23E	FY24E	FY23E	FY24E	
Assumptions					
D/E (%)	0	0	0	0	N/A
D/A (%)	0	0	0	0	
Tax rate (%)	30.9	30.9	30.9	30.9	
Valuations					
TP (US\$)	72.7		72.3		Higher TP mainly due to change in number of shares based on 1Q23 disclosure
TP (HK\$)	570.3		567.5		
P/E (x)	35.26	28.87	35.33	28.93	
P/B (x)	4.33	3.82	4.33	3.83	

Note: Previous report was published on Feb 9, 2023

Source(s): ABCI Securities estimates

Exhibit 2: Changes in major forecasts

As of Dec 31	Current report			Previous report			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Net revenue (US\$ mn)	11,589	13,008	14,489	11,589	13,008	14,489	0.00	0.00	0.00
Net profit (to shareholders of the Company) (US\$ mn)	861	1,052	1,218	861	1,052	1,218	0.00	0.00	0.00
EPS (US\$)	2.06	2.52	2.91	2.05	2.50	2.89	0.01	0.01	0.01

Source(s): ABCI Securities estimates

Exhibit 3: Quarterly figures

As of Dec 31	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23
Revenue growth (YoY %)									
Total	45.8	28.9	8.8	1.4	4.3	(13.2)	5.1	(8.9)	9.3
KFC	44.4	32.7	9.4	2.3	10.1	(8.1)	12.0	(2.8)	9.0
Pizza Hut	67.0	26.9	7.8	1.7	1.1	(16.7)	1.8	(15.7)	9.1
Margins (%)									
<u>Restaurant margin</u>	<u>18.7</u>	<u>15.8</u>	<u>12.2</u>	<u>7.5</u>	<u>13.8</u>	<u>12.1</u>	<u>18.8</u>	<u>10.4</u>	<u>20.3</u>
KFC	19.9	16.8	13.6	8.6	15.2	13.4	20.6	12.7	22.2
Pizza Hut	15.3	13.1	8.2	5.9	10.7	8.6	13.4	1.8	14.2
<u>OPM</u>	<u>14.7</u>	<u>10.4</u>	<u>7.7</u>	<u>30.3</u>	<u>7.5</u>	<u>4.0</u>	<u>12.3</u>	<u>2.1</u>	<u>15.0</u>
KFC	18.3	14.2	11.2	4.1	11.1	7.7	16.5	7.5	19.4
Pizza Hut	11.1	7.2	3.5	(1.4)	5.5	2.5	8.8	(5.0)	9.3
<u>NPM (to shareholders of the Company)</u>	<u>9.0</u>	<u>7.4</u>	<u>4.1</u>	<u>20.7</u>	<u>3.7</u>	<u>3.9</u>	<u>8.5</u>	<u>1.1</u>	<u>9.9</u>

Source(s): the Group, ABCI Securities

Financial statements

Consolidated income statement

FY ended Dec 31 (US\$ mn, except per share data)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	9,853	9,569	11,589	13,008	14,489
- Company sales	8,961	9,110	10,769	12,071	13,446
- Others	892	459	820	936	1,044
Company restaurant expenses	(7,734)	(7,829)	(9,063)	(10,041)	(11,129)
Restaurant profit	1,227	1,281	1,705	2,031	2,316
General and administrative expenses	(564)	(594)	(640)	(742)	(827)
Franchise expenses	(64)	(34)	(48)	(64)	(89)
Expenses for transactions with franchisees and unconsolidated affiliates	(649)	(279)	(526)	(573)	(569)
Other operating costs and expenses	(65)	(78)	(54)	(64)	(70)
Closures and impairment expenses, net	(34)	(32)	(36)	(40)	(43)
Other income, net	643	(94)	(18)	(17)	(22)
Operating profit	1,386	629	1,203	1,467	1,741
Others	6	58	100	125	104
Pretax profit	1,392	687	1,304	1,592	1,844
Tax	(369)	(207)	(402)	(491)	(569)
Net profit	1,023	478	901	1,101	1,275
- Owners	990	442	861	1,052	1,218
- MI	33	36	40	49	57
Cash Dividend	203	202	205	201	201
EPS (US\$)					
- Basic	2.34	1.05	2.06	2.52	2.91
- Diluted	2.28	1.04	2.04	2.49	2.88
Cash DPS (US\$)	0.48	0.48	0.49	0.48	0.48

Note: Items may not sum up due to rounding

Source(s): The Group, ABCI Securities estimates

Key operating figures

FY ended Dec 31 (US\$ mn, except store figures)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue					
- KFC	7,003	7,219	8,654	9,700	10,850
- Pizza Hut	2,109	1,960	2,208	2,471	2,713
Company sales					
- KFC	6,816	7,120	8,519	9,542	10,653
- Pizza Hut	2,092	1,939	2,178	2,433	2,667
Restaurant profit					
- KFC	1,013	1,121	1,458	1,724	1,949
- Pizza Hut	224	178	228	276	312
Operating profit					
- KFC	827	787	1,000	1,198	1,351
- Pizza Hut	111	70	91	115	130
Number of stores (units, as of end of FY)					
- Total	11,788	12,947	14,230	15,445	16,789
- KFC	8,168	9,094	9,945	10,930	11,978
- Pizza Hut	2,590	2,903	3,141	3,287	3,486

Note: Items may not sum up due to rounding

Source(s): The Group, ABCI Securities estimates

Consolidated balance sheet

FY ended Dec 31 (US\$ mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash and cash equivalents	1,136	1,130	1,698	2,449	3,359
Accounts receivable	67	64	141	152	213
Inventories	432	417	558	524	749
Others	3,081	2,329	2,171	2,418	2,273
Current assets	4,716	3,940	4,568	5,542	6,595
PP&E	2,251	2,118	2,320	2,412	2,537
Operating lease right-of-use assets	2,612	2,219	2,305	2,462	2,555
Intangible assets & goodwill	2,414	2,147	2,194	2,218	2,217
Others	1,230	1,402	1,710	1,777	1,791
Non-current assets	8,507	7,886	8,528	8,869	9,101
Total assets	13,223	11,826	13,096	14,411	15,695
Accounts payable and other current liabilities	2,332	2,098	2,606	2,703	2,884
Income taxes payable	51	68	115	143	141
Current liabilities	2,383	2,166	2,721	2,846	3,025
Non-current operating lease liabilities	2,286	1,906	2,088	2,264	2,316
Non-current finance lease obligations	40	42	37	40	39
Others	592	552	513	552	539
Non-current liabilities	2,918	2,500	2,637	2,856	2,894
Shareholders' capital	7,056	6,482	7,020	7,942	8,952
MI	852	666	706	755	811
Total equity	7,908	7,148	7,726	8,697	9,763
Redeemable non-controlling interest	14	12	12	12	12
Total liabilities and equity	13,223	11,826	13,096	14,411	15,695

Note: Items may not sum up due to rounding

Source(s): The Group, ABCI Securities estimates

Consolidated cash flow statement

FY ended Dec 31 (US\$ mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Net profit	1,023	478	901	1,101	1,275
Depreciation and amortization	516	602	647	738	916
Change in working capital	25	203	448	(175)	39
Others	(433)	130	61	149	100
Cash flow from operating activities	1,131	1,413	2,057	1,813	2,330
Capital spending	(689)	(679)	(734)	(995)	(915)
Others	(166)	157	22	10	12
Cash flow from investing activities	(855)	(522)	(712)	(984)	(903)
Cash dividend	(203)	(202)	(205)	(201)	(201)
Others	(110)	(642)	(547)	162	(278)
Cash flow from financing activities	(313)	(844)	(752)	(39)	(479)
Effect of foreign exchange rate changes	15	(53)	(25)	(39)	(37)
Net change in cash, cash equivalent, and restricted cash	(22)	(6)	568	750	911
Cash, cash equivalent, and restricted cash - end	1,136	1,130	1,698	2,449	3,359

Note: Items may not sum up due to rounding

Source(s): The Group, ABCI Securities estimates

Key operating and financial ratios

FY ended Dec 31	FY21A	FY22A	FY23E	FY24E	FY25E
Growth (YoY %)					
Net revenue	19.2	(2.9)	21.1	12.2	11.4
- KFC	20.3	3.1	19.9	12.1	11.8
- Pizza Hut	21.9	(7.1)	12.7	11.9	9.8
Restaurant profit	11.7	4.4	33.1	19.1	14.1
- KFC	10.1	10.7	30.1	18.3	13.0
- Pizza Hut	23.8	(20.5)	28.0	21.3	13.0
Operating profit	44.2	(54.6)	91.3	21.9	18.7
- KFC	3.2	(4.8)	27.1	19.8	12.7
- Pizza Hut	79.0	(36.9)	30.5	26.0	12.9
Net profit (to shareholders of the Company)	26.3	(55.4)	94.9	22.1	15.8
Non-GAAP operating profit	4.6	(17.4)	90.1	21.9	18.7
Non-GAAP net profit	(14.6)	(15.0)	93.1	22.1	15.8
Profitability ratios (%)					
Restaurant margin	13.7	14.1	15.8	16.8	17.2
- KFC	14.9	15.7	17.1	18.1	18.3
- Pizza Hut	10.7	9.2	10.5	11.4	11.7
OPM	15.5	6.9	11.2	12.2	12.9
- KFC	12.1	11.0	11.7	12.6	12.7
- Pizza Hut	5.3	3.6	4.2	4.7	4.9
NPM (to shareholders of the Company)	10.0	4.6	7.4	8.1	8.4
Non-GAAP OPM	7.8	6.6	10.4	11.3	12.0
Non-GAAP NPM	5.3	4.7	7.4	8.1	8.4
Return ratios (%)					
ROAA	8.5	3.8	7.2	8.0	8.5
ROAE	14.9	6.5	12.8	14.1	14.4
Liquidity ratio (x)					
Current ratio	2.0	1.8	1.7	1.9	2.2
Quick ratio	1.8	1.6	1.5	1.8	1.9
Cash ratio	0.5	0.5	0.6	0.9	1.1
Working capital (days)					
Receivable turnover	3.1	2.5	3.2	4.1	4.6
Inventory turnover	45.6	47.6	46.6	47.3	50.7
Payable turnover	54.2	61.5	59.8	61.7	65.6
CCC	(5.5)	(11.4)	(9.9)	(10.2)	(10.3)
Leverage ratios (%)					
Total debt to Equity	0.0	0.0	0.0	0.0	0.0
Total debt to Total assets	0.0	0.0	0.0	0.0	0.0
Net debt/(cash) to Equity	(14.4)	(15.8)	(22.0)	(28.2)	(34.4)
Net debt/(cash) to Total assets	(8.6)	(9.6)	(13.0)	(17.0)	(21.4)

Note: 1) Restaurant profit is defined as company sales less expenses incurred directly by company-owned restaurants in generating company sales; 2) Restaurant margin is defined as restaurant profit divided by company sales; 3) Company sales refers to revenues from Company-owned restaurants; 4) OPM is defined as operating profit divided by company sales; 5) Non-GAAP measures exclude the impact of share-based compensation expenses on operating costs and expenses; 6) Receivable turnover days equals the average of the beginning and ending balances of net accounts receivable for that FY divided by total revenues for that FY, and multiplied by the number of days; 7) Inventory turnover days equals the average of the beginning and ending balances of net inventory (including inventory procured by the Company, which is subsequently supplied to stores of unconsolidated affiliates and franchisees) for that FY divided by total cost of food and paper for Company-owned stores and stores of unconsolidated affiliates and franchisees for that FY, and multiplied by the number of days; 8) Payable turnover days equals the average of the beginning and ending balances of accounts payable related to inventory purchase and distribution for that FY divided by total cost of food and paper for Company-owned stores and stores of unconsolidated affiliates and franchisees for that FY and, multiplied by the number of day; 9) Items may not sum up due to rounding.

Source(s): The Group, ABCI Securities estimates

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Rating	Definition
Buy	Stock return rate \geq Market return rate ($\sim 9\%$)
Hold	- Market return rate ($\sim 9\%$) \leq Stock return rate $<$ Market return rate ($\sim 9\%$)
Sell	Stock return rate $<$ - Market return rate ($\sim 9\%$)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2006 (For reference: HSI total return index 2006-22 averaged at 8.4%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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