

## Yum China (YUMC US / 9987HK)

### Maintain BUY on improving profitability

- Revenue growth to recover as we expect easing COVID restrictions and reviving consumer market
- Margin improvement to continue despite pandemic challenges and rising raw material costs
- Maintain **BUY**; TP represents 37.40x/29.60x FY22E/23E P/E, or 3.91x/3.54x FY22E/23E P/B

**Revenue recovery shows operational strength.** In line with our previous view of revenue growth recovery, revenue growth reached 5.1% YoY in 3Q22 vs. a decline of 13.2% YoY in 2Q22; 3Q22 revenue of KFC and Pizza Hut grew by 12.0% YoY and 1.8% YoY. We believe relaxing COVID restrictions in 3Q22 boosted growth while flexible operation model in store format and product offerings helped capture opportunities. We expect revenue growth to reach 1.9% YoY for FY22E and improve to 15.3% YoY in FY23E, assuming easing of COVID-related measures and recovery in consumer market to continue. We project the total store number to reach ~12.9k by end-FY22E (~9.0k for KFC and ~2.8k for Pizza Hut), which is in line with the Group's outlook of opening 1k-1.2k net new stores for FY22. FY21-24E revenue CAGR is expected to be 9.6%, and that of KFC and Pizza Hut would be 11.0% and 7.9%.

**Better margins ahead.** Restaurant margin, OPM, and NPM (to shareholders of the Company) improved to 18.8%, 12.3%, and 8.5% in 3Q22 vs. 12.1%, 4.0%, and 3.9% in 2Q22. Margin profile improvement was supported by the reviving sales growth and efforts to balance the cost structure, though business environment remained challenging. We believe the Group's ability to improve cost efficiency amid challenges demonstrated in 3Q22 would help further improve margins. As such, we raise our projection of profit levels. Restaurant margin, OPM, and NPM (to shareholders of the Company) are estimated to reach 14.5%, 10.6%, and 6.9% in FY22E and 15.4%, 11.4%, and 7.5% in FY23E.

**Maintain BUY; TP at US\$ 61.1/HK\$ 479.3.** Maintain **BUY** on the improving margin and profit level. Basic EPS is projected to grow by 26.4%/20.3% YoY in FY23E/24E. We raise our DCF-derived TP due to the upward adjustment in profit projections. Current TP represents 37.40x/29.60x FY22E/23E P/E, or 3.91x/3.54x FY22E/23E P/B.

**Risk factors:** 1) Macroeconomic risk; 2) Pandemic risk; 3) Regulatory/policy risk; 4) Operational risk; 5) Inflation risk; 6) Concentration risk; 7) Seasonality risk; 8) Non-GAAP financial metrics; 9) Downward revision of projected revenue growth against upward revision of projected net profit in FY22E-24E.

#### Results and Valuation

FY ended Dec 31	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (US\$ mn)	8,263	9,853	10,041	11,582	12,964
Chg (% YoY)	(5.8)	19.2	1.9	15.3	11.9
Net profit (US\$ mn) <sup>(1)</sup>	784	990	689	870	1,047
Chg (% YoY)	10.0	26.3	(30.4)	26.4	20.3
EPS (US\$)	2.01	2.34	1.63	2.06	2.48
Chg (% YoY)	6.3	16.4	(30.4)	26.4	20.3
BVPS (US\$)	15.91	16.72	15.57	17.19	18.98
Chg (% YoY)	95.0	5.1	(6.9)	10.4	10.4
P/E (x) – US	26.91	23.11	33.21	26.28	21.85
P/E (x) – HK	26.21	22.52	32.36	25.61	21.28
P/B (x) – US	3.40	3.23	3.47	3.15	2.85
P/B (x) – HK	3.31	3.15	3.38	3.06	2.78
ROAA (%)	9.1	8.5	5.6	7.0	7.8
ROAE (%)	16.9	14.9	10.1	12.6	13.7
DPS (US\$)	0.24	0.48	0.48	0.48	0.48
Yield (%) – US	0.4	0.9	0.9	0.9	0.9
Yield (%) – HK	0.5	0.9	0.9	0.9	0.9

Source(s): The Group, ABCI Securities estimates

## Company Report

### Nov 14, 2022

Rating (US): BUY  
Rating (HK): BUY  
TP (US): US\$ 61.1  
TP (HK): HK\$ 479.3

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Price (US/HK)	US\$ 54.08/HK\$ 413.6
Est. price return (US/HK)	12.9%/15.9%
Est. dividend yield (US/HK)	0.9%/0.9%
Est. total return (US/HK)	13.8%/16.8%
Previous Rating &	BUY;
TP (US/HK)	US\$ 53.9/HK\$ 423.3
Previous Report Date	Aug 3, 2022

Source(s): Bloomberg, ABCI Securities estimate

#### Key Data

52Wk H/L (US\$) (US shr)	55.78/33.55
52Wk H/L (HK\$) (HK shr)	438.8/281.0
Total issued shares (mn)	418
Issued US shr (mn)	377
Issued HK shr(mn)	42
US-shr market cap (US\$ mn)	20,363
H-shr market cap (HK\$ mn)	17,334
3-mth avg daily turnover (US\$ mn) (US shr)	285.4
3-mth avg daily turnover (HK\$ mn) (HK shr)	115.2
Major shareholder(s) (%):	
Invesco	9.68

Source(s): Bloomberg, ABCI Securities

#### Price performance – US (%)

	Absolute	Relative*
1-mth	13.2	2.7
3-mth	11.8	16.9
6-mth	39.0	39.2

\*Relative to S&P 500 Index

Source(s): Bloomberg, ABCI Securities

#### Price performance – HK (%)

	Absolute	Relative*
1-mth	11.5	8.6
3-mth	11.0	22.7
6-mth	34.1	45.9

\*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 Nov 11, 2022



### Exhibit 1: Changes in assumptions and valuations

Exhibit 1: Changes in assumptions and valuations					
As of Dec 31	Current report		Previous report		Rationale
	FY22E	FY23E	FY22E	FY23E	
<b>Assumptions</b>					
D/E (%)	0	0	0	0	N/A
D/A (%)	0	0	0	0	
Tax rate (%)	32.7	32.7	30.3	30.1	Adjusted based on 3Q22 company release
<b>Valuations</b>					
TP (US\$)	61.1		53.9		Higher TP mainly due to higher profit projections
TP (HK\$)	479.3		423.3		
P/E (x)	37.40	29.60	44.57	29.71	
P/B (x)	3.91	3.54	3.34	3.05	

Note: Previous report was published on May 25, 2022

Source(s): ABCI Securities estimates

### Exhibit 2: Changes in major forecasts

As of Dec 31	Current report			Previous report			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Net revenue (US\$ mn)	10,041	11,582	12,964	10,732	11,914	13,068	(6.4)	(2.8)	(0.8)
Net profit (to shareholders of the Company) (US\$ mn)	689	870	1,047	511	766	872	34.9	13.6	20.1
EPS (US\$)	1.63	2.06	2.48	1.21	1.81	2.06	34.9	13.6	20.1

Source(s): ABCI Securities estimates



## Financial statements

### Consolidated income statement

FY ended Dec 31 (US\$ mn, except per share data)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Revenue</b>	<b>8,263</b>	<b>9,853</b>	<b>10,041</b>	<b>11,582</b>	<b>12,964</b>
- Company sales	7,396	8,961	9,348	10,749	12,122
- Others	867	892	693	832	842
Company restaurant expenses	(6,298)	(7,734)	(7,990)	(9,097)	(10,131)
<b>Restaurant profit</b>	<b>1,098</b>	<b>1,227</b>	<b>1,358</b>	<b>1,652</b>	<b>1,991</b>
General and administrative expenses	(479)	(564)	(509)	(619)	(668)
Franchise expenses	(65)	(64)	(39)	(68)	(72)
Expenses for transactions with franchisees and unconsolidated affiliates	(633)	(649)	(345)	(507)	(540)
Other operating costs and expenses	(57)	(65)	(71)	(53)	(58)
Closures and impairment expenses, net	(55)	(34)	(29)	(36)	(39)
Other income, net	285	643	(63)	19	5
<b>Operating profit</b>	<b>961</b>	<b>1,386</b>	<b>994</b>	<b>1,221</b>	<b>1,461</b>
Others	147	6	79	122	153
<b>Pretax profit</b>	<b>1,108</b>	<b>1,392</b>	<b>1,073</b>	<b>1,343</b>	<b>1,614</b>
Tax	(295)	(369)	(351)	(439)	(526)
<b>Net profit</b>	<b>813</b>	<b>1,023</b>	<b>719</b>	<b>904</b>	<b>1,088</b>
- Owners	784	990	689	870	1,047
- MI	29	33	30	34	41
<b>Cash Dividend</b>	<b>94</b>	<b>203</b>	<b>203</b>	<b>203</b>	<b>203</b>
<b>EPS (US\$)</b>					
- Basic	2.01	2.34	1.63	2.06	2.48
- Diluted	1.95	2.28	1.58	2.00	2.41
<b>Cash DPS (US\$)</b>	<b>0.24</b>	<b>0.48</b>	<b>0.48</b>	<b>0.48</b>	<b>0.48</b>

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)	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Revenue</b>					
- KFC	5,821	7,003	7,370	8,533	9,581
- Pizza Hut	1,730	2,109	2,095	2,362	2,652
<b>Company sales</b>					
- KFC	5,633	6,816	7,223	8,353	9,405
- Pizza Hut	1,721	2,092	2,068	2,325	2,603
<b>Restaurant profit</b>					
- KFC	920	1,013	1,146	1,373	1,607
- Pizza Hut	181	224	204	257	328
<b>Operating profit</b>					
- KFC	801	827	753	965	1,171
- Pizza Hut	62	111	70	116	159
<b>Number of stores ( units, as of end of FY)</b>					
- Total	10,506	11,788	12,962	14,125	15,371
- KFC	7,166	8,168	9,028	9,857	10,673
- Pizza Hut	2,355	2,590	2,874	3,156	3,397

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)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash and cash equivalents	1,158	1,136	1,459	1,884	2,751
Accounts receivable	99	67	129	99	144
Inventories	398	432	404	560	505
Others	3,281	3,081	3,026	3,081	3,120
<b>Current assets</b>	<b>4,936</b>	<b>4,716</b>	<b>5,018</b>	<b>5,624</b>	<b>6,520</b>
PP&E	1,765	2,251	2,253	2,320	2,398
Operating lease right-of-use assets	2,164	2,612	2,151	2,208	2,285
Intangible assets & goodwill	1,078	2,414	2,125	2,140	2,164
Others	932	1,230	957	1,069	1,241
<b>Non-current assets</b>	<b>5,939</b>	<b>8,507</b>	<b>7,487</b>	<b>7,735</b>	<b>8,088</b>
<b>Total assets</b>	<b>10,875</b>	<b>13,223</b>	<b>12,505</b>	<b>13,359</b>	<b>14,608</b>
Accounts payable and other current liabilities	1,995	2,332	2,263	2,488	2,515
Income taxes payable	72	51	183	49	272
<b>Current liabilities</b>	<b>2,067</b>	<b>2,383</b>	<b>2,446</b>	<b>2,536</b>	<b>2,787</b>
Non-current operating lease liabilities	1,915	2,286	2,028	2,088	2,250
Non-current finance lease obligations	28	40	31	33	35
Others	394	592	518	501	537
<b>Non-current liabilities</b>	<b>2,337</b>	<b>2,918</b>	<b>2,578</b>	<b>2,623</b>	<b>2,823</b>
Shareholders' capital	6,206	7,056	6,587	7,272	8,028
MI	253	852	882	916	957
<b>Total equity</b>	<b>6,459</b>	<b>7,908</b>	<b>7,469</b>	<b>8,187</b>	<b>8,985</b>
<b>Redeemable non-controlling interest</b>	<b>12</b>	<b>14</b>	<b>13</b>	<b>13</b>	<b>13</b>
<b>Total liabilities and equity</b>	<b>10,875</b>	<b>13,223</b>	<b>12,505</b>	<b>13,359</b>	<b>14,608</b>

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)	FY20A	FY21A	FY22E	FY23E	FY24E
Net profit	813	1,023	719	904	1,088
Depreciation and amortization	450	516	594	651	739
Change in working capital	52	69	(47)	44	(15)
Others	(201)	(477)	94	(196)	260
<b>Cash flow from operating activities</b>	<b>1,114</b>	<b>1,131</b>	<b>1,359</b>	<b>1,404</b>	<b>2,071</b>
Capital spending	(419)	(689)	(983)	(1,001)	(1,104)
Others	(2,690)	(166)	59	29	20
<b>Cash flow from investing activities</b>	<b>(3,109)</b>	<b>(855)</b>	<b>(924)</b>	<b>(973)</b>	<b>(1,085)</b>
Share issuance - HK	2,195	0	0	0	0
Cash dividend	(95)	(203)	(203)	(203)	(203)
Others	(42)	(110)	99	216	129
<b>Cash flow from financing activities</b>	<b>2,058</b>	<b>(313)</b>	<b>(104)</b>	<b>12</b>	<b>(74)</b>
Effect of foreign exchange rate changes	40	15	(8)	(19)	(45)
<b>Net change in cash, cash equivalent, and restricted cash</b>	<b>103</b>	<b>(22)</b>	<b>323</b>	<b>425</b>	<b>867</b>
<b>Cash, cash equivalent, and restricted cash - end</b>	<b>1,158</b>	<b>1,136</b>	<b>1,459</b>	<b>1,884</b>	<b>2,751</b>

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	FY20A	FY21A	FY22E	FY23E	FY24E
<b>Growth (YoY %)</b>					
Net revenue	(5.8)	19.2	1.9	15.3	11.9
- KFC	(3.6)	20.3	5.2	15.8	12.3
- Pizza Hut	(15.8)	21.9	(0.6)	12.7	12.2
Restaurant profit	(13.3)	11.7	10.7	21.6	20.5
- KFC	(11.7)	10.1	13.1	19.9	17.0
- Pizza Hut	(20.3)	23.8	(9.1)	26.4	27.3
Operating profit	6.7	44.2	(28.3)	22.8	19.7
- KFC	(15.7)	3.2	(9.0)	28.1	21.4
- Pizza Hut	(45.6)	79.0	(36.9)	65.6	37.4
Net profit (to shareholders of the Company)	10.0	26.3	(30.4)	26.4	20.3
Non-GAAP operating profit	(19.7)	4.6	0.6	34.4	21.7
Non-GAAP net profit	(15.6)	(14.6)	35.9	26.9	18.2
<b>Profitability ratios (%)</b>					
Restaurant margin	14.9	13.7	14.5	15.4	16.4
- KFC	16.3	14.9	15.9	16.4	17.1
- Pizza Hut	10.5	10.7	9.8	11.1	12.6
OPM	13.0	15.5	10.6	11.4	12.1
- KFC	14.2	12.1	10.4	11.5	12.4
- Pizza Hut	3.6	5.3	3.4	5.0	6.1
NPM (to shareholders of the Company)	9.5	10.0	6.9	7.5	8.1
Non-GAAP OPM	8.9	7.8	7.7	8.9	9.7
Non-GAAP NPM	7.4	5.3	7.1	7.8	8.3
<b>Return ratios (%)</b>					
ROAA	9.1	8.5	5.6	7.0	7.8
ROAE	16.9	14.9	10.1	12.6	13.7
<b>Liquidity ratio (x)</b>					
Current ratio	2.4	2.0	2.1	2.2	2.3
Quick ratio	2.2	1.8	1.9	2.0	2.2
Cash ratio	0.6	0.5	0.6	0.7	1.0
<b>Working capital (days)</b>					
Receivable turnover	4.1	3.1	3.6	3.6	3.4
Inventory turnover	49.1	45.6	45.1	45.2	45.3
Payable turnover	42.8	47.9	49.7	50.3	50.8
CCC	10.4	0.8	(1.0)	(1.5)	(2.1)
<b>Leverage ratios (%)</b>					
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	(17.9)	(14.4)	(19.5)	(23.0)	(30.6)
Net debt/(cash) to Total assets	(10.6)	(8.6)	(11.7)	(14.1)	(18.8)

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 $\geq$ Market return rate ( $\sim 10\%$ )
Hold	- Market return ( $\sim 10\%$ ) $\leq$ Stock return $<$ Market return rate ( $+ \sim 10\%$ )
Sell	Stock return $<$ - Market return ( $\sim 10\%$ )

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 2008 (HSI total return index 2008-20 CAGR at 9.2%)

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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