

Yum China (YUMC US / 9987HK)

Profitability outlook to improve

- Revenue grew 24.7% YoY in 2Q23 partly due to the low-base effect from 2Q22 and proactive measures in new product launches, sales promotional events, and store network expansion
- Improved margin profile shows effective cost control associated with store operations and higher efficiency in other operating costs
- Maintain **BUY**; current TP represents 32.05x/28.31x 23E/24E P/E, or 4.31x/3.80x 23E/24E 23E/24E P/B

Proactive growth strategy and favorable policy environment will boost growth. 2Q23 net revenue was up 24.7% YoY, with net revenue of KFC and Pizza Hut increasing 24.5% YoY and 23.7% YoY. 1H23 net revenue growth reached 16.2% YoY, with net revenue of KFC and Pizza Hut up by 15.8% and 15.7% YoY. Meanwhile, the Group's no. of stores increased 422/655 in 2Q23/1H23, reaching 13.5k by end-1H23; the no. of store of KFC and Pizza Hut reached ~9.6k and ~3.1k as of end-2Q23. The Group's higher net revenue growth is driven by (1) the low-base effect from 2Q22 when revenue declined 13.2% YoY on pandemic in China; (2) proactive measures in new product launches, sales promotional events, and store network expansion, which helped offset weakness in the consumer market and impact of COVID resurgence emerging in Apr 2023. Going forward, we believe the recently announced consumption-boosting policies targeting the catering and tourism industry would help promote growth. On Jul 28, 2023, the State Council released the "Measures to Recover and Expand Consumption", which targets service consumption with measures to boost catering and tourism. Our total store number forecast for end-FY23 is unchanged at ~14.2k, which is in line with the net new store opening target set by the Group (1.1k-1.3k). FY23E revenue growth is projected at 21.3% YoY, with KFC and Pizza Hut's revenue going up by 19.5% YoY and 14.8% YoY; 2H23E revenue growth would be 26.4% YoY, with KFC and Pizza Hut's revenue expanding at 23.3% YoY and 13.8% YoY. We estimate FY22-25E revenue CAGR to be 14.8%.

Rising margins shows better efficiency and cost control. 2Q23 restaurant margin increased by 4ppt to 16.1% compared to 2Q22; restaurant margin of KFC and Pizza Hut also rose to 17.3% and 12.4%. 2Q23 OPM was up 6.2ppt to 10.2% compared to 2Q22; OPM of KFC and Pizza Hut increased by 6.3ppt and 3.9ppt. The larger improvement observed in OPM than in restaurant margin shows the Group was able to increase efficiency in other operating costs. We expect restaurant margin, OPM, and NPM (to shareholders of the Company) to reach 17.0%, 12.5%, and 8.2% in FY23E.

Maintain BUY; TP at US\$ 73.3/HK\$ 571.5. Based on 2Q23 performance, we believe the Group would be able to deliver consistent growth and attains higher profitability and operational efficiency. This forms the underlying reasons for our raised revenue and profit estimates, as well as DCF-derived TP. Maintain **BUY**. Current TP represents 32.05x/28.31x 23E/24E P/E, or 4.31x/3.80x 23E/24E P/B.

Risk factors: 1) Macroeconomic risk; 2) Regulatory/policy risk; 3) Operational risk; 4) Inflation risk; 5) Business 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	11,605	13,007	14,495
Chg (% YoY)	19.2	(2.9)	21.3	12.1	11.4
Net profit (US\$ mn) ⁽¹⁾	990	442	956	1,083	1,229
Chg (% YoY)	26.3	(55.4)	116.4	13.2	13.6
EPS (US\$)	2.34	1.05	2.29	2.59	2.94
Chg (% YoY)	16.4	(55.1)	117.9	13.2	13.6
BVPS (US\$)	16.72	15.40	17.02	19.30	21.74
Chg (% YoY)	5.1	(7.9)	10.6	13.4	12.7
P/E (x) – US	24.52	54.64	25.08	22.15	19.51
P/E (x) – HK	26.07	58.09	26.66	23.55	20.74
P/B (x) – US	3.43	3.73	3.37	2.97	2.64
P/B (x) – HK	3.65	3.96	3.58	3.16	2.81
ROAA (%)	8.5	3.8	8.0	8.2	8.5
ROAE (%)	14.9	6.5	14.1	14.3	14.3
DPS (US\$)	0.48	0.48	0.49	0.48	0.48
Yield (%) - US	0.8	0.8	0.9	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

Aug 2, 2023

Rating (US): BUY
Rating (HK): BUY
TP (US): US\$ 73.3
TP (HK): HK\$ 571.5

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Price (US/HK)	US\$ 57.37/HK\$ 475.4
Est. price return (US/HK)	27.8%/20.2%
Est. dividend yield (US/HK)	0.9%/0.8%
Est. total return (US/HK)	28.7%/21.0%
Previous Rating &	BUY;
TP (US/HK)	US\$ 72.7/HK\$ 570.3
Previous Report Date	May 5, 2022

Source(s): Bloomberg, ABCI Securities estimate

Key Data

52Wk H/L (US\$) (US shr)	64.7/38.58
52Wk H/L (HK\$) (HK shr)	514.5/300
Total issued shares (mn)	418
Issued US shr (mn)	377
Issued HK shr(mn)	42
US-shr market cap (US\$ mn)	21,602
H-shr market cap (HK\$ mn)	19,924
3-mth avg daily turnover (US\$ mn) (US shr)	99.1
3-mth avg daily turnover (HK\$ mn) (HK shr)	121.1
Major shareholder(s) (%):	
JP Morgan	10.4

Source(s): Bloomberg, ABCI Securities

Price performance – US (%)

	Absolute	Relative*
1-mth	(0.2)	(2.9)
3-mth	(7.6)	(17.4)
6-mth	(7.8)	(18.9)

*Relative to S&P 500 Index

Source(s): Bloomberg, ABCI Securities

Price performance – HK (%)

	Absolute	Relative*
1-mth	4.9	1.3
3-mth	(1.9)	(2.3)
6-mth	(2.1)	7.2

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Note:

- 1) refers to net profit to shareholders of the Company ;
2) US\$/HK\$= 7.7936; 3) Market data as of Aug 1, 2023

Exhibit 1: Changes in assumptions and valuations

Exhibit A: 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\$)	73.3		72.7		Higher TP mainly due to improved profit outlook
TP (HK\$)	571.5		570.3		
P/E (x)	32.05	28.31	35.26	28.87	
P/B (x)	4.31	3.80	4.33	3.82	

Note: Previous report was published on May 5, 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)	11,605	13,007	14,495	11,589	13,008	14,489	0.14	(0.00)	0.04
Net profit (to shareholders of the Company) (US\$ mn)	956	1,083	1,229	861	1,052	1,218	11.04	2.92	0.90
EPS (US\$)	2.29	2.59	2.94	2.06	2.52	2.91	11.04	2.92	0.90

Source(s): ABCI Securities estimates

Exhibit 3: Quarterly figures

As of Dec 31	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23
Revenue growth (YoY %)									
Total	28.9	8.8	1.4	4.3	(13.2)	5.1	(8.9)	9.3	24.7
KFC	32.7	9.4	2.3	10.1	(8.1)	12.0	(2.8)	9.0	24.5
Pizza Hut	26.9	7.8	1.7	1.1	(16.7)	1.8	(15.7)	9.1	23.7
Margins (%)									
<u>Restaurant margin</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>	<u>16.1</u>
KFC	16.8	13.6	8.6	15.2	13.4	20.6	12.7	22.2	17.3
Pizza Hut	13.1	8.2	5.9	10.7	8.6	13.4	1.8	14.2	12.4
<u>OPM</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>	<u>10.2</u>
KFC	14.2	11.2	4.1	11.1	7.7	16.5	7.5	19.4	14.0
Pizza Hut	7.2	3.5	(1.4)	5.5	2.5	8.8	(5.0)	9.3	6.4
<u>NPM (to shareholders of the Company)</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>	<u>7.4</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	11,605	13,007	14,495
- Company sales	8,961	9,110	10,772	12,045	13,413
- Others	892	459	833	963	1,082
Company restaurant expenses	(7,734)	(7,829)	(8,936)	(9,986)	(11,098)
Restaurant profit	1,227	1,281	1,836	2,059	2,316
General and administrative expenses	(564)	(594)	(642)	(742)	(827)
Franchise expenses	(64)	(34)	(48)	(65)	(92)
Expenses for transactions with franchisees and unconsolidated affiliates	(649)	(279)	(527)	(586)	(591)
Other operating costs and expenses	(65)	(78)	(54)	(64)	(71)
Closures and impairment expenses, net	(34)	(32)	(36)	(40)	(43)
Other income, net	643	(94)	(18)	(17)	(22)
Operating profit	1,386	629	1,345	1,507	1,753
Others	6	58	103	132	108
Pretax profit	1,392	687	1,448	1,639	1,861
Tax	(369)	(207)	(447)	(506)	(574)
Net profit	1,023	478	1,001	1,133	1,286
- Owners	990	442	956	1,083	1,229
- MI	33	36	44	50	57
Cash Dividend	203	202	205	201	201
EPS (US\$)					
- Basic	2.34	1.05	2.29	2.59	2.94
- Diluted	2.28	1.04	2.26	2.56	2.91
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	8,629	9,684	10,832
- Pizza Hut	2,109	1,960	2,249	2,487	2,736
Company sales					
- KFC	6,816	7,120	8,488	9,507	10,606
- Pizza Hut	2,092	1,939	2,212	2,442	2,682
Restaurant profit					
- KFC	1,013	1,121	1,571	1,744	1,944
- Pizza Hut	224	178	245	284	316
Operating profit					
- KFC	827	787	1,114	1,205	1,322
- Pizza Hut	111	70	106	122	133
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	1,772	2,599	3,484
Accounts receivable	67	64	142	151	214
Inventories	432	417	546	532	740
Others	3,081	2,329	2,171	2,417	2,274
Current assets	4,716	3,940	4,631	5,699	6,711
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	1,776	1,792
Non-current assets	8,507	7,886	8,528	8,869	9,101
Total assets	13,223	11,826	13,159	14,568	15,813
Accounts payable and other current liabilities	2,332	2,098	2,550	2,741	2,843
Income taxes payable	51	68	135	131	156
Current liabilities	2,383	2,166	2,685	2,871	3,000
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	7,115	8,068	9,089
MI	852	666	710	761	818
Total equity	7,908	7,148	7,826	8,829	9,907
Redeemable non-controlling interest	14	12	12	12	12
Total liabilities and equity	13,223	11,826	13,159	14,568	15,813

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	1,001	1,133	1,286
Depreciation and amortization	516	602	647	738	916
Change in working capital	25	203	403	(146)	(25)
Others	(433)	130	81	117	127
Cash flow from operating activities	1,131	1,413	2,131	1,843	2,304
Capital spending	(689)	(679)	(735)	(995)	(915)
Others	(166)	157	22	10	12
Cash flow from investing activities	(855)	(522)	(713)	(984)	(903)
Cash dividend	(203)	(202)	(205)	(201)	(201)
Others	(110)	(642)	(543)	213	(279)
Cash flow from financing activities	(313)	(844)	(748)	12	(480)
Effect of foreign exchange rate changes	15	(53)	(28)	(43)	(36)
Net change in cash, cash equivalent, and restricted cash	(22)	(6)	642	827	884
Cash, cash equivalent, and restricted cash - end	1,136	1,130	1,772	2,599	3,484

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)	21.3	12.1	11.4
- KFC	20.3	3.1	19.5	12.2	11.9
- Pizza Hut	21.9	(7.1)	14.8	10.6	10.0
Restaurant profit	11.7	4.4	43.3	12.2	12.5
- KFC	10.1	10.7	40.2	11.0	11.4
- Pizza Hut	23.8	(20.5)	37.6	15.9	11.4
Operating profit	44.2	(54.6)	113.8	12.1	16.3
- KFC	3.2	(4.8)	41.6	8.1	9.7
- Pizza Hut	79.0	(36.9)	51.6	14.8	9.0
Net profit (to shareholders of the Company)	26.3	(55.4)	116.4	13.2	13.6
Non-GAAP operating profit	4.6	(17.4)	112.4	12.1	16.3
Non-GAAP net profit	(14.6)	(15.0)	114.4	13.2	13.6
Profitability ratios (%)					
Restaurant margin	13.7	14.1	17.0	17.1	17.3
- KFC	14.9	15.7	18.5	18.3	18.3
- Pizza Hut	10.7	9.2	11.1	11.6	11.8
OPM	15.5	6.9	12.5	12.5	13.1
- KFC	12.1	11.0	13.1	12.7	12.5
- Pizza Hut	5.3	3.6	4.8	5.0	5.0
NPM (to shareholders of the Company)	10.0	4.6	8.2	8.3	8.5
Non-GAAP OPM	7.8	6.6	11.6	11.6	12.1
Non-GAAP NPM	5.3	4.7	8.2	8.3	8.5
Return ratios (%)					
ROAA	8.5	3.8	8.0	8.2	8.5
ROAE	14.9	6.5	14.1	14.3	14.3
Liquidity ratio (x)					
Current ratio	2.0	1.8	1.7	2.0	2.2
Quick ratio	1.8	1.6	1.5	1.8	2.0
Cash ratio	0.5	0.5	0.7	0.9	1.2
Working capital (days)					
Receivable turnover	3.1	2.5	3.2	4.1	4.6
Inventory turnover	45.6	47.6	46.0	47.1	50.5
Payable turnover	54.2	61.5	58.9	61.4	65.5
CCC	(5.5)	(11.4)	(9.7)	(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)	(22.6)	(29.4)	(35.2)
Net debt/(cash) to Total assets	(8.6)	(9.6)	(13.5)	(17.8)	(22.0)

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

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 (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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