

## Yum China (YUMC US / 9987HK)

### Bracing for consumer market softness ahead

- More challenges arisen from the weakness in consumer market prompt us to lower our revenue growth forecasts
- Challenges in consumer market and increased competition would drive down overall margins
- Maintain **BUY**; current TP represents 31.79x/27.18x 23E/24E P/E, or 3.91x/3.35x 23E/24E P/B

**Challenges in consumer market to affect growth.** 3Q23 revenue growth slowed to 8.5% YoY vs. 24.7% YoY in 2Q23. 3Q23 revenue growth of KFC and Pizza Hut were 8.4% YoY and 6.8% YoY vs. 24.5% YoY and 23.7% YoY in 2Q23. The Group achieved 500 net new store opening in 3Q23 and total number of restaurant counts reached ~14.1k as of end-3Q23. However, SSSG in 3Q23 only reached 4% and ticket average of KFC and Pizza Hut both declined, showing weakness in customer spending and overall recovery in the consumer market. We expect macroeconomic challenges would continue to weigh down the consumer market recovery and the Group's growth performance in the short term. Based on our projections, the total number of stores in FY23 would reach ~14.5k; of which KFC and Pizza Hut would take up ~10.1k and ~3.3k; net new store opening would be ~1.53k. FY23E revenue growth would be 14.6% YoY, supported by the growth of KFC and Pizza Hut at 11.0% YoY and 14.0% YoY. FY22-25E revenue would expand at 11.9% CAGR, and that of KFC and Pizza Hut would increase at 11.3% and 12.0% CAGRs.

**Lower margins on challenging market conditions.** 3Q23 restaurant margin and OPM were 17.0% and 11.7% vs. 18.8% and 12.3% in 3Q22. The lower margins can be attributed to elimination of temporary relief, which was present in 3Q22, as well as the higher wage level and promotional costs in 3Q23. We lower our margin projections on the subdued consumer market and increased competition in the industry marked by new entrants. We project restaurant margin, OPM and NPM (to shareholders of the Company) to be 16.0%, 11.4%, and 7.5% in FY23E.

**Maintain BUY; TP at US\$ 62.6/HK\$ 489.2.** We believe the Group would be able to stay competitive with its strong brand portfolio and expansion plan. However, as recovery in the consumer market recovery remains slow, we lower our revenue and profit projections and DCF-derived TP is adjusted down as a result. Maintain **BUY**. Current TP represents 31.79x/27.18x 23E/24E P/E, or 3.91x/3.35x 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	10,964	12,043	13,414
Chg (% YoY)	19.2	(2.9)	14.6	9.8	11.4
Net profit (US\$ mn) <sup>(1)</sup>	990	442	819	957	1,088
Chg (% YoY)	26.3	(55.4)	85.2	17.0	13.6
EPS (US\$)	2.34	1.05	1.97	2.30	2.62
Chg (% YoY)	16.4	(55.1)	87.4	17.0	13.6
BVPS (US\$)	16.72	15.40	16.01	18.70	20.77
Chg (% YoY)	5.1	(7.9)	4.0	16.8	11.1
P/E (x) – US	19.22	42.83	22.85	19.54	17.19
P/E (x) – HK	19.78	44.08	23.52	20.11	17.70
P/B (x) – US	2.69	2.92	2.81	2.41	2.16
P/B (x) – HK	2.77	3.01	2.89	2.48	2.23
ROAA (%)	8.5	3.8	7.3	7.8	8.1
ROAE (%)	14.9	6.5	12.5	13.3	13.3
DPS (US\$)	0.48	0.48	0.52	0.52	0.52
Yield (%) - US	1.1	1.1	1.2	1.2	1.2
Yield (%) - HK	1.0	1.0	1.1	1.1	1.1

Source(s): The Group, ABCI Securities estimates

## Company Report

### Nov 7, 2023

Rating (US): BUY  
Rating (HK): BUY  
TP (US): US\$ 62.6  
TP (HK): HK\$ 489.2

Analyst : Paul Pan  
Tel: (852) 2147 8829  
paulpan@abci.com.hk

Price (US/HK)	US\$ 44.97/HK\$ 362
Est. price return (US/HK)	39.1%/35.1%
Est. dividend yield (US/HK)	1.2%/1.1%
Est. total return (US/HK)	40.3%/36.2%
Previous Rating & TP (US/HK)	BUY; US\$ 76.2/HK\$ 596
Previous Report Date	Sep 19, 2023

Source(s): Bloomberg, ABCI Securities estimate

#### Key Data

52Wk H/L (US\$) (US shr)	64.7/41.48
52Wk H/L (HK\$) (HK shr)	514.5/326.8
Total issued shares (mn)	415
Issued US shr (mn)	373
Issued HK shr(mn)	42
US-shr market cap (US\$ mn)	16,778
HK-shr market cap (HK\$ mn)	15,172
3-mth avg daily turnover (US\$ mn) (US shr)	105.1
3-mth avg daily turnover (HK\$ mn) (HK shr)	151.9
Major shareholder(s) (%):	
JP Morgan	13.02

Source(s): Bloomberg, ABCI Securities

#### Price performance – US (%)

	Absolute	Relative*
1-mth	(15.2)	(17.7)
3-mth	(19.7)	(17.2)
6-mth	(28.1)	(33.7)

\*Relative to S&P 500 Index

Source(s): Bloomberg, ABCI Securities

#### Price performance – HK (%)

	Absolute	Relative*
1-mth	(13.4)	(17.7)
3-mth	(18.4)	(10.3)
6-mth	(24.1)	(13.8)

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Note:

- refers to net profit to shareholders of the Company ;
- US\$/HK\$= 7.8208; 3) Market data as of Nov 6, 2023

**Exhibit 1: Changes in assumptions and valuations**

As of Dec 31	Current report		Previous report		Rationale
	FY23E	FY24E	FY23E	FY24E	
<b>Assumptions</b>					
D/E (%)	2.9	2.2	0.0	0.0	
D/A (%)	1.7	1.3	0.0	0.0	N/A
Tax rate (%)	30.2	30.2	32.7	32.6	
<b>Valuations</b>					
TP (US\$)	62.6		76.2		
TP (HK\$)	489.2		596.0		
P/E (x)	31.79	27.18	32.89	27.16	Lower TP on lower revenue and profit projections
P/B (x)	3.91	3.35	4.48	3.91	

Note: Previous report was published on Sep 19, 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)	10,964	12,043	13,414	11,716	13,607	15,638	(6.4)	(11.5)	(14.2)
Net profit (to shareholders of the Company) (US\$ mn)	819	957	1,088	969	1,173	1,428	(15.5)	(18.4)	(23.8)
EPS (US\$)	1.97	2.30	2.62	2.32	2.81	3.42	(15.2)	(18.1)	(23.5)

Source(s): ABCI Securities estimates

**Exhibit 3: Quarterly figures**

As of Dec 31	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23
<b>Revenue growth (YoY %)</b>									
Total	8.8	1.4	4.3	(13.2)	5.1	(8.9)	9.3	24.7	8.5
KFC	9.4	2.3	10.1	(8.1)	12.0	(2.8)	9.0	24.5	8.4
Pizza Hut	7.8	1.7	1.1	(16.7)	1.8	(15.7)	9.1	23.7	6.8
<b>Margins (%)</b>									
<i>Restaurant margin</i>	<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>	<u>17.0</u>
KFC	13.6	8.6	15.2	13.4	20.6	12.7	22.2	17.3	18.6
Pizza Hut	8.2	5.9	10.7	8.6	13.4	1.8	14.2	12.4	12.7
<i>OPM</i>	<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>	<u>11.7</u>
KFC	11.2	4.1	11.1	7.7	16.5	7.5	19.4	14.0	15.0
Pizza Hut	3.5	(1.4)	5.5	2.5	8.8	(5.0)	9.3	6.4	8.0
<i>NPM (to shareholders of the Company)</i>	<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>	<u>8.4</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
<b>Revenue</b>	<b>9,853</b>	<b>9,569</b>	<b>10,964</b>	<b>12,043</b>	<b>13,414</b>
- Company sales	8,961	9,110	10,157	11,377	12,594
- Others	892	459	806	666	819
Company restaurant expenses	(7,734)	(7,829)	(8,534)	(9,541)	(10,583)
<b>Restaurant profit</b>	<b>1,227</b>	<b>1,281</b>	<b>1,623</b>	<b>1,836</b>	<b>2,011</b>
General and administrative expenses	(564)	(594)	(669)	(611)	(729)
Franchise expenses	(64)	(34)	(44)	(45)	(54)
Expenses for transactions with franchisees and unconsolidated affiliates	(649)	(279)	(396)	(401)	(468)
Other operating costs and expenses	(65)	(78)	(127)	(72)	(86)
Closures and impairment expenses, net	(34)	(32)	(32)	(35)	(38)
Other income, net	643	(94)	(2)	(2)	(3)
<b>Operating profit</b>	<b>1,386</b>	<b>629</b>	<b>1,159</b>	<b>1,336</b>	<b>1,453</b>
Others	6	58	120	159	247
<b>Pretax profit</b>	<b>1,392</b>	<b>687</b>	<b>1,279</b>	<b>1,496</b>	<b>1,700</b>
Tax	(369)	(207)	(386)	(452)	(514)
<b>Net profit</b>	<b>1,023</b>	<b>478</b>	<b>892</b>	<b>1,044</b>	<b>1,186</b>
- Owners	990	442	819	957	1,088
- MI	33	36	74	86	98
<b>Cash Dividend</b>	<b>203</b>	<b>202</b>	<b>216</b>	<b>216</b>	<b>216</b>
<b>EPS (US\$)</b>					
- Basic	2.34	1.05	1.97	2.30	2.62
- Diluted	2.28	1.04	1.95	2.28	2.59
<b>Cash DPS (US\$)</b>	<b>0.48</b>	<b>0.48</b>	<b>0.52</b>	<b>0.52</b>	<b>0.52</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)	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Revenue</b>					
- KFC	7,003	7,219	8,013	8,962	9,966
- Pizza Hut	2,109	1,960	2,234	2,528	2,754
<b>Company sales</b>					
- KFC	6,816	7,120	7,897	8,821	9,798
- Pizza Hut	2,092	1,939	2,206	2,490	2,712
<b>Restaurant profit</b>					
- KFC	1,013	1,121	1,481	1,599	1,761
- Pizza Hut	224	178	248	262	274
<b>Operating profit</b>					
- KFC	827	787	1,148	1,176	1,282
- Pizza Hut	111	70	102	95	89
<b>Number of stores ( units, as of end of FY)</b>					
- Total	11,788	12,947	14,478	16,309	18,192
- KFC	8,168	9,094	10,116	11,404	12,739
- Pizza Hut	2,590	2,903	3,343	3,722	4,089

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	1,518	2,339	3,597
Accounts receivable	67	64	72	169	119
Inventories	432	417	415	557	587
Others	3,081	2,329	2,315	2,378	2,382
<b>Current assets</b>	<b>4,716</b>	<b>3,940</b>	<b>4,320</b>	<b>5,443</b>	<b>6,685</b>
PP&E	2,251	2,118	2,175	2,169	2,109
Operating lease right-of-use assets	2,612	2,219	1,921	2,094	1,950
Intangible assets & goodwill	2,414	2,147	2,127	2,118	2,111
Others	1,230	1,402	2,035	2,242	2,205
<b>Non-current assets</b>	<b>8,507</b>	<b>7,886</b>	<b>8,258</b>	<b>8,623</b>	<b>8,375</b>
<b>Total assets</b>	<b>13,223</b>	<b>11,826</b>	<b>12,578</b>	<b>14,066</b>	<b>15,060</b>
Accounts payable and other current liabilities	2,332	2,096	2,344	2,579	2,661
Short-term borrowings	0	2	210	189	170
Income taxes payable	51	68	160	108	202
<b>Current liabilities</b>	<b>2,383</b>	<b>2,164</b>	<b>2,714</b>	<b>2,877</b>	<b>3,033</b>
Non-current operating lease liabilities	2,286	1,906	1,958	2,036	1,926
Non-current finance lease obligations	40	42	37	40	39
Others	592	552	513	552	539
<b>Non-current liabilities</b>	<b>2,918</b>	<b>2,500</b>	<b>2,507</b>	<b>2,628</b>	<b>2,504</b>
Shareholders' capital	7,056	6,482	6,660	7,778	8,642
MI	852	666	685	771	869
<b>Total equity</b>	<b>7,908</b>	<b>7,148</b>	<b>7,344</b>	<b>8,549</b>	<b>9,511</b>
<b>Redeemable non-controlling interest</b>	<b>14</b>	<b>12</b>	<b>13</b>	<b>13</b>	<b>13</b>
<b>Total liabilities and equity</b>	<b>13,223</b>	<b>11,824</b>	<b>12,578</b>	<b>14,066</b>	<b>15,060</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)	FY21A	FY22A	FY23E	FY24E	FY25E
Net profit	1,023	478	892	1,044	1,186
Depreciation and amortization	516	602	633	699	849
Change in working capital	25	203	256	(185)	98
Others	(433)	130	49	(9)	92
<b>Cash flow from operating activities</b>	<b>1,131</b>	<b>1,413</b>	<b>1,830</b>	<b>1,549</b>	<b>2,225</b>
Capital spending	(689)	(679)	(694)	(998)	(1,155)
Others	(166)	157	22	10	12
<b>Cash flow from investing activities</b>	<b>(855)</b>	<b>(522)</b>	<b>(672)</b>	<b>(987)</b>	<b>(1,143)</b>
Cash dividend	(203)	(202)	(216)	(216)	(216)
Others	(110)	(642)	(536)	519	444
<b>Cash flow from financing activities</b>	<b>(313)</b>	<b>(844)</b>	<b>(752)</b>	<b>303</b>	<b>228</b>
Effect of foreign exchange rate changes	15	(53)	(17)	(43)	(51)
<b>Net change in cash, cash equivalent, and restricted cash</b>	<b>(22)</b>	<b>(6)</b>	<b>388</b>	<b>821</b>	<b>1,258</b>
<b>Cash, cash equivalent, and restricted cash - end</b>	<b>1,136</b>	<b>1,130</b>	<b>1,518</b>	<b>2,339</b>	<b>3,597</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	FY21A	FY22A	FY23E	FY24E	FY25E
<b>Growth (YoY %)</b>					
Net revenue	19.2	(2.9)	14.6	9.8	11.4
- KFC	20.3	3.1	11.0	11.8	11.2
- Pizza Hut	21.9	(7.1)	14.0	13.1	8.9
Restaurant profit	11.7	4.4	26.7	13.1	9.5
- KFC	10.1	10.7	32.1	8.0	10.1
- Pizza Hut	23.8	(20.5)	39.2	5.9	4.4
Operating profit	44.2	(54.6)	84.3	15.3	8.7
- KFC	3.2	(4.8)	45.9	2.4	9.1
- Pizza Hut	79.0	(36.9)	46.2	(6.9)	(6.1)
Net profit (to shareholders of the Company)	26.3	(55.4)	85.2	17.0	13.6
Non-GAAP operating profit	4.6	(17.4)	83.1	15.3	8.7
Non-GAAP net profit	(14.6)	(15.0)	83.5	17.0	13.6
<b>Profitability ratios (%)</b>					
Restaurant margin	13.7	14.1	16.0	16.1	16.0
- KFC	14.9	15.7	18.8	18.1	18.0
- Pizza Hut	10.7	9.2	11.2	10.5	10.1
OPM	15.5	6.9	11.4	11.7	11.5
- KFC	12.1	11.0	14.5	13.3	13.1
- Pizza Hut	5.3	3.6	4.6	3.8	3.3
NPM (to shareholders of the Company)	10.0	4.6	7.5	8.0	8.1
Non-GAAP OPM	7.8	6.6	10.6	11.1	10.8
Non-GAAP NPM	5.3	4.7	7.5	8.0	8.1
<b>Return ratios (%)</b>					
ROAA	8.5	3.8	7.3	7.8	8.1
ROAE	14.9	6.5	12.5	13.3	13.3
<b>Liquidity ratio (x)</b>					
Current ratio	2.0	1.8	1.6	1.9	2.2
Quick ratio	1.8	1.6	1.4	1.7	2.0
Cash ratio	0.5	0.5	0.6	0.8	1.2
<b>Working capital (days)</b>					
Receivable turnover	3.1	2.5	2.3	3.7	3.9
Inventory turnover	45.6	47.5	41.8	45.0	48.0
Payable turnover	54.2	61.3	59.3	60.8	65.1
CCC	(5.5)	(11.3)	(15.3)	(12.1)	(13.1)
<b>Leverage ratios (%)</b>					
Total debt to Equity	0.0	0.0	2.9	2.2	1.8
Total debt to Total assets	0.0	0.0	1.7	1.3	1.1
Net debt/(cash) to Equity	(14.4)	(15.8)	(17.8)	(25.2)	(36.0)
Net debt/(cash) to Total assets	(8.6)	(9.5)	(10.4)	(15.3)	(22.8)

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 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 $<$ - Market return ( $\sim 9\%$ )

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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**Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.**

**Tel: (852) 2868 2183**