

Yum China (YUMC US / 9987HK)

Store network expansion as key growth driver

- Store network expansion remains crucial driver to the Group's growth; the Group reiterated the 20k store count by 2026
- As consumers turn more cost conscious amid a softening economy, customer spending at the Group's restaurants may decrease
- Normalization of operating environment to impact margin profile
- Shareholders' return enhanced via share repurchase program and higher DPS
- Maintain **BUY**; TP implies 26.7x/24.6x 24E/25E P/E, or 4.0x/3.6x 24E/25E P/B

Store network expansion crucial to revenue growth. The Group reiterated the total store count target of 20k by 2026 in its 4Q23 results announcement. Total number of store count reached ~14.6K by end FY23. We believe store network expansion would enhance market penetration, reaching a wider group of customers and raise the ability to capture opportunities, as 2023 catering retail sales grew 20.4% YoY and sales of catering companies above designated sizes increased 17% YoY during the CNY holiday, according to NBS and MOFCOM. We expect net new store opening in FY24E to be ~1.69k and total store count at end-FY24E would be ~16.3k. The Group's effort in maintain reasonable pricing and constantly updating its menu items would help attract customers. Yet, softness in consumer market would remain a major challenge. Attractive pricing enabled by the Group's entry price point offerings, regular discount events (e.g. Crazy Thursday at KFC), and adjustment in pricing strategies at certain brands bear the risk of customers opting for lower-priced items, meaning ticket average might go down. We project FY24E revenue to grow 11.2% YoY, and FY23-26E revenue CAGR to be 10.4%.

Margin profile to be affected by normalization of operating environment. Margin improvement in FY23 mainly occurs in 1H, especially in 1Q23, partly due to a stronger consumer sentiment in initial reopening stages and productivity gain as a result of the labor shortage. The temporary rent relief also helped expand margins. As operating environment normalizes and the above factors become non-recurring, we lower projected net profit⁽¹⁾ by ~4% for FY24E; OPM and NPM⁽¹⁾ to reach 10.3% and 7.5% FY24E.

Maintain BUY; TP at US\$ 58.8/HK\$ 460.0. We believe the Group's store network expansion and product offerings will strengthen its market leadership. The Group also raises 4Q23 DPS to US\$ 0.16 and its budget for common stock repurchase in 2024 is US\$ 1.25bn, enhancing shareholder return. Maintain **BUY**. We lower our DCF-derived TP to reflect the lower level of profit projections. Current TP represents 26.7x/24.6x 24E/25E P/E, or 4.0x/3.6x 24E/25E 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	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (US\$ mn)	9,569	10,978	12,202	13,453	14,785
Chg (% YoY)	(2.9)	14.7	11.2	10.3	9.9
Net profit (US\$ mn) ⁽¹⁾	442	827	916	994	1,161
Chg (% YoY)	(55.4)	87.1	10.8	8.5	16.8
EPS (US\$)	1.05	1.99	2.25	2.44	2.85
Chg (% YoY)	(55.1)	89.3	13.2	8.5	16.8
BVPS (US\$)	15.40	15.40	15.03	16.84	19.01
Chg (% YoY)	(7.9)	0.0	(2.4)	12.0	12.8
P/E (x) – US	39.37	20.79	18.37	16.93	14.49
P/E (x) – HK	39.11	20.66	18.24	16.81	14.39
P/B (x) – US	2.68	2.69	2.75	2.45	2.17
P/B (x) – HK	2.67	2.67	2.73	2.44	2.16
ROAA (%)	3.8	7.6	8.1	8.4	8.8
ROAE (%)	6.5	12.8	14.6	15.3	15.9
DPS (US\$)	0.48	0.55	0.64	0.64	0.64
Yield (%) - US	1.2	1.3	1.5	1.5	1.5
Yield (%) - HK	1.2	1.3	1.6	1.6	1.6

Source(s): The Group, ABCI Securities estimates

Company Report

Feb 20, 2024

Rating(US/HK): BUY/BUY
TP(US/HK):US\$ 58.8/HK\$ 460.0

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Price (US/HK)	US\$ 41.34/HK\$ 321.2
Est. price return (US/HK)	42.2%/43.2%
Est. dividend yield (US/HK)	1.5%/1.6%
Est. total return (US/HK)	43.7%/44.8%
Previous Rating &	BUY;
TP (US/HK)	US\$ 62.6/HK\$ 489.2
Previous Report Date	Nov 7, 2023

Source(s): Bloomberg, ABCI Securities estimate

Key Data

52Wk H/L (US\$) (US shr)	64.7/33.55
52Wk H/L (HK\$) (HK shr)	514.5/260.2
Total issued shares (mn)	404
Issued US shr (mn)	329
Issued HK shr(mn)	75
US-shr market cap (US\$ mn)	13,613
H-shr market cap (HK\$ mn)	24,066
3-mth avg daily turnover (US\$ mn) (US shr)	105.1
3-mth avg daily turnover (HK\$ mn) (HK shr)	150.7
Major shareholder(s) (%):	
JP Morgan	15.1

Source(s): Bloomberg, ABCI Securities

Price performance – US (%)

	Absolute	Relative*
1-mth	10.3	5.7
3-mth	(9.8)	(21.0)
6-mth	(24.1)	(36.9)

*Relative to S&P 500 Index

Source(s): Bloomberg, ABCI Securities

Price performance – HK (%)

	Absolute	Relative*
1-mth	18.0	13.0
3-mth	(9.8)	(2.4)
6-mth	(22.9)	(12.9)

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Note:

- refers to net profit to shareholders of the Company;
- US\$/HK\$= 7.8223; 3) Market data as of Feb 19, 2024



Exhibit 1: Changes in assumptions and valuations

As of Dec 31	Current report		Previous report		Rationale
	FY24E	FY25E	FY24E	FY25E	
Assumptions					
D/E (%)	2.2	1.8	2.2	1.8	
D/A (%)	1.2	1.0	1.3	1.1	N/A
Tax rate (%)	25.8	25.8	30.2	30.2	
Valuations					
TP (US\$)	58.8		62.6		
TP (HK\$)	460.0		489.2		Lower TP mainly due to reduced profit projections
P/E (x)	26.7	24.6	27.2	23.9	
P/B (x)	4.0	3.6	3.4	3.0	

Note: Previous report was published on Nov 7, 2023

Source(s): ABCI Securities estimates

Exhibit 2: Changes in major forecasts

As of Dec 31	Current report			Previous report			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Net revenue (US\$ mn)	12,202	13,453	14,785	12,043	13,414	N/A	1.3	0.3	N/A
Net profit (to shareholders of the Company) (US\$ mn)	916	994	1,161	957	1,088	N/A	(4.3)	(8.6)	N/A
EPS (US\$)	2.25	2.44	2.85	2.30	2.62	N/A	(2.2)	(6.6)	N/A

Source(s): ABCI Securities estimates

Exhibit 3: Quarterly figures

As of Dec 31	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23
Revenue growth (YoY %)								
Total	4.3	(13.2)	5.1	(8.9)	9.3	24.7	8.5	19.4
KFC	10.1	(8.1)	12.0	(2.8)	9.0	24.5	8.4	17.7
Pizza Hut	1.1	(16.7)	1.8	(15.7)	9.1	23.7	6.8	22.8
Margins (%)								
<i>Restaurant margin</i>	<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>	<u>10.7</u>
KFC	15.2	13.4	20.6	12.7	22.2	17.3	18.6	12.0
Pizza Hut	10.7	8.6	13.4	1.9	14.2	12.4	12.7	7.3
<i>OPM</i>	<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>	<u>4.7</u>
KFC	11.1	7.7	16.5	7.4	19.4	14.0	15.8	9.1
Pizza Hut	5.5	2.5	8.8	(5.0)	9.3	6.4	7.9	1.1
<i>NPM (to shareholders of the Company)</i>	<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>	<u>3.9</u>

Source(s): the Group, ABCI Securities



Financial statements

Consolidated income statement

FY ended Dec 31 (US\$ mn, except per share data)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	9,569	10,978	12,202	13,453	14,785
- Company sales	9,110	10,391	11,730	13,092	14,476
- Others	459	587	472	361	309
Company restaurant expenses	(7,829)	(8,701)	(9,786)	(10,861)	(11,962)
Restaurant profit	1,281	1,690	1,944	2,231	2,514
General and administrative expenses	(594)	(638)	(667)	(633)	(681)
Franchise expenses	(34)	(36)	(39)	(44)	(47)
Expenses for transactions with franchisees and unconsolidated affiliates	(279)	(356)	(372)	(407)	(426)
Other operating costs and expenses	(78)	(112)	(99)	(91)	(88)
Closures and impairment expenses, net	(32)	(29)	(28)	(30)	(34)
Other income, net	(94)	0	(2)	(3)	(3)
Operating profit	629	1,106	1,208	1,384	1,546
Others	58	120	136	75	159
Profit before taxes and equity in net earnings (losses) from equity method investments	687	1,226	1,344	1,459	1,704
Tax	(207)	(329)	(346)	(376)	(439)
Equity in net earnings (losses) from equity method investments	(2)	4	0	0	0
Net profit	478	901	998	1,083	1,265
- Owners	442	827	916	994	1,161
- MI	36	74	82	89	104
Cash Dividend	202	229	260	260	260
EPS (US\$)					
- Basic	1.05	1.99	2.25	2.44	2.85
- Diluted	1.04	1.97	2.23	2.42	2.83
Cash DPS (US\$)	0.48	0.55	0.64	0.64	0.64

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)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue					
- KFC	7,219	8,240	9,231	10,249	11,268
- Pizza Hut	1,960	2,246	2,567	2,885	3,222
Company sales					
- KFC	7,120	8,116	9,104	10,115	11,122
- Pizza Hut	1,939	2,214	2,534	2,856	3,192
Restaurant profit					
- KFC	1,121	1,440	1,618	1,825	2,041
- Pizza Hut	178	263	300	348	393
Operating profit					
- KFC	787	1,202	1,241	1,409	1,576
- Pizza Hut	70	142	138	165	195
Number of stores (units, as of end of FY)					
- Total	12,947	14,644	16,338	18,175	20,007
- KFC	9,094	10,296	11,503	12,778	14,021
- Pizza Hut	2,903	3,312	3,721	4,147	4,590

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)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash and cash equivalents	1,130	1,128	935	701	2,269
Accounts receivable	64	68	70	112	88
Inventories	417	424	575	581	643
Others	2,329	1,811	1,755	1,859	1,826
Current assets	3,940	3,431	3,336	3,253	4,826
PP&E	2,118	2,310	2,422	2,548	2,699
Operating lease right-of-use assets	2,219	2,217	2,431	2,502	2,680
Intangible assets & goodwill	2,147	2,082	2,077	2,081	2,089
Others	1,402	1,991	2,491	2,754	3,213
Non-current assets	7,886	8,600	9,420	9,885	10,681
Total assets	11,826	12,031	12,756	13,138	15,507
Accounts payable and other current liabilities	2,096	2,164	2,778	2,326	3,565
Short-term borrowing	2	168	151	136	122
Income taxes payable	68	90	96	101	147
Current liabilities	2,166	2,422	3,025	2,563	3,834
Non-current operating lease liabilities	1,906	1,899	2,210	2,238	2,351
Non-current finance lease obligations	42	44	42	43	43
Others	552	547	564	554	555
Non-current liabilities	2,500	2,490	2,815	2,835	2,949
Shareholders' capital	6,482	6,405	6,119	6,856	7,736
MI	666	701	783	872	976
Total equity	7,148	7,106	6,902	7,728	8,712
Redeemable non-controlling interest	12	13	13	13	13
Total liabilities and equity	11,826	12,031	12,756	13,138	15,507

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)	FY22A	FY23A	FY24E	FY25E	FY26E
Net profit	478	901	998	1,083	1,265
Depreciation and amortization	602	453	721	901	986
Change in working capital	203	24	209	(603)	1,234
Others	130	95	145	158	261
Cash flow from operating activities	1,413	1,473	2,074	1,539	3,747
Capital spending	(679)	(710)	(1,011)	(1,158)	(1,457)
Others	157	(33)	5	5	5
Cash flow from investing activities	(522)	(743)	(1,006)	(1,154)	(1,452)
Cash dividend	(202)	(216)	(260)	(260)	(260)
Others	(642)	(500)	(1,011)	(369)	(395)
Cash flow from financing activities	(844)	(716)	(1,271)	(629)	(654)
Effect of foreign exchange rate changes	(53)	(16)	10	10	(72)
Net change in cash, cash equivalent, and restricted cash	(6)	(2)	(193)	(234)	1,569
Cash, cash equivalent, and restricted cash - end	1,130	1,128	935	701	2,269

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	FY22A	FY23A	FY24E	FY25E	FY26E
Growth (YoY %)					
Net revenue	(2.9)	14.7	11.2	10.3	9.9
- KFC	3.1	14.1	12.0	11.0	9.9
- Pizza Hut	(7.1)	14.6	14.3	12.4	11.7
Restaurant profit	4.4	31.9	15.0	14.8	12.7
- KFC	10.7	28.5	12.4	12.7	11.9
- Pizza Hut	(20.5)	47.8	14.2	15.7	13.2
Operating profit	(54.6)	75.8	9.2	14.6	11.7
- KFC	(4.8)	52.7	3.3	13.5	11.8
- Pizza Hut	(36.9)	102.9	(2.5)	19.6	17.6
Core OP	N/A	78.8	10.1	16.3	11.4
- KFC	N/A	50.2	2.9	13.5	12.9
- Pizza Hut	N/A	197.9	1.4	16.6	17.2
Net profit (to shareholders of the Company)	(55.4)	87.1	10.8	8.5	16.8
Non-GAAP operating profit	(17.4)	77.1	8.3	14.2	11.7
Non-GAAP net profit	(15.0)	88.8	9.5	8.1	16.9
Profitability ratios (%)					
Restaurant margin	14.1	16.3	16.6	17.0	17.4
- KFC	15.7	17.7	17.8	18.0	18.3
- Pizza Hut	9.2	11.8	11.9	12.2	12.3
OPM	6.9	10.6	10.3	10.6	10.7
- KFC	11.0	14.8	13.6	13.9	14.2
- Pizza Hut	3.6	6.4	5.5	5.8	6.1
Core OPM	6.9	10.8	10.5	11.0	11.0
- KFC	11.3	14.9	13.7	14.0	14.3
- Pizza Hut	2.5	6.5	5.7	5.9	6.2
NPM (to shareholders of the Company)	4.6	7.5	7.5	7.4	7.9
Non-GAAP OPM	6.6	10.2	10.0	10.3	10.5
Non-GAAP NPM	4.7	7.7	7.6	7.4	7.9
Return ratios (%)					
ROAA	3.8	7.6	8.1	8.4	8.8
ROAE	6.5	12.8	14.6	15.3	15.9
Liquidity ratio (x)					
Current ratio	1.8	1.4	1.1	1.3	1.3
Quick ratio	1.6	1.2	0.9	1.0	1.1
Cash ratio	0.5	0.5	0.3	0.3	0.6
Working capital (days)					
Receivable turnover	2.5	2.2	2.1	2.5	2.5
Inventory turnover	50.3	43.7	46.2	48.6	45.8
Payable turnover	74.2	71.4	70.1	71.4	65.2
CCC	(21.5)	(25.4)	(21.9)	(20.3)	(17.0)
Leverage ratios (%)					
Total debt to Equity	0.0	2.4	2.2	1.8	1.4
Total debt to Total assets	0.0	1.4	1.2	1.0	0.8
Net debt/(cash) to Equity	(15.8)	(13.5)	(11.4)	(7.3)	(24.6)
Net debt/(cash) to Total assets	(9.5)	(8.0)	(6.1)	(4.3)	(13.8)

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) Core operating profit is defined as excludes special Items, and further adjusted for items affecting comparability and the impact of F/X; 6) Core OPM is defined as core operating profit divided by company sales; 7) Non-GAAP measures exclude the impact of share-based compensation expenses on operating costs and expenses; 8) 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; 9) 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; 10) 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; 11) 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 ($\sim 7\%$)
Hold	- Market return rate ($\sim 7\%$) \leq Stock return rate $<$ Market return rate ($\sim 7\%$)
Sell	Stock return $<$ - Market return ($\sim 7\%$)

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 2005 (2005-23 HSI total return index averages at 7.4%)

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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