

# China / Hong Kong Company Update

# Yum China Holdings

Bloomberg: 9987 HK Equity | YUMC US Equity | Reuters: 9987.HK | YUMC.N

Refer to important disclosures at the end of this report

DBS Group Research . Equity

2 Nov 2023

## HK: BUY

Last Traded Price ( 1 Nov 2023): HK\$356.20 (HSI : 17,102)  
Price Target 12-mth: HK\$417 (17.1% upside) (Prev HK\$563)

## US: BUY

Last Traded Price ( 1 Nov 2023): US\$44.56 (NASDAQ : 13,061)  
Price Target 12-mth: US\$53.50 (20.1% upside) (Prev US\$72.18)

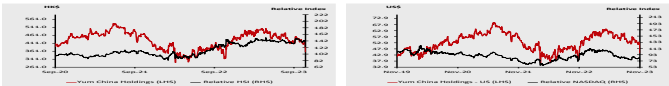
### Analysts

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### What's New

- Yum China 3Q23 trails behind expectations on slowdown in same-store sales and currency impact
- Net store expansion of 500 in 3Q23, with 1,155 net new store openings YTD, on track with expectations
- 4Q23 is a seasonally soft quarter, with normalising growth trends ahead in FY24E; company reiterates no change in system sales and EPS guidance
- We cut our earnings by 11%/18% in FY23E/FY24E to account for lower sales/unit and higher labour cost trends, maintain BUY as we remain positive on the medium term outlook and strategy with TP cut to HK\$417

### Price Relative



### Forecasts and Valuation (HK Shares)

| FY Dec (US\$m)                 | 2021A  | 2022A  | 2023F  | 2024F  |
|--------------------------------|--------|--------|--------|--------|
| Turnover                       | 9,853  | 9,569  | 10,859 | 12,052 |
| EBITDA                         | 1,383  | 1,207  | 1,631  | 1,861  |
| Pre-tax Profit                 | 1,392  | 685    | 1,155  | 1,289  |
| Net Profit                     | 990    | 442    | 802    | 899    |
| Net Pft (Pre Ex) (core profit) | 525    | 446    | 802    | 899    |
| Net Profit Gth (Pre-ex) (%)    | 26.3   | (55.4) | 81.4   | 12.1   |
| EPS (US\$)                     | 2.28   | 1.04   | 1.91   | 2.14   |
| EPS (HK\$)                     | 17.85  | 8.14   | 14.93  | 16.74  |
| Core EPS (US\$)                | 1.21   | 1.05   | 1.91   | 2.14   |
| Core EPS (HK\$)                | 9.46   | 8.21   | 14.93  | 16.74  |
| EPS Gth (%)                    | 25.3   | (54.4) | 83.5   | 12.1   |
| Core EPS Gth (%)               | (15.3) | (13.2) | 81.9   | 12.1   |
| Diluted EPS (HK\$)             | 9.46   | 8.21   | 14.93  | 16.74  |
| DPS (HK\$)                     | 3.76   | 3.76   | 4.07   | 4.07   |
| BV Per Share (HK\$)            | 127.20 | 119.32 | 131.35 | 144.02 |
| PE (X)                         | 20.0   | 43.8   | 23.9   | 21.3   |
| CorePE (X)                     | 37.6   | 43.4   | 23.9   | 21.3   |
| P/Cash Flow (X)                | 17.5   | 13.7   | 10.9   | 10.4   |
| P/Free CF (X)                  | 44.7   | 26.4   | 22.0   | 20.1   |
| EV/EBITDA (X)                  | 12.0   | 14.0   | 9.8    | 8.2    |
| Net Div Yield (%)              | 1.1    | 1.1    | 1.1    | 1.1    |
| P/Book Value (X)               | 2.8    | 3.0    | 2.7    | 2.5    |
| Net Debt/Equity (X)            | CASH   | CASH   | CASH   | CASH   |
| ROAE (%)                       | 14.9   | 6.5    | 11.8   | 12.2   |
| Earnings Rev (%):              |        |        | (11)   | (18)   |
| Consensus EPS (US\$)           |        |        | 2.04   | 2.43   |
| Other Broker Recs:             |        | B:33   | S:1    | H:3    |

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

## Near-term headwinds

### Investment Thesis

#### Largest restaurant operator to ride on China's growing catering market.

Yum China is the largest restaurant chain operator in China with a total store count of 14,102 units as of Sep 23, with a footprint spanning over 1,900 cities. The group holds exclusive rights to operate and sub-license the KFC, Pizza Hut, and Taco Bell brands in China, while owning Little Sheep and Huang Ji Huang. The company also partners with Lavazza, a coffee concept. Beyond its store footprint, Yum China excels in terms of brand awareness; digital engagement, with over ~460m loyalty members as of Sep 23; delivery channel (~35% of 3Q23 sales) and supply chain management; and product innovation. The company is known for promoting locally favoured foods such as congee, chicken wings, etc., and its expertise is built on its strong understanding of customers in the local market.

**Sales rebound to lift earnings recovery.** We forecast Yum China to deliver sales growth of 13% in FY23E and 11% in FY24E, driven by a net store expansion of 12% and 11% over the same period, respectively. We expect the operating margin to stage a 3.2ppt/0.3ppt recovery to 10.1%/10.4% in FY23E/FY24E.

**China's reopening a boon for restaurant sector.** Between 2020-22, Yum China added over 2,400 stores (c.11% p.a.) in China by investing in smaller sized outlets and focusing on delivery (+9ppt of total sales in 2020-22). Its three-year adjusted operating margin stood at ~8% vs. ~11% pre-pandemic, and we expect the group to record an improvement going forward, driven by strong sales leverage.

BUY with target price at HK\$417 (vs. HK\$563 previously). Helmed with a net cash position of US\$4.1bn as of Sep 23, we believe Yum China is well equipped to continue raising its store penetration in China. We cut our earnings by 11%/18% in FY23E/FY24E on the back of slower-than-expected sales/unit, and higher labour costs, while trimming our valuation multiple to 24x FY24E PE, still at a premium to its restaurant peers, due to a derating of sector multiples YTD on uncertainty in the macro environment. We retain a BUY rating, with TP cut to HK\$417.

### Key Risks

A weak macroeconomic environment will lead to weaker-than-expected sales recovery. Other risks include inflationary pressure (food and wages), food safety concerns, and reputation risks.

### At A Glance

|   |                  |
|---|------------------|
| Issued Capital (m shrs)                                   | 419              |
| Mkt Cap (HKm/US\$m)                                       | 149,248 / 19,076 |
| Major Shareholders (%)                                    |                  |
| Invesco Advisers, Inc.                                    | 7.9              |
| Free Float (%)  | 92.1             |
| 3m Avg. Daily Val. (US\$m)                                | 17.6             |
| GICS Industry: Consumer Discretionary / Consumer Services |                  |

## Yum China Holdings

### WHAT'S NEW

#### Near-term headwinds

**A tempered quarter.** Yum China (9987.HK)'s adjusted net earnings rose 19% to US\$248m, trailing behind expectations on the back of a currency exchange impact of roughly 6%. Separately, same-store sales slowed to 4% in Yum China (KFC: +4%; Pizza Hut: +2%) versus 9M23 of 8% (KFC: +9%; Pizza Hut: +7%) in 3Q23. Adjusted operating profit rose 3% to US\$327m, slowed by the normalisation of labour costs and a mid-single digit increase in wages for frontline staff. Quarterly DPS of US\$0.13/sh was declared, while 2.9m shares were repurchased in 3Q23.

**Enrichment in menu offering and store expansion priority to address rise in competition.** Pressure on the ticket average and competition remain key concerns of the market. To address this, Yum China continues to enrich its core menu offering. The beef burger and whole chicken categories combined made up more than 6% of KFC's sales mix. With rising cost-conscious behaviour among consumers, Yum China has been expanding their price ranges across brands. At Pizza Hut, Yum China has expanded their pizza selection that is priced below Rmb50. At KFC, the company has expanded its Rmb19.9 three-item value combo offering to address customer needs. In 3Q23, the company recorded a net store opening of 500 stores, with a combined total of 1,155 net new stores in 9M23 and remains on track to reach its guidance of 1,400-1,600 stores. Looking ahead, 4Q is a seasonally soft quarter, accounting for c.10%-11% of full-year adjusted earnings historically. The company has made no change to its store expansion guidance to open 1,400-1,600 stores, as updated during Investor Day in Sept 23, with capex unchanged, at between US\$700-900m. Yum China remains fundamentally strong, with a net cash position of US\$4.2bn (Sept 22: US\$3.8bn). We will review our earnings subsequently. Our last rating was a BUY, with TP under review.

#### Key summary

3Q23 revenue increased by 9% y-o-y to US\$2.91bn, or a c.15% y-o-y increase in constant currency terms. Same-store sales growth slowed to 4% y-o-y in 3Q23, where KFC recorded a 4% increase y-o-y and Pizza Hut 2% y-o-y. The company opened 500 net new stores in 3Q23, with the total store count reaching 14,102 as of 30 Sept. By sales mix, delivery as a percentage of company sales contracted by 3ppt to 35% of sales, in line with the normalisation in dine-in store traffic. Operating profit rose 2% to US\$323m. The slowdown in the rate of increase of operating profit is primarily due to a 1.8ppt increase in payroll and employee benefits to 25.3% of sales, on the back of normalising frontline staff members and a mid-single digit increase in salaries for frontline staff. Food and paper as a percentage of sales contracted 0.4ppt to 31.1%,

while occupancy and other operating expenses increased by 0.4ppt to 26.6%. Overall OP margin contracted 0.6ppt to 11.7%. Excluding temporary reliefs, adjusted operating profit rose 21% y-o-y in constant currency terms. In 3Q23, Yum China repurchased 2.9m shares for US\$157m. As of Sept 23, c.US\$870m remained available for future share repurchases. The company declared a quarterly DPS of US\$0.13 in 3Q23.

**Looking ahead, the fourth quarter of 2023 (4Q23) is traditionally a weaker period.** We have reduced our earnings projections by 11% for FY23E and by 18% for FY24E, considering the anticipated drop in sales per unit and rising labour costs. Given the observed slowdown in consumption demand since October, we've further adjusted our FY23E earnings downwards by 11%, factoring in the decreased sales per unit and the aforementioned labour cost trends. We anticipate that FY24E will see top-line growth of 11%, propelled by a net store expansion of 11% and sustained improvements in store traffic. Concurrently, we expect net earnings to increase by 12%, reaching US\$899m in FY24E.

**How does the company view the rise in competition in the restaurant industry?** The company views rising competition as a positive sign with greater investments by domestic and international players, particularly for the chain-store business model. The company noted vibrant competition in the lower tier cities, which Yum China has been heavily investing in. The company has launched Chinese-style burgers in tier 2 cities, at a competitive price point. Their strategy tries to adapt to lower tier cities' demand.

**Growth in the company's operating profit has slowed relative to sales growth in 3Q23, which is a different trend to what was seen in 1Q/2Q. Why is this?** Labour costs have been increasing steadily, where historically, the company has been reducing the pressure from occupancy costs through store portfolio organisation. Same-store sales levels remain 10% below 2019 levels.

**How should we view the pressure on the ticket average, with the ongoing value campaign to broaden price ranges and sell more coupons on TikTok?** For example, KFC's ticket average is still higher than 2019 levels, thanks to a higher delivery sales mix, where the ticket average is generally higher. Second, breakfast daypart saw a solid recovery in 3Q23, which commands a lower ticket average in general.

## Yum China Holdings

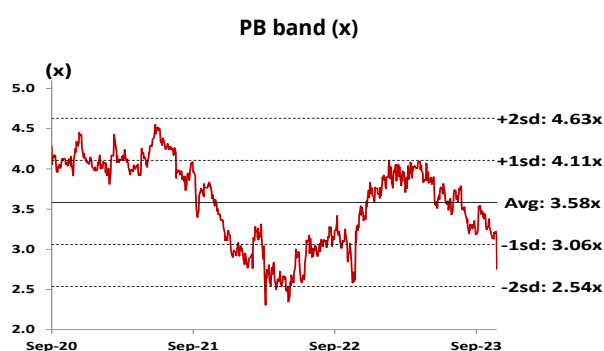
With the normalising of labour costs and absence of subsidies, how should we view the operating profit margin, especially with a hike in store expansion going forward? The company will continue to focus on the performance of new store openings, with KFC having a rough payback of around two years and Pizza Hut having three years. As long as store economics remains steady, they will remain focused on store expansion.

Was there a fall-off in festivities, or would there be any further details regarding the softness in the sales trend? July-August was pretty firm with the school holidays and residual pent-up spending. However, the mid-Autumn National Day saw softer sales than expected.

### Company Background

Yum China is engaged in the operation and management of restaurants and fast-food chains and is a licensee of Yum! Brands (KFC, Pizza Hut, & Taco Bell) in Mainland China. It is the largest restaurant group in China with c.14,102 outlets as of Sep 23, across 1,900 cities. Its restaurant brand concepts include KFC, Pizza Hut, and Taco Bell, as well as Little Sheep and Huang Ji Huang. In addition, Yum China has partnered with Lavazza, a coffee concept.

### Historical PE and PB band



Source: Thomson Reuters, DBS HK

## Yum China Holdings

### Key Assumptions

| FY Dec                   | 2020A   | 2021A   | 2022A   | 2023F    | 2024F    |
|--------------------------|---------|---------|---------|----------|----------|
| No. of KFC Outlets       | 7,166.0 | 8,168.0 | 9,094.0 | 10,294.0 | 11,494.0 |
| No. of Pizza Hut Outlets | 2,355.0 | 2,590.0 | 2,903.0 | 3,253.0  | 3,603.0  |
| No. of Other Outlets     | 985.0   | 1,030.0 | 950.0   | 1,010.0  | 1,060.0  |

Source: Company, DBS HK

### Segmental Breakdown (US\$ m)

| FY Dec                   | 2020A        | 2021A        | 2022A        | 2023F         | 2024F         |
|--------------------------|--------------|--------------|--------------|---------------|---------------|
| <b>Revenues (US\$ m)</b> |              |              |              |               |               |
| KFC                      | 5,821        | 7,003        | 7,219        | 8,179         | 9,052         |
| Pizza Hut                | 1,730        | 2,109        | 1,960        | 2,250         | 2,566         |
| Others                   | 712          | 741          | 390          | 430           | 434           |
| <b>Total</b>             | <b>8,263</b> | <b>9,853</b> | <b>9,569</b> | <b>10,859</b> | <b>12,052</b> |

Source: Company, DBS HK

### Income Statement (US\$ m)

| FY Dec                     | 2020A        | 2021A        | 2022A        | 2023F        | 2024F        |
|----------------------------|--------------|--------------|--------------|--------------|--------------|
| Revenue                    | 8,263        | 9,853        | 9,569        | 10,859       | 12,052       |
| Cost of Goods Sold         | (2,342)      | (2,812)      | (2,836)      | (3,161)      | (3,507)      |
| <b>Gross Profit</b>        | <b>5,921</b> | <b>7,041</b> | <b>6,733</b> | <b>7,698</b> | <b>8,545</b> |
| Other Opg (Exp)/Inc        | (5,129)      | (6,120)      | (6,036)      | (6,663)      | (7,355)      |
| <b>Operating Profit</b>    | <b>792</b>   | <b>921</b>   | <b>697</b>   | <b>1,035</b> | <b>1,189</b> |
| Other Non Opg (Exp)/Inc    | 104          | (54)         | (92)         | (40)         | (40)         |
| Associates & JV Inc        | 0            | 0            | 0            | 0            | 0            |
| Net Interest (Exp)/Inc     | 43           | 60           | 84           | 160          | 140          |
| Dividend Income            | 0            | 0            | 0            | 0            | 0            |
| Exceptional Gain/(Loss)    | 169          | 465          | (4)          | 0            | 0            |
| <b>Pre-tax Profit</b>      | <b>1,108</b> | <b>1,392</b> | <b>685</b>   | <b>1,155</b> | <b>1,289</b> |
| Tax                        | (295)        | (369)        | (207)        | (318)        | (355)        |
| Minority Interest          | (29)         | (33)         | (36)         | (36)         | (36)         |
| Preference Dividend        | 0            | 0            | 0            | 0            | 0            |
| <b>Net Profit</b>          | <b>784</b>   | <b>990</b>   | <b>442</b>   | <b>802</b>   | <b>899</b>   |
| Net Profit before Except.  | 615          | 525          | 446          | 802          | 899          |
| EBITDA                     | 1,346        | 1,383        | 1,207        | 1,631        | 1,861        |
| <b>Growth</b>              |              |              |              |              |              |
| Revenue Gth (%)            | (5.8)        | 19.2         | (2.9)        | 13.5         | 11.0         |
| EBITDA Gth (%)             | (4.4)        | 2.7          | (12.7)       | 35.1         | 14.1         |
| Opg Profit Gth (%)         | (13.6)       | 16.3         | (24.3)       | 48.6         | 14.9         |
| Net Profit Gth (%)         | 10.0         | 26.3         | (55.4)       | 81.4         | 12.1         |
| <b>Margins &amp; Ratio</b> |              |              |              |              |              |
| Gross Margins (%)          | 71.7         | 71.5         | 70.4         | 70.9         | 70.9         |
| Opg Profit Margin (%)      | 9.6          | 9.3          | 7.3          | 9.5          | 9.9          |
| Net Profit Margin (%)      | 9.5          | 10.0         | 4.6          | 7.4          | 7.5          |
| ROAE (%)                   | 16.9         | 14.9         | 6.5          | 11.8         | 12.2         |
| ROA (%)                    | 8.8          | 8.2          | 3.5          | 6.5          | 6.8          |
| ROCE (%)                   | 8.3          | 6.9          | 4.7          | 7.5          | 8.1          |
| Div Payout Ratio (%)       | 13.2         | 21.0         | 46.2         | 27.2         | 24.3         |
| Net Interest Cover (x)     | NM           | NM           | NM           | NM           | NM           |

Source: Company, DBS HK

## Yum China Holdings

### Balance Sheet (US\$ m)

| FY Dec                        | 2020A         | 2021A         | 2022A         | 2023F         | 2024F         |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|
| Net Fixed Assets              | 1,765         | 2,251         | 2,118         | 2,374         | 2,553         |
| Invt in Associates & JVs      | 0             | 0             | 0             | 0             | 0             |
| Other LT Assets               | 4,174         | 6,256         | 5,768         | 5,768         | 5,768         |
| Cash & ST Invt                | 4,263         | 3,996         | 3,152         | 3,781         | 4,536         |
| Inventory                     | 398           | 432           | 417           | 465           | 516           |
| Debtors                       | 99            | 67            | 64            | 73            | 81            |
| Other Current Assets          | 176           | 221           | 307           | 322           | 338           |
| <b>Total Assets</b>           | <b>10,875</b> | <b>13,223</b> | <b>11,826</b> | <b>12,783</b> | <b>13,792</b> |
| ST Debt                       | 0             | 0             | 0             | 0             | 0             |
| Creditors                     | 2,067         | 2,383         | 2,166         | 2,517         | 2,810         |
| Other Current Liab            | 0             | 0             | 0             | 0             | 0             |
| LT Debt                       | 0             | 0             | 0             | 0             | 0             |
| Other LT Liabilities          | 2,337         | 2,918         | 2,500         | 2,500         | 2,500         |
| Shareholder's Equity          | 6,206         | 7,056         | 6,482         | 7,051         | 7,732         |
| Minority Interests            | 265           | 866           | 678           | 714           | 750           |
| <b>Total Cap. &amp; Liab.</b> | <b>10,875</b> | <b>13,223</b> | <b>11,826</b> | <b>12,783</b> | <b>13,792</b> |
| Non-Cash Wkg. Capital         | (1,394)       | (1,663)       | (1,378)       | (1,658)       | (1,875)       |
| Net Cash/(Debt)               | 4,263         | 3,996         | 3,152         | 3,781         | 4,536         |
| Debtors Turn (avg days)       | 4.4           | 2.5           | 2.4           | 2.4           | 2.4           |
| Creditors Turn (avg days)     | 310.9         | 302.7         | 270.0         | 270.0         | 270.0         |
| Inventory Turn (avg days)     | 62.0          | 56.1          | 53.7          | 53.7          | 53.7          |
| Asset Turnover (x)            | 0.9           | 0.8           | 0.8           | 0.9           | 0.9           |
| Current Ratio (x)             | 2.4           | 2.0           | 1.8           | 1.8           | 1.9           |
| Quick Ratio (x)               | 2.1           | 1.7           | 1.5           | 1.5           | 1.6           |
| Net Debt/Equity (X)           | CASH          | CASH          | CASH          | CASH          | CASH          |
| Net Debt/Equity ex MI (X)     | CASH          | CASH          | CASH          | CASH          | CASH          |
| Capex to Debt (%)             | N/A           | N/A           | N/A           | N/A           | N/A           |
| Z-Score (X)                   | NA            | NA            | NA            | NA            | NA            |

Source: Company, DBS HK

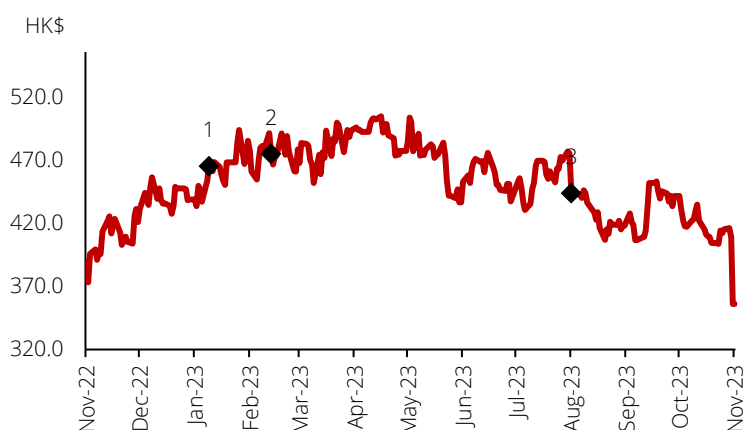
### Cash Flow Statement (US\$ m)

| FY Dec                         | 2020A          | 2021A        | 2022A        | 2023F        | 2024F        |
|--------------------------------|----------------|--------------|--------------|--------------|--------------|
| Pre-Tax Profit                 | 813            | 1,023        | 478          | 838          | 935          |
| Dep. & Amort.                  | 450            | 516          | 602          | 635          | 712          |
| Tax Paid                       | (168)          | (197)        | 0            | 0            | 0            |
| Assoc. & JV Inc/(loss)         | 0              | 0            | 0            | 0            | 0            |
| (Pft)/ Loss on disposal of FAs | 0              | 0            | 0            | 0            | 0            |
| Chg in Wkg.Cap.                | (369)          | (446)        | (131)        | 206          | 187          |
| Other Operating CF             | 388            | 235          | 464          | 83           | 9            |
| <b>Net Operating CF</b>        | <b>1,114</b>   | <b>1,131</b> | <b>1,413</b> | <b>1,762</b> | <b>1,843</b> |
| Capital Exp.(net)              | (419)          | (689)        | (679)        | (892)        | (892)        |
| Other Invt.(net)               | 0              | 0            | 0            | 0            | 0            |
| Invt in Assoc. & JV            | 0              | 0            | 0            | 0            | 0            |
| Div from Assoc & JV            | 0              | 0            | 0            | 0            | 0            |
| Other Investing CF             | (2,690)        | (166)        | 157          | 0            | 0            |
| <b>Net Investing CF</b>        | <b>(3,109)</b> | <b>(855)</b> | <b>(522)</b> | <b>(892)</b> | <b>(892)</b> |
| Div Paid                       | (95)           | (203)        | (202)        | (211)        | (218)        |
| Chg in Gross Debt              | 0              | 0            | 0            | 0            | 0            |
| Capital Issues                 | (8)            | (75)         | (466)        | (124)        | 0            |
| Other Financing CF             | 2,170          | (26)         | (167)        | 93           | 22           |
| <b>Net Financing CF</b>        | <b>2,067</b>   | <b>(304)</b> | <b>(835)</b> | <b>(242)</b> | <b>(197)</b> |
| Currency Adjustments           | 40             | 6            | (62)         | 0            | 0            |
| Chg in Cash                    | 112            | (22)         | (6)          | 629          | 755          |
| Opg CFPS (US\$)                | 3.44           | 3.63         | 3.63         | 3.71         | 3.94         |
| Free CFPS (US\$)               | 1.61           | 1.02         | 1.73         | 2.07         | 2.27         |

Source: Company, DBS HK

## Yum China Holdings

### HK Share - Target Price & Ratings 12-mth History

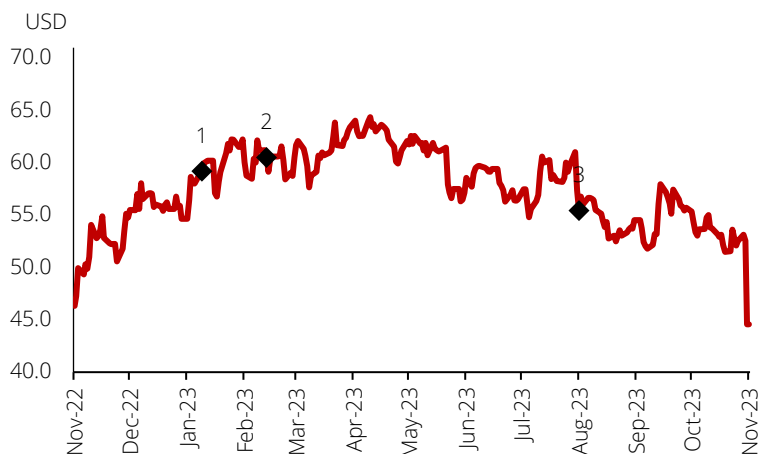


| S.No. | Date      | Closing Price | Target Price | Rating |
|-------|-----------|---------------|--------------|--------|
| 1     | 10-Jan-23 | HK\$9.88      | HK\$523.00   | BUY    |
| 2     | 14-Feb-23 | HK\$491.60    | HK\$561.00   | BUY    |
| 3     | 2-Aug-23  | HK\$475.40    | HK\$563.00   | BUY    |

Source: DBS HK

Analyst: Alison Fok  
Mavis Hui

### US Share - Target Price & Ratings 12-mth History



| S.No. | Date      | Closing Price | Target Price | Rating |
|-------|-----------|---------------|--------------|--------|
| 1     | 10-Jan-23 | HK\$454.00    | US\$67.20    | BUY    |
| 2     | 14-Feb-23 | US\$61.17     | US\$71.92    | BUY    |
| 3     | 2-Aug-23  | US\$57.37     | US\$72.18    | BUY    |

Source: DBS HK

Analyst: Alison Fok  
Mavis Hui

## Yum China Holdings

DBS HK recommendations are based on an Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

Completed Date: 2 Nov 2023 10:00:38 (HKT)

Dissemination Date: 2 Nov 2023 11:05:00 (HKT)

Sources for all charts and tables are DBS HK unless otherwise specified.

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**Yum China Holdings**

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