

Yum China (YUMC US / 9987HK)

Increase in gross new store opening target boosts growth outlook

- 2Q21 revenue growth and system sales growth slowed compared to 1Q21 due to the receding low-base effect from 2Q20; network expansion and improved performance of Pizza Hut were major growth contributors in 2Q21
- 2Q21 margins were lower than 1Q21 due to cost of wage inflation and lapping of COVID-19 related government subsidies
- The Group lifted the targeted number of gross new stores to 1,300; as a result, we raise the FY20-23E revenue CAGR to 15.9%
- Maintain **BUY**; TP represents 32.99x/26.22x 21E/22E P/E, or 4.34x/3.70x 21E/22E P/B

2Q21 revenue growth reached 28.9%. 2Q21 revenue growth of KFC and Pizza Hut reached 32.7% YoY and 26.9% YoY. In 1H21, overall revenue grew 37.0% YoY, among which revenues of KFC and Pizza Hut were up 38.4% YoY and 44.3% YoY. System sales of the Group, KFC, and Pizza Hut grew 14% YoY, 14% YoY, and 16% YoY in 2Q21 vs. 34% YoY, 24% YoY, and 57% YoY in 1Q21. The slower revenue and system sales growth in 2Q21 (compared to 1Q21) was mainly due to the receding low-base effect from 2Q20. Nonetheless, the Group's efforts in network expansion, digital platform, and product development continue to deliver results and the growth performance of Pizza Hut indicates a possible new growth engine. The Group raises the targeted increase of gross new stores to 1,300 from 1,000 in the 1Q21 results announcement. As such, we lift the Group's FY21E revenue growth to 20.9% YoY (previous: 19.3% YoY) and FY20-23E revenue CAGR to 15.9% (previous: 14.8%); revenues of KFC and Pizza Hut would expand at 18.1% and 8.8% CAGRs in FY20-23E. The overall restaurant count is expected to increase at 7.8% CAGR in FY20-23E. By end-FY23E, overall restaurant count is expected to reach ~13,200; restaurant counts of KFC and Pizza Hut are expected to reach ~9,500 and ~2,700.

Margin declined QoQ due to rising costs. Cost pressure rose in 2Q21. In 2Q21, overall restaurant margin was 15.8% and 16.8% and 13.1% for KFC and Pizza Hut; OPM was 10.4% and 14.2% and 7.2% for KFC and Pizza Hut. The margins were lower than 1Q21 due to the 3% cost of wage inflation and lapping of COVID-19 related government subsidies. Such a rise in labor costs offsets the impact from lower raw material costs. We believe that the cost pressure to persist as the Group will increase employee compensation; moreover, the potential rise of commodity prices would push up raw material costs for the Group. We maintain our margin forecasts as the cost increases were factored into our forecasts in previous update. We project restaurant margin, OPM and NPM (to shareholders of the Company) to reach 15.0%, 11.2%, and 8.8% in FY21E and further increase to 16.2%, 12.1%, and 9.7% in FY23E.

Maintain BUY; TP at US\$ 74.2/HK\$577.4. With the increase in store opening target and improving Pizza Hut performance, we raise our DCF-derived TP to US\$ 74.2/HK\$577.4, representing 32.99x/26.22x 21E/22E P/E, or 4.34x/3.70x 21E/22E P/B. Maintain **BUY**.

Risk factors: 1) Macroeconomic risk; 2) Regulatory/policy risk; 3) Operational risk; 4) Increase in raw material/operating costs and margin decline; 5) Concentration risk; 6) Seasonality risk; 7) Non-GAAP financial metrics; 8) Prolonged pandemic risk.

Results and Valuation

FY ended Dec 31	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (US\$ mn)	8,776	8,263	9,992	11,364	12,877
Chg (% YoY)	4.3	(5.8)	20.9	13.7	13.3
Net profit (US\$ mn) ⁽¹⁾	713	784	878	1,104	1,247
Chg (% YoY)	0.7	10.0	11.9	25.8	13.0
EPS (US\$)	1.89	2.01	2.08	2.62	2.96
Chg (% YoY)	2.7	6.3	3.7	25.8	13.0
BVPS (US\$)	8.16	15.91	15.83	18.57	20.83
Chg (% YoY)	9.1	95.0	(0.5)	17.3	12.1
P/E (x) – US	33.05	31.08	29.97	23.81	21.08
P/E (x) – HK	32.58	30.63	29.54	23.47	20.78
P/B (x) – US	7.65	3.93	3.95	3.36	3.00
P/B (x) – HK	7.54	3.87	3.89	3.32	2.96
ROAA (%)	12.9	9.1	7.9	8.9	8.9
ROAE (%)	24.0	16.9	13.6	15.2	15.0
DPS (US\$)	0.48	0.24	0.48	0.48	0.48
Yield (%) - US	0.8	0.4	0.8	0.8	0.8
Yield (%) - HK	0.8	0.4	0.8	0.8	0.8

Source(s): The Group, ABCI Securities estimates

Company Report

Aug 6, 2021

Rating (US): BUY
 Rating (HK): BUY
 TP (US): US\$ 74.2
 TP (HK): HK\$ 577.4

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Price (US/HK)	US\$ 62.47/HK\$ 478.8
Est. price return (US/HK)	18.85%/20.58%
Est. dividend yield (US/HK)	0.77%/0.78%
Est. total return (US/HK)	19.62%/21.36%
Previous Rating&	BUY;
TP (US/HK)	US\$ 73.1/HK\$ 567.0
Previous Report Date	May 7, 2021

Source(s): Bloomberg, ABCI Securities estimate

Key Data

52Wk H/L (US\$) (US shr)	69.67/49.81
52Wk H/L (HK\$) (HK shr)	544/385.6
Total issued shares (mn)	421
Issued US shr (mn)	379
Issued HK shr(mn)	42
US-shr market cap (US\$ mn)	23,682
H-shr market cap (HK\$ mn)	20,067
3-mth avg daily turnover (US\$ mn) (US shr)	134.96
3-mth avg daily turnover (HK\$ mn) (HK shr)	74.40
Major shareholder(s) (%):	
Invesco	8.98

Source(s): Bloomberg, ABCI Securities

Price performance – US (%)

	Absolute	Relative*
1-mth	(5.76)	(7.01)
3-mth	0.99	(5.03)
6-mth	9.27	(4.80)

*Relative to S&P 500 Index

Source(s): Bloomberg, ABCI Securities

Price performance – HK (%)

	Absolute	Relative*
1-mth	(6.94)	(0.40)
3-mth	(0.52)	6.00
6-mth	11.52	20.36

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Note:

- refers to net profit to shareholders of the Company ;
- US\$/HK\$= 7.7762; 3) System sales includes sales generated from company-owned, franchise, and unconsolidated affiliate restaurants; 4) Market data as of Aug 5, 2021



Exhibit 1: Changes in assumptions and valuations

As of Dec 31	Current report		Previous report		Rationale
	FY21E	FY22E	FY21E	FY22E	
Assumptions					
D/E (%)	0	0	0	0	N/A
D/A (%)	0	0	0	0	N/A
Tax rate (%)	26.5	26.5	26.5	26.5	N/A
Valuations					
TP (US\$)	74.2		73.1		TP and valuation increases due to upward revision of growth projections
TP (HK\$)	577.4		567.0		
P/E (x)	32.99	26.22	32.87	26.46	
P/B (x)	4.34	3.70	4.29	3.66	

Note: Previous report was published on Apr 16, 2021

Source(s): ABCI Securities estimates

Exhibit 2: Changes in major forecasts

As of Dec 31	Current report			Previous report			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Net revenue (US\$ mn)	9,992	11,364	12,877	9,859	11,091	12,500	1.3	2.5	3.0
Net profit (to shareholders of the Company) (US\$ mn)	878	1,104	1,247	868	1,078	1,210	1.1	2.4	3.1
EPS (US\$)	2.08	2.62	2.96	2.07	2.57	2.89	0.7	2.0	2.6

Source(s): ABCI Securities estimates

Financial statements

Consolidated income statement

FY ended Dec 31 (US\$ mn, except per share data)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	8,776	8,263	9,992	11,364	12,877
- Company sales	7,925	7,396	8,938	10,181	11,564
- Others	851	867	1,054	1,184	1,313
Company restaurant expenses	(6,659)	(6,298)	(7,600)	(8,543)	(9,686)
Restaurant profit	1,266	1,098	1,337	1,638	1,878
General and administrative expenses	(487)	(479)	(554)	(628)	(707)
Franchise expenses	(71)	(65)	(78)	(92)	(110)
Expenses for transactions with franchisees and unconsolidated affiliates	(645)	(633)	(768)	(856)	(955)
Other operating costs and expenses	(37)	(57)	(49)	(55)	(63)
Closures and impairment expenses, net	(36)	(55)	(53)	(56)	(63)
Other income, net	60	285	227	242	269
Operating profit	901	961	1,115	1,377	1,563
Others	102	147	117	175	196
Pretax profit	1,003	1,108	1,232	1,552	1,759
Tax	(260)	(295)	(327)	(412)	(466)
Net profit	743	813	905	1,140	1,293
- Owners	713	784	878	1,104	1,247
- MI	30	29	27	36	45
Cash Dividend	181	94	202	202	202
EPS (US\$)					
- Basic	1.89	2.01	2.08	2.62	2.96
- Diluted	1.84	1.95	2.02	2.54	2.87
Cash DPS (US\$)	0.48	0.24	0.48	0.48	0.48

Source(s): The Group, ABCI Securities estimates

Consolidated balance sheet

FY ended Dec 31 (US\$ mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Cash and cash equivalents	1,046	1,158	1,488	1,994	3,275
Accounts receivable	88	99	103	132	141
Inventories	380	398	415	535	570
Others	745	3,281	3,343	3,526	3,598
Current assets	2,259	4,936	5,349	6,187	7,584
PP&E	1,594	1,765	1,862	2,084	2,299
Operating lease right-of-use assets	1,985	2,164	2,416	2,761	3,165
Intangible assets & goodwill	348	1,078	1,093	1,153	1,172
Others	764	932	1,255	1,356	1,422
Non-current assets	4,691	5,939	6,626	7,355	8,058
Total assets	6,950	10,875	11,975	13,542	15,642
Accounts payable and other current liabilities	1,691	1,995	2,532	2,535	3,220
Income taxes payable	45	72	55	107	75
Current liabilities	1,736	2,067	2,587	2,642	3,295
Non-current operating lease liabilities	1,803	1,915	2,085	2,418	2,837
Non-current finance lease obligations	26	28	26	27	27
Others	210	394	320	308	341
Non-current liabilities	2,039	2,337	2,431	2,752	3,204
Shareholders' capital	3,077	6,206	6,664	7,819	8,768
MI	98	253	280	316	362
Total equity	3,175	6,459	6,944	8,136	9,130
Redeemable noncontrolling interest	0	12	12	12	12
Total liabilities and equity	6,950	10,875	11,975	13,542	15,642

Source(s): The Group, ABCI Securities estimates

Consolidated cash flow statement

FY ended Dec 31 (US\$ mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net profit	743	813	905	1,140	1,293
Depreciation and amortization	767	818	921	1,015	1,129
Change in working capital	82	52	547	(233)	667
Others	(407)	(569)	(79)	47	(74)
Cash flow from operating activities	1,185	1,114	2,294	1,969	3,015
Capital spending	(435)	(419)	(602)	(615)	(622)
Others	(475)	(2,690)	(67)	(64)	(61)
Cash flow from investing activities	(910)	(3,109)	(669)	(678)	(683)
Share issuance - HK	0	2,195	0	0	0
Cash dividend	(181)	(95)	(202)	(202)	(202)
Others	(299)	(42)	(1,064)	(570)	(793)
Cash flow from financing activities	(480)	2,058	(1,266)	(772)	(995)
Effect of foreign exchange rate changes	(6)	40	(29)	(13)	(57)
Net change in cash, cash equivalent, and restricted cash	(211)	103	330	506	1,281
Cash, cash equivalent, and restricted cash - end	1,055	1,158	1,488	1,994	3,275

Source(s): The Group, ABCI Securities estimates

Key operating and financial ratios

FY ended Dec 31	FY19A	FY20A	FY21E	FY22E	FY23E
Growth (YoY %)					
Net revenue	4.3	(5.8)	20.9	13.7	13.3
Restaurant profit	5.6	(13.3)	21.8	22.5	14.6
Operating profit	(4.3)	6.7	16.0	23.5	13.5
Net profit (to shareholders of the Company)	0.7	10.0	11.9	25.8	13.0
Non-GAAP operating profit	6.7	2.5	15.0	25.9	12.4
Non-GAAP net profit	20.3	17.7	1.4	31.5	13.4
Profitability ratios (%)					
Restaurant margin	16.0	14.8	15.0	16.1	16.2
OPM	11.4	11.6	11.2	12.1	12.1
NPM (to shareholders of the Company)	8.1	9.5	8.8	9.7	9.7
Non-GAAP OPM	10.4	11.3	10.8	11.9	11.8
Non-GAAP NPM	8.3	10.4	8.7	10.1	10.1
Return ratios (%)					
ROAA	12.9	9.1	7.9	8.9	8.9
ROAE	24.0	16.9	13.6	15.2	15.0
Liquidity ratio (x)					
Current ratio	1.3	2.4	2.1	2.3	2.3
Quick ratio	1.1	2.2	1.9	2.1	2.1
Cash ratio	0.6	0.6	0.6	0.8	1.0
Working capital (days)					
Receivable turnover	3.5	4.1	3.7	3.8	3.9
Inventory turnover	41.5	49.8	43.0	44.6	46.1
Payable turnover	45.8	44.6	45.6	45.4	45.1
CCC	(0.8)	9.3	1.1	3.0	4.9
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	(32.9)	(17.9)	(21.4)	(24.5)	(35.9)
Net debt/(cash) to Total assets	(15.1)	(10.6)	(12.4)	(14.7)	(20.9)

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) Non-GAAP measures exclude the impact of share-based compensation expenses on operating costs and expenses; 5) 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; 6) 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; 7) 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

Source(s): The Group, ABCI Securities estimates

Disclosures

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Definition of equity rating

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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