

Yum China (YUMC US)

The darkest hour is just before the dawn

Maintain BUY on YUMC, as we believe the drags in 1Q21E could be short-lived and mid-term growth story is still intact (KFC expansions and Pizza Hut reform). We lowered our TP to US\$ 66.59, based on 36x FY21E P/E (unchanged). YUMC's valuation is attractive at 31x FY21E P/E, vs HDL's 74x and JMJ's 77x.

- 4Q20 net profit beat.** YUMC's 4Q20 net profit grew by 68% YoY to US\$ 151mn, beating BBG/ CMBI est. by 38%/ 59%, driven by robust sales growth of 11%, which is also ahead of BBG/ CMBI est. by 6%/ 6%. We attributed the beat to: 1) more-than-expected new stores of 356 (vs CMBI est. of 208), 2) lower-than-expected food costs and 3) better-than-expected government and rental reliefs. Hence operating profit grew by 90% YoY in 4Q20 (78% if we use constant FX).
- Cautious outlook for 1Q21E.** Despite the resilient SSSG in 4Q20 (-4%/ -5% YoY for KFC/ Pizza Hut, roughly in-line with CMBI est.), management expects significant headwind in 1Q21E, due to: 1) stricter government measures on mini COVID outbreak and reduced social activities, 2) weaker travellers demand in transportation hubs and related locations and 3) weaker demand in lower tier cities as more workers are advised to stay put instead of returning to their hometowns. **GP margin in 1Q21E may only be flattish vs 1Q20**, as benefits from lower poultry prices will be offset by more value campaign to attract traffic, lower delivery demand (small ticket sizes and less high margin items) and adoption of eco-friendly packaging materials since FY21E.
- Gradual recovery throughout FY21E is still valid but EBIT margin may remain subdued.** YUMC's mid-term growth story, in our view, is still intact given its superior execution, product innovation and digital capability. We are still expecting a sequential improvement onwards, but the management also flagged that EBIT margin in FY21E may not be able to return to FY19E level, due to absence of government and rental reliefs and needs to hire more staffs.
- KFC to speed up expansion and Pizza Hut's improvement continue.** YUMC also target gross openings of 1,000+ stores in FY21E (ahead of CMBI est. of 900) while Pizza Hut should have a stronger rebound in FY21E, driven by menu upgrades (75%+ SKUs were new or upgraded since 2Q20), return of value for money, more remodelling (40%+ stores since FY18) and better digital (tableside ordering mix reached 37% in 4Q20) and delivery experience.
- Maintain BUY but lower TP to US\$ 66.59**, based on 36x FY21E P/E (unchanged). We revised down FY21E/ 22E NP forecast by 8%/ 8%, to factor in: 1) a weaker 1Q21 sales, 2) higher capex, 3) higher staff and rental costs but 4) a faster store openings. YUMC is trading at 31x FY21E P/E, attractive vs HDL's 74x and JMJ's 77x, given a 21% EBIT CAGR in FY20-23E.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (USD mn)	8,776	8,263	9,626	10,864	12,028
YoY growth (%)	4.3	(5.8)	16.5	12.9	10.7
Net income (USD mn)	713	784	809	975	1,141
Diluted EPS (USD)	1.81	1.89	1.85	2.22	2.58
YoY growth (%)	1.8	4.5	(2.2)	19.8	16.4
Consensus EPS (USD)	n/a	n/a	2.02	2.34	2.92
P/E (x)	30.9	29.6	30.3	25.3	21.7
P/B (x)	6.7	3.9	3.5	3.2	2.8
Yield (%)	0.9	0.4	0.8	1.0	1.1
ROE (%)	23.2	17.0	12.7	13.6	14.2
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	US\$66.59
(Previous TP)	US\$72.61)
Up/Downside	+18.9%
Current Price	US\$55.98

China Catering Sector

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Stock Data

Mkt Cap (US\$ mn)	23,512
Avg 3 mths t/o (US\$ mn)	112.54
52w High/Low (US\$)	61.18/38.33
Total Issued Shares (mn)	420.0

Source: Bloomberg

Shareholding Structure

Primavera Capital	5.7%
BlackRock	6.5%
Invesco	9.7%
Management	0.2%
Free Float	77.8%

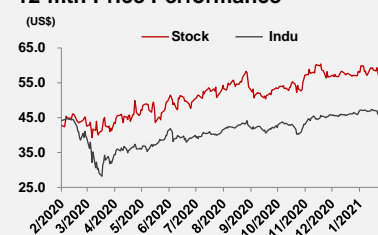
Source: HKEX

Share Performance

	Absolute	Relative
1-mth	-1.9%	-4.5%
3-mth	1.3%	-9.1%
6-mth	6.3%	-8.1%
12-mth	26.3%	17.2%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

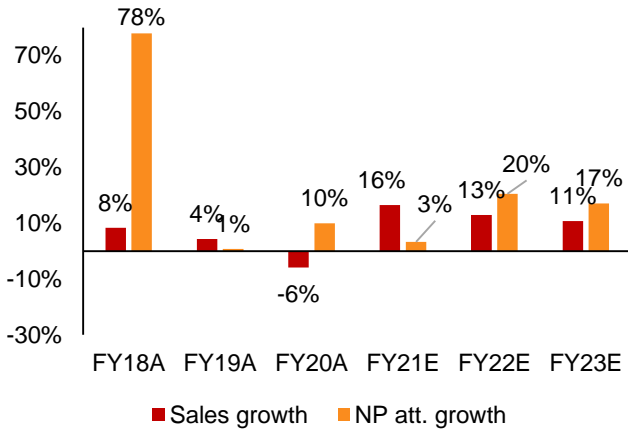
Auditor: KPMG

Related Reports

- Yum China (YUMC US, BUY) - Digital, delivery, Pizza Hut reform driven growth – 7 Dec 2020

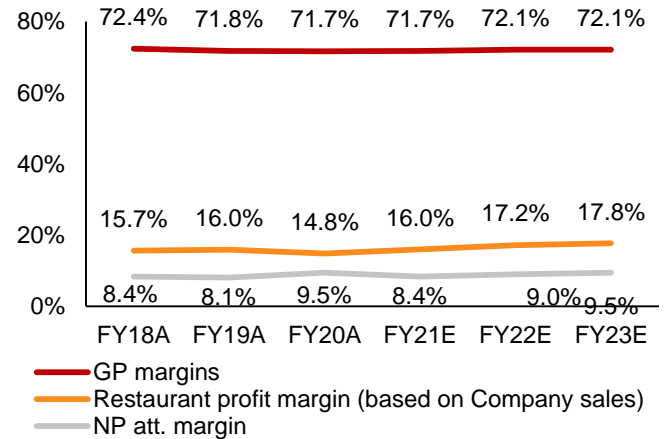
Focus Charts

Figure 1: Yearly Sales/ net profit att. growth



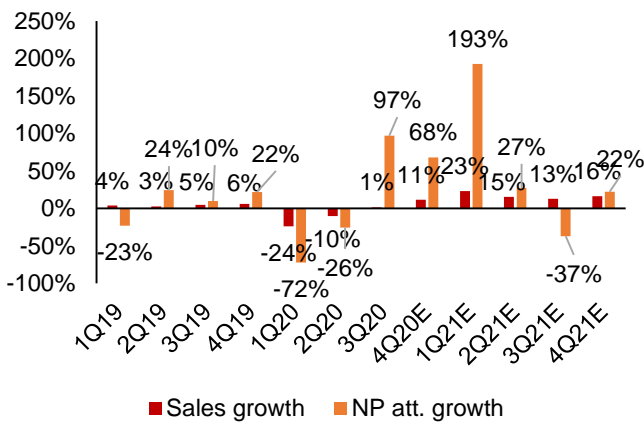
Source: Company data, CMBIS estimates

Figure 2: Yearly GP/ restaurant OP/ NP att. margin



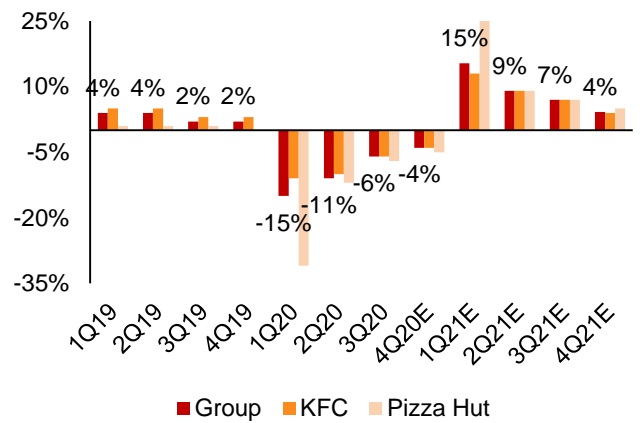
Source: Company data, CMBIS estimates

Figure 3: Quarterly sales/ net profit att. growth



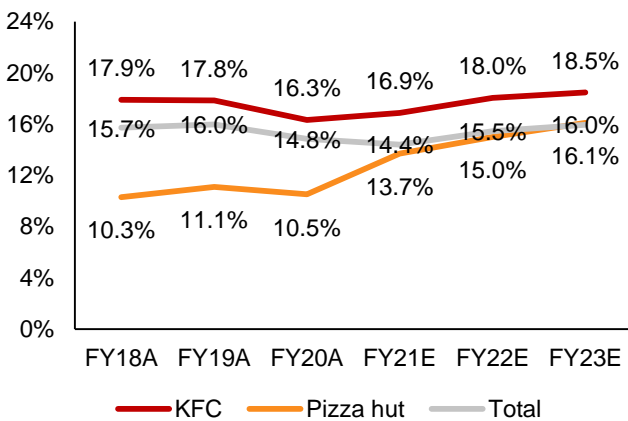
Source: Company data, CMBIS estimates

Figure 4: KFC/ Pizza Hut/ Group's SSSG



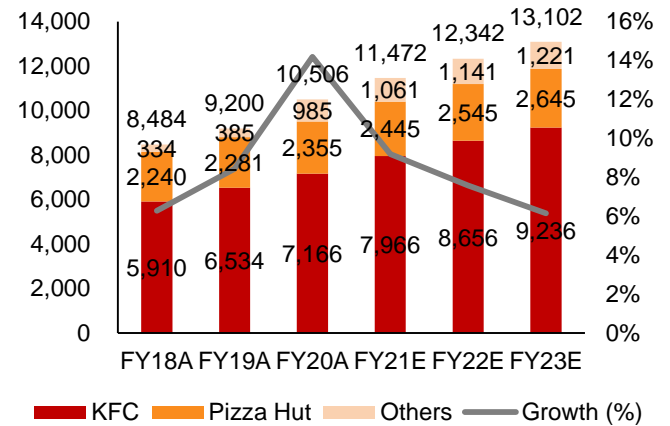
Source: Company data, CMBIS estimates

Figure 5: KFC/ Pizza Hut/ Group's restaurant OP margin



Source: Company data, CMBIS estimates

Figure 6: KFC/ Pizza Hut/ Group's number of restaurants



Source: Company data, CMBIS estimates

Earnings revision

Figure 7: Earnings revision

US\$ mn	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	9,626	10,864	12,028	9,818	10,930	n/a	-2.0%	-0.6%	n/a
Operating Profit	976	1,241	1,445	1,089	1,329	n/a	-10.3%	-6.6%	n/a
Net profit	809	975	1,141	878	1,057	n/a	-7.8%	-7.7%	n/a
EPS (US\$ cents)	1.850	2.215	2.578	2.017	2.413	n/a	-8.3%	-8.2%	n/a
Gross margin	71.7%	72.1%	72.1%	71.7%	72.0%	n/a	0ppt	0ppt	n/a
Operating Margin	10.1%	11.4%	12.0%	11.1%	12.2%	n/a	-0.9ppt	-0.7ppt	n/a
Net profit att. margin	8.4%	9.0%	9.5%	8.9%	9.7%	n/a	-0.5ppt	-0.7ppt	n/a

Source: Company data, CMBIS estimates

Figure 8: CMBIS estimates vs consensus

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	9,626	10,864	12,028	9,864	10,856	11,851	-2.4%	0.1%	1.5%
Operating Profit	976	1,241	1,445	1,106	1,279	1,655	-11.8%	-2.9%	-12.7%
Net profit	809	975	1,141	843	962	1,258	-4.0%	1.4%	-9.3%
EPS (US\$ cents)	1.850	2.215	2.578	2.023	2.342	2.920	-8.6%	-5.4%	-11.7%
Gross Margin	71.7%	72.1%	72.1%	71.6%	71.6%	71.7%	0.1ppt	0.4ppt	0.5ppt
Operating Margin	10.1%	11.4%	12.0%	11.2%	11.8%	14.0%	-1.1ppt	-0.4ppt	-2ppt
Net Margin	8.4%	9.0%	9.5%	8.5%	8.9%	10.6%	-0.1ppt	0.1ppt	-1.1ppt

Source: Company data, CMBIS estimates

Assumptions

Figure 9: CMBIS' assumptions

Major assumptions	FY18A	FY19A	FY20A	FY21E	FY22E	FY23E
Sales by segment (RMB mn)						
KFC - eat in sales	4,882	4,911	4,137	4,672	5,107	5,421
KFC - delivery sales	808	1,129	1,617	2,128	2,617	3,166
PH - eat in sales	1,611	1,527	1,146	1,249	1,317	1,385
PH- delivery sales	500	527	642	755	861	964
Others	614	682	721	823	961	1,091
Total	8,415	8,776	8,263	9,626	10,864	12,028
Sales by segment growth (%)						
KFC - eat in sales	9.2%	0.6%	-15.8%	12.9%	9.3%	6.1%
KFC - delivery sales	35.8%	39.7%	43.2%	31.6%	23.0%	21.0%
PH - eat in sales	-3.5%	-5.2%	-25.0%	9.0%	5.5%	5.1%
PH- delivery sales	18.1%	5.4%	21.7%	17.7%	14.0%	12.0%
Others	0.7%	11.1%	5.8%	14.1%	16.8%	13.6%
Total	8.3%	4.3%	-5.8%	16.5%	12.9%	10.7%
Sales network by brand						
KFC	5,910	6,534	7,166	7,966	8,656	9,236
Pizza Hut	2,240	2,281	2,355	2,445	2,545	2,645
Others	334	385	985	1,061	1,141	1,221
Total	8,484	9,200	10,506	11,472	12,342	13,102
Restaurant profit margin by brand						
KFC	17.9%	17.8%	16.3%	16.9%	18.0%	18.5%
Pizza hut	10.3%	11.1%	10.5%	13.7%	15.0%	16.1%
Others	0.0%	-0.4%	-0.4%	0.0%	0.2%	0.3%
Total	15.7%	16.0%	14.8%	14.4%	15.5%	16.0%
Costs breakdown						
Food and paper/ sales	27.6%	28.2%	28.3%	28.3%	27.9%	27.9%
Payroll and employee benefits/ sales	20.4%	20.6%	20.9%	20.8%	20.4%	20.2%
Rental and other operating expenses/ sales	28.4%	27.0%	26.9%	26.3%	26.1%	25.9%
G & A expenses/ sales	5.4%	5.5%	5.8%	5.5%	5.3%	5.2%
Franchisees expenses/ sales	7.1%	7.3%	7.7%	7.7%	7.8%	7.8%
Effective tax rate	22.5%	25.9%	26.6%	26.0%	25.5%	25.0%
NP att. margin	8.4%	8.1%	9.5%	8.4%	9.0%	9.5%
NP att. growth (%)	77.9%	0.7%	10.0%	3.3%	20.5%	17.1%

Source: Company data, CMBIS estimates

Valuation

Figure 10: Peers valuation table

Company	Ticker	Rating	12m TP (LC)	Price (LC)	Up/Down-side	Mkt. Cap (HK\$m)	Year End	P/E (x)		P/B (x)		ROE (%)	3yrs PEG (x)	Yield (%)	
								FY1E	FY2E	FY1E	FY2E	FY1E	FY1E	FY1E	
Leading Greater China Catering															
Yum China#	YUMC US	BUY	66.59	55.98	19%	182,271	Dec-20	29.6	30.3	3.9	3.5	23.2	4.3	0.4	
Jiumaojiu	9922 HK	BUY	20.88	30.45	-31%	44,256	Dec-19	747.6	77.3	15.0	12.7	101.4	16.0	0.0	
Haidilao	6862 HK	BUY	53.56	76.85	-30%	407,305	Dec-19	401.0	73.5	30.0	20.4	5.2	10.2	0.1	
Cafe De Coral	341 HK	BUY	18.37	16.64	10%	9,746	Mar-20	25.6	22.9	3.6	3.4	3.0	0.3	2.8	
Xiabuxiabu	520 HK	NR	n/a	21.00	n/a	22,790	Dec-19	674.3	36.1	7.9	6.6	(6.0)	20.2	0.1	
Yihai	1579 HK	NR	n/a	132.30	n/a	138,505	Dec-19	114.6	84.5	31.7	24.1	34.3	3.3	0.2	
Gourmet Master	2723 TT	NR	n/a	131.00	n/a	6,538	Dec-19	23.6	17.6	2.1	1.9	8.1	1.1	2.4	
								Avg.	288.0	48.9	13.5	10.4	24.2	7.9	0.9
								Med.	114.6	36.1	7.9	6.6	8.1	4.3	0.2
Other Greater China Catering															
Fairwood	52 HK	NR	n/a	17.50	n/a	2,267	Mar-20	n/a	15.0	3.2	2.8	9.3	n/a	2.3	
Tai Hing	6811 HK	NR	n/a	1.57	n/a	1,573	Dec-19	41.3	9.8	3.2	3.0	11.5	1.2	1.3	
Hop Hing	47 HK	NR	n/a	0.04	n/a	423	Dec-19	n/a	n/a	n/a	n/a	(4.2)	n/a	n/a	
Ajisen China	538 HK	NR	n/a	1.27	n/a	1,386	Dec-19	19.6	11.7	n/a	n/a	(1.2)	n/a	4.7	
								Avg.	30.5	12.1	3.2	2.9	3.9	1.2	2.8
								Med.	30.5	11.7	3.2	2.9	4.0	1.2	2.3
Greater China Catering															
								Avg.	230.8	37.9	11.2	8.7	16.8	7.1	1.4
								Med.	41.3	26.7	3.9	3.5	8.1	3.8	0.9
International Catering															
Yum! Brands	YUM US	NR	n/a	105.08	n/a	245,737	Dec-20	26.2	23.5	n/a	n/a	n/a	1.4	2.0	
Mcdonald'S	MCD US	NR	n/a	211.45	n/a	1,221,435	Dec-20	25.4	23.0	n/a	n/a	n/a	1.5	2.5	
Starbucks	SBUX US	NR	n/a	103.71	n/a	946,563	Sep-20	36.5	30.1	n/a	n/a	n/a	0.5	1.9	
Rest. Brands	QSR US	NR	n/a	59.73	n/a	217,807	Dec-19	27.6	21.4	10.0	9.7	23.8	3.3	3.5	
Wingstop	CMG US	NR	n/a	1490.4	n/a	323,524	Dec-20	65.4	49.3	18.1	15.3	19.2	1.5	0.0	
Shake Shack	DRI US	NR	n/a	129.50	n/a	130,843	May-20	39.1	20.1	6.3	5.6	(4.9)	(0.1)	1.1	
Chipotle	DPZ US	NR	n/a	372.28	n/a	113,712	Dec-19	29.9	28.9	n/a	n/a	n/a	2.1	0.8	
Darden	DNKN US	NR	n/a	n/a	n/a	n/a	Dec-19	n/a	n/a	n/a	n/a	n/a	n/a	n/a	
Domino'S Pizza	WEN US	NR	n/a	21.27	n/a	36,948	Dec-19	37.2	29.8	8.5	8.8	18.0	3.1	1.3	
Dunkin' Brands	SHAK US	NR	n/a	115.76	n/a	37,191	Dec-19	n/a	548.6	11.5	11.2	(7.0)	n/a	0.0	
Wendy'S	WING US	NR	n/a	153.67	n/a	35,363	Dec-19	126.2	108.2	n/a	n/a	n/a	3.5	1.6	
Jollibee Foods	JFC PM	NR	n/a	180.00	n/a	32,113	Dec-19	n/a	57.8	3.5	3.4	(19.4)	n/a	0.4	
								Avg.	46.0	85.5	9.6	9.0	5.0	1.9	1.4
								Med.	36.5	29.8	9.2	9.2	6.6	1.5	1.3
H-shares Consumer Staples															
UPC	220 HK	NR	n/a	9.27	n/a	40,040	Dec-19	21.3	19.8	2.4	2.4	10.8	1.8	4.5	
Tingyi	322 HK	NR	n/a	15.02	n/a	84,478	Dec-19	18.1	18.3	3.5	3.4	22.6	1.9	5.1	
Want Want*	151 HK	BUY	7.36	5.60	31%	68,123	Mar-20	13.8	13.3	3.6	3.5	28.8	1.4	6.1	
China Mengniu*	2319 HK	BUY	42.00	46.85	-10%	184,969	Dec-19	45.1	29.8	4.8	4.2	11.5	2.8	0.5	
Vitasoy	345 HK	NR	n/a	33.55	n/a	35,727	Mar-20	51.8	48.6	10.2	9.2	19.7	3.2	1.2	
Budweiser	1876 HK	NR	n/a	24.75	n/a	327,774	Dec-19	69.4	39.4	4.2	3.9	9.0	8.2	0.5	
Tsingtao*	168 HK	BUY	78.10	75.30	4%	130,050	Dec-19	37.8	32.0	4.1	3.7	10.9	1.9	1.0	
CR Beer	291 HK	NR	n/a	71.30	n/a	231,310	Dec-19	74.8	51.1	9.1	8.2	7.2	1.3	0.5	
Dali Foods	3799 HK	NR	n/a	4.65	n/a	63,678	Dec-19	13.8	12.5	3.1	2.9	22.1	1.7	5.0	
								Avg.	38.4	29.4	5.0	4.6	15.8	2.7	2.7
								Med.	37.8	29.8	4.1	3.7	11.5	1.9	1.2

Source: Bloomberg, Company data, CMBIS estimates, *cover by another analyst - Albert Yip, #FY1E and FY2E to stay as FY20 and FY21E for YUMC

Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (USD mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec (USD mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	8,776	8,263	9,626	10,864	12,028	Net income	901	961	976	1,241	1,445
Company sales	7,925	7,396	8,644	9,760	10,808	D&A	419	386	427	461	505
Franchise fees and income	148	148	172	188	204	Change in working capital	74	(7)	74	63	62
Fran. & uncol. affiliates sales	654	647	755	854	949	Income tax paid	16	(295)	(295)	(346)	(394)
Other revenues	49	72	56	62	67	Others	(225)	234	195	124	134
Cost of goods sold	(2,479)	(2,342)	(2,723)	(3,035)	(3,350)	Net cash from operating	1,185	1,279	1,377	1,545	1,751
Gross profit	6,297	5,921	6,903	7,828	8,677	Capex & investments	(435)	(578)	(578)	(543)	(601)
Other net income	60	285	67	76	84	Associated companies	-	-	-	-	-
Operating expenses	(5,456)	(5,245)	(5,994)	(6,663)	(7,317)	Interest received	-	-	-	-	-
Staff costs	(1,807)	(1,730)	(2,006)	(2,213)	(2,427)	Others	(475)	-	-	-	-
Admin	(560)	(591)	(635)	(684)	(746)	Net cash from investing	(910)	(578)	(578)	(543)	(601)
Property rent & related	(877)	(814)	(951)	(1,074)	(1,189)	Equity raised	(265)	2,220	-	-	-
D & A	(428)	(404)	(438)	(471)	(507)	Change of Debts	-	-	-	-	-
Other operating expenses	(1,784)	(1,706)	(1,964)	(2,221)	(2,448)	Dividend paid	(181)	(181)	(95)	(195)	(235)
EBIT	901	961	976	1,241	1,445	Others	(34)	-	-	-	-
Finance costs, net	39	43	81	94	108	Net cash from financing	(480)	2,039	(95)	(195)	(235)
JV & associates	-	-	-	-	-	Net change in cash	(205)	2,740	704	807	915
Exceptional	63	104	77	22	24	Beginning cash balance	1,266	1,046	3,786	4,490	5,296
Pre-tax profit	1,003	1,108	1,134	1,357	1,577	Exchange difference	(15)	-	-	-	-
Income tax	(260)	(295)	(295)	(346)	(394)	Cash at the end of the year	1,046	3,786	4,490	5,296	6,211
Less: Minority interests	30	29	30	36	41						
Net profit	713	784	809	975	1,141						

Balance sheet						Key ratios					
YE 31 Dec (USD mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	4,691	4,797	4,911	4,983	5,078	Sales mix (%)					
Fixed asset	1,594	1,775	1,926	2,008	2,105	Company sales	90.3	89.5	89.8	89.8	89.9
Intangible assets & goodwill	94	75	64	54	52	Franchise fees and income	1.7	1.8	1.8	1.7	1.7
Prepaid lease payments	-	-	-	-	-	Fran. & uncol. affiliates sales	7.5	7.8	7.8	7.9	7.9
Interest in asso. & JV	89	89	89	89	89	Other revenues	0.6	0.9	0.6	0.6	0.6
Others	2,914	2,858	2,832	2,833	2,833	Total	100.0	100.0	100.0	100.0	100.0
Current assets	2,259	4,934	5,726	6,608	7,597	P&L ratios (%)					
Cash and cash equivalents	1,046	3,786	4,490	5,296	6,211	Gross margin	71.8	71.7	71.7	72.1	72.1
Inventories	380	321	373	416	459	Operating margin	10.3	11.6	10.1	11.4	12.0
Trade and other receivables	88	91	105	119	132	Pre-tax margin	11.4	13.4	11.8	12.5	13.1
Prepayments	134	126	147	166	184	Net margin	8.1	9.5	8.4	9.0	9.5
Others	611	611	611	611	611	Effective tax rate	25.9	26.6	26.0	25.5	25.0
Current liabilities	1,736	1,665	1,827	1,965	2,101	Balance sheet ratios					
Borrowings	-	-	-	-	-	Current ratio (x)	1.3	3.0	3.1	3.4	3.6
Trade payables	623	577	671	748	826	Quick ratio (x)	1.1	2.8	2.9	3.2	3.4
Accruals & other payables	437	411	479	541	599	Cash ratio (x)	0.6	2.3	2.5	2.7	3.0
Tax payables	45	45	45	45	45	Inventory turnover days	51	50	50	50	50
Others	631	631	631	631	631	Trade receivables days	3	4	4	4	4
Non-current liabilities	2,039	2,039	2,039	2,039	2,039	Trade payables days	91	90	90	90	90
Borrowings	-	-	-	-	-	Total debt / total equity ratio (%)	-	-	-	-	-
Deferred income	-	-	-	-	-	Net debt / equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Deferred tax	136	136	136	136	136	Returns (%)					
Others	1,903	1,903	1,903	1,903	1,903	ROE	22.5	13.0	12.0	12.9	13.4
Minority Interest	-	-	-	-	-	ROA	10.3	8.1	7.6	8.4	9.0
Total net assets	3,175	6,027	6,771	7,587	8,535	Per share					
Shareholders' equity	3,175	6,027	6,771	7,587	8,535	EPS (USD)	1.81	1.89	1.85	2.22	2.58
						DPS (USD)	0.48	0.23	0.46	0.55	0.64
						BVPS (USD)	8.44	14.35	16.03	17.85	19.96

Source: Company data, CMBIS estimates

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