

Yum China (YUMC US)

Confidence increases after upbeat 1Q23 result

1Q23 result was tremendous, and both sales recovery and margins are better than expected. After one and a half year, YUMC recorded its first +ve SSSG, as turnaround is finally here, we upgrade it to BUY and raise TP to US\$ 76.82, based on 35x FY23E P/E (up from 33x). YUMC is still one of our sector top picks, as we think its margin and store expansion can continue to surprise the market.

■ **An all-round beat in 1Q23.** In 1Q23, YUMC's sales increased by 9% YoY to US\$ 2.92bn (17% in constant FX), beating BBG est. by 4%, driven by: 1) robust SSSG of 8%, 2) resilient delivery sale growth of 9% (store density increased in the last few years and able to capture lots of sales during CNY by its self-owned rider team) and 3) increased marketing efforts. In 1Q23, YUMC's net profit rocketed by 189% YoY to US\$ 289mn, 51% higher than BBG est.. We attribute this impressive result to: 1) decent GP margin improvement (1.1ppt higher than BBG est.) through menu innovations, some VAT reduction and rental relief, 2) significant operating leverage, 3) savings in staff costs, through better labour scheduling and more cross-stores headcount sharing, and 4) lower than expected D&A expenses (reduced capex per store and less amortization related to the Hangzhou KFC acquisition). All in all, restaurant level OPM for KFC/ Pizza Hut had reached 22.2%/ 14.2% in 1Q23, already better than the 19.4%/ 14.2% in 1Q19. Noted that KFC/ Pizza Hut's SSSG of 8%/ 7% in 1Q23 were already industry leading vs SBUX's 3% and MCD's +ve growth, and we think YUMC is gaining more market shares as consumers are more value conscious.

■ **We are more optimistic about 2Q23E.** Following its rapid SSSG in 1Q23 (better than CMBI est. of MSD in FY23E), we are confident about its 2Q23E, because of: 1) strong sales growth momentum during the 5-1 Golden Week (narrowed to just LSD below 2019, far better than teens level below 2019 during CNY), 2) heavy promotions (value campaigns like Crazy Thursday/ Scream Wednesday for KFC/ Pizza Hut), 3) further improvement in tourist attractions and transportation hubs (still 20-30% below 2019, hence huge room for catch up) and 4) solid pipeline of high-quality new products.

■ **We see room for margin improvement.** We do see ample room for margin expansions in FY23E, aided by: 1) meaningful operating leverage ahead, as bases are easier in 2Q23E-4Q23E, 2) much healthier store portfolio (lots of underperforming stores were closed and many more productive new stores were opened), 3) further increase in labour productivity through better staff scheduling and sharing between stores (wage inflation will only be at around MSD to HSD) and 4) excellent control over rental expenses, partly thanks to lowered capex and hence depreciations.

■ **Turnaround is happening, upgrade to BUY and raise TP to US\$ 76.82.** Our new TP is based on 35x FY23E P/E (up from 33x), about 2 s.d. above 5 years average of 27x since the industry is entering an upcycle and well supported by 48% NP CAGR during FY22-25E. We lifted FY23E/ 24E/ 25E NP by 3%/ 6%/ 5% to factor in better KFC GP margin, operating leverage and other opex. YUMC is currently trading at 29x FY23E P/E, not too demanding.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (US\$ mn)	9,853	9,569	11,069	12,411	13,934
YoY growth (%)	19.2	(2.9)	15.7	12.1	12.3
Operating profit (US\$ mn)	1,386	629	1,313	1,544	1,914
Net profit (US\$ mn)	990.0	442.0	905.4	1,154.8	1,433.4
EPS (Reported) (US\$)	2.28	1.04	2.19	2.73	3.39
YoY growth (%)	17.0	(54.2)	110.1	24.4	24.1
P/E (x)	27.4	59.9	28.5	22.9	18.5
P/B (x)	3.6	3.6	3.4	3.1	2.7
Yield (%)	0.7	0.8	1.0	1.3	1.6
ROE (%)	13.8	5.9	12.0	13.8	15.2

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Up)

Target Price US\$76.82
(Previous TP US\$56.42)
Up/Downside 22.8%
Current Price US\$62.57

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Stock Data

Mkt Cap (US\$ mn) 25,873.3
Avg 3 mths t/o (US\$ mn) 98.4
52w High/Low (US\$) 64.36/37.47
Total Issued Shares (mn) 419.0
Source: FactSet

Shareholding Structure

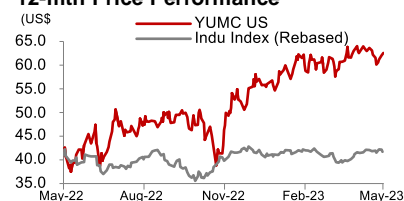
Invesco 9.5%
BlackRock 7.3%
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-3.5%	-3.8%
3-mth	5.1%	5.8%
6-mth	30.6%	24.1%

Source: FactSet

12-mth Price Performance



Source: FactSet

- **Target for FY23E remained unchanged.** Management reiterated its 1,100 to 1,300 net new store target in FY23E (as well as its capex budget of US\$700-900mn). The relatively slow store expansion in 1Q23, in our view, was only the result of pandemic and labour shortage in Jan 2023 and growth rate should catch up since 2Q23.

Earnings revision

Figure 1: Earnings revision

US\$ mn	New			Old			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	11,069	12,411	13,934	11,072	12,414	13,938	0.0%	0.0%	0.0%
Gross profit	7,845	8,803	9,894	7,814	8,769	9,856	0.4%	0.4%	0.4%
Operating Profit	1,313	1,544	1,914	1,117	1,370	1,718	17.6%	12.7%	11.4%
Net profit	905	1,155	1,433	881	1,087	1,363	2.8%	6.2%	5.2%
EPS (US\$ cents)	2.195	2.730	3.389	2.169	2.677	3.357	1.2%	2.0%	1.0%
Gross margin	70.9%	70.9%	71.0%	70.6%	70.6%	70.7%	0.3ppt	0.3ppt	0.3ppt
EBIT margin	11.9%	12.4%	13.7%	10.1%	11.0%	12.3%	1.8ppt	1.4ppt	1.4ppt
Net profit att. margin	8.2%	9.3%	10.3%	8.0%	8.8%	9.8%	0.2ppt	0.5ppt	0.5ppt

Source: Company data, CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

US\$ mn	CMBIGM			Consensus			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	11,069	12,411	13,934	11,369	12,736	14,032	-2.6%	-2.6%	-0.7%
Gross profit	7,845	8,803	9,894	7,995	8,170	8,733	-1.9%	7.7%	13.3%
Operating Profit	1,313	1,544	1,914	1,163	1,385	1,590	12.9%	11.5%	20.3%
Net profit	905	1,155	1,433	828	1,028	1,193	9.3%	12.4%	20.1%
EPS (US\$ cents)	2.195	2.730	3.389	1.967	2.455	2.843	11.6%	11.2%	19.2%
Gross Margin	70.9%	70.9%	71.0%	70.3%	64.1%	62.2%	0.6ppt	6.8ppt	8.8ppt
Operating Margin	11.9%	12.4%	13.7%	10.2%	10.9%	11.3%	1.6ppt	1.6ppt	2.4ppt
Net Margin	8.2%	9.3%	10.3%	7.3%	8.1%	8.5%	0.9ppt	1.2ppt	1.8ppt

Source: Company data, CMBIGM estimates

Assumptions

Figure 3: CMBIGM's assumptions

Major assumptions	FY21A	FY22A	FY23E	FY24E	FY25E
Sales by segment (US\$ mn)					
KFC - dine in sales	4,818	4,457	5,068	5,538	6,166
KFC - delivery sales	2,185	2,762	3,354	3,938	4,506
PH - dine in sales	1,340	1,125	1,270	1,404	1,622
PH- delivery sales	769	835	977	1,124	1,225
Others	741	390	400	407	415
Total	9,853	9,569	11,069	12,411	13,934
Sales by segment growth (%)					
KFC - dine in sales	16.0%	-7.5%	13.7%	9.3%	11.4%
KFC - delivery sales	34.7%	26.4%	21.4%	17.4%	14.4%
PH - dine in sales	17.0%	-16.1%	12.9%	10.6%	15.5%
PH- delivery sales	19.8%	8.6%	17.0%	15.0%	9.0%
Others	5.7%	-47.4%	2.7%	1.7%	1.9%
Total	19.2%	-2.9%	15.7%	12.1%	12.3%
Sales network by brand					
KFC	8,168	9,094	10,034	10,974	11,914
Pizza Hut	2,590	2,903	3,223	3,563	3,903
Others	1,030	950	990	1,040	1,120
Total	11,788	12,947	14,247	15,577	16,937
Restaurant profit margin by brand					
KFC	14.5%	15.5%	19.9%	20.0%	21.2%
Pizza hut	10.6%	9.1%	11.2%	12.5%	13.5%
Others	-1.3%	-4.6%	-0.2%	0.4%	0.5%
Total	13.7%	14.1%	18.2%	18.5%	19.7%
Costs breakdown					
Food and paper/ sales	28.5%	29.6%	29.1%	29.1%	29.0%
Payroll and employee benefits/ sales	22.9%	25.0%	23.8%	23.8%	23.6%
Rental and other operating expenses/ sales	27.0%	27.2%	25.5%	25.6%	25.1%
G & A expenses/ sales	5.7%	6.2%	6.0%	5.8%	5.6%
Franchisees expenses/ sales	6.6%	2.9%	2.5%	2.2%	1.9%
Effective tax rate	26.5%	30.4%	30.0%	25.0%	25.0%
NP att. margin	10.0%	4.6%	8.2%	9.3%	10.3%
NP att. growth (%)	26.3%	-55.4%	104.8%	27.5%	24.1%

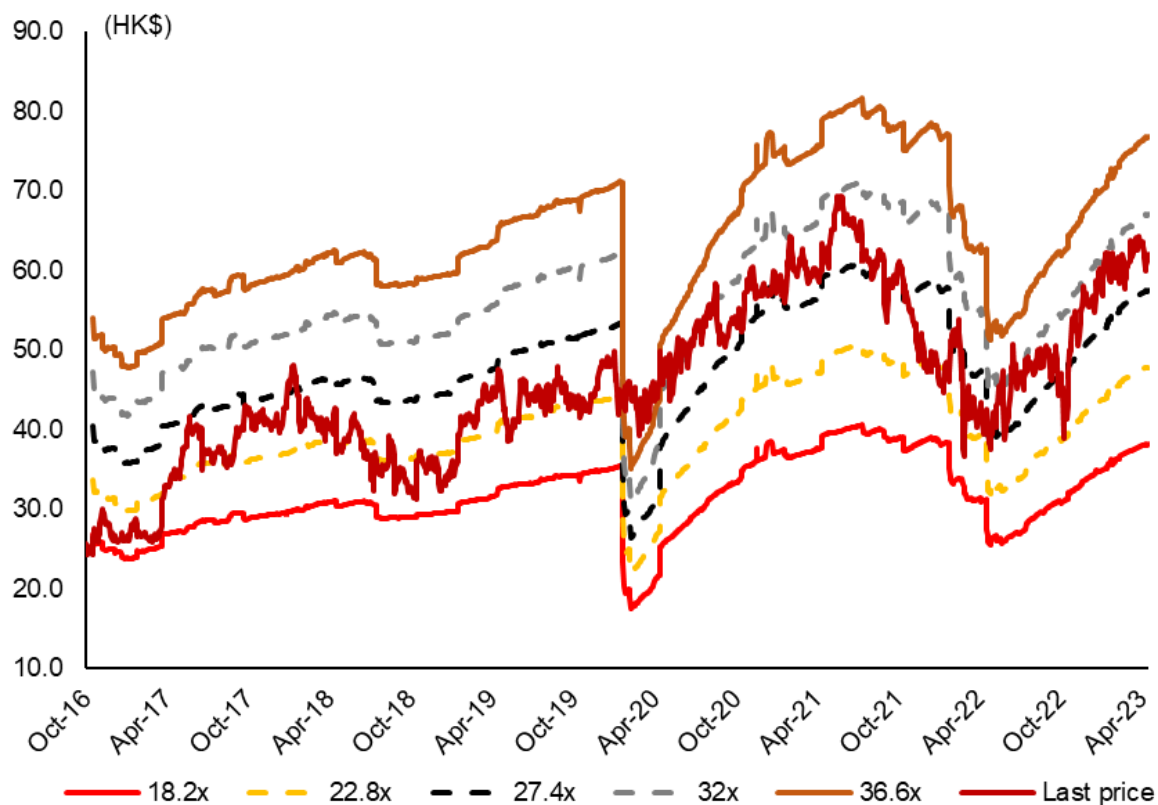
Source: Company data, CMBIGM estimates

Valuation

Figure 4: Peers valuation table

			12m TP	Price	Up/ Down-	Mkt. Cap	Year	P/E (x)		P/B (x)	ROE (%)	3yrs PEG (x)	Yield (%)	YTD perf.
Company	Ticker	Rating	(LC)	(LC)	side	(HK\$mn)	End	FY1E	FY2E	FY2E	FY2E	FY1E	FY1E	FY1E
Leading Greater China Catering														
Yum China	YUMC US	BUY	76.82	62.57	23%	210,625	Dec-22	28.5	22.9	3.4	5.9	0.6	1.0	14.8
Jiumaojiu	9922 HK	BUY	23.52	16.90	39%	24,581	Dec-22	34.2	21.9	5.7	1.6	0.2	0.6	(18.9)
Haidilao	6862 HK	BUY	29.97	19.34	55%	107,801	Dec-22	29.1	22.9	9.0	17.9	0.6	1.0	(13.7)
Helens	9869 HK	NR	n/a	11.50	n/a	14,569	Dec-22	32.5	19.2	5.8	(68.1)	(0.2)	0.2	(22.4)
Tam Jai	2217 HK	NR	n/a	2.03	n/a	2,722	Mar-22	20.3	10.7	1.8	19.3	1.4	1.5	(22.8)
Cafe De Coral	341 HK	BUY	15.10	11.10	36%	6,501	Mar-22	28.5	16.4	2.2	1.7	0.2	2.6	(25.5)
Xiabuxiabu	520 HK	NR	n/a	5.75	n/a	6,246	Dec-22	19.0	11.8	3.3	(20.6)	(0.1)	1.7	(35.2)
Yihai	1579 HK	BUY	108.52	20.75	423%	21,723	Dec-22	20.8	17.8	3.7	18.3	1.3	1.4	(24.8)
Gourmet Master	2723 TT	NR	n/a	156.00	n/a	7,174	Dec-22	26.2	19.3	2.3	4.4	0.5	2.9	3.0
Avg.								27.7	18.2	4.0	(2.9)	0.4	1.3	(14.3)
Med.								28.8	18.7	3.4	3.1	0.3	1.2	(20.7)
International Catering														
Yum! Brands	YUM US	NR	n/a	142.90	n/a	314,090	Dec-22	27.8	24.2	n/a	n/a	2.0	1.7	11.6
Mcdonald's	MCD US	NR	n/a	298.07	n/a	1,708,143	Dec-22	27.2	24.8	n/a	n/a	1.7	2.1	13.1
Starbucks Corp	SBUX US	NR	n/a	114.46	n/a	1,030,040	Oct-22	33.5	28.0	n/a	n/a	1.7	1.9	15.4
Rest' Brands	QSR US	NR	n/a	72.14	n/a	257,305	Dec-22	23.5	21.2	8.8	41.7	4.8	3.1	11.6
Chipotle	CMG US	NR	n/a	2054.0	n/a	444,841	Dec-22	46.7	38.8	19.7	44.7	1.8	0.0	48.0
Darden	DRI US	NR	n/a	151.83	n/a	144,130	May-22	19.1	17.2	8.7	43.8	2.1	3.1	9.8
Domino's Pizza	DPZ US	NR	n/a	311.59	n/a	86,438	Jan-23	23.3	20.8	n/a	n/a	2.4	1.5	(10.0)
Wendy's Co	WEN US	NR	n/a	22.02	n/a	36,655	Jan-23	22.5	19.6	15.4	39.3	1.4	4.4	(2.7)
Shake Shack	SHAK US	NR	n/a	54.48	n/a	18,069	Dec-22	n/a	972.9	5.5	(6.0)	n/a	n/a	31.2
Wingstop Inc	WING US	NR	n/a	199.31	n/a	46,832	Dec-22	103.2	85.0	n/a	n/a	6.1	0.4	44.8
Jollibee Foods	JFC PM	NR	n/a	224.00	n/a	35,575	Dec-22	29.4	23.3	3.0	10.6	1.5	1.3	(2.6)
Avg.								35.6	116.0	10.2	29.0	2.6	2.0	15.5
Med.								27.5	24.2	8.7	40.5	1.9	1.8	11.6
H-shares Consumer Staples														
UPC	220 HK	NR	n/a	7.73	n/a	33,388	Dec-22	16.8	15.3	2.2	9.1	0.8	6.6	(1.0)
Tingyi	322 HK	NR	n/a	13.76	n/a	77,526	Dec-22	18.8	15.6	5.1	16.4	0.8	6.9	(0.1)
Want Want	151 HK	NR	n/a	4.96	n/a	58,935	Mar-22	13.5	12.2	3.1	25.6	23.5	6.1	(5.0)
China Mengniu*	2319 HK	BUY	57.00	31.85	79%	125,912	Dec-22	17.8	15.3	2.4	13.8	1.2	1.7	(10.0)
Nongfu Spring*	9633 HK	BUY	53.00	42.45	25%	477,412	Dec-22	43.8	37.5	14.1	37.9	3.0	1.7	(3.7)
Vitasoy	345 HK	NR	n/a	13.96	n/a	14,958	Mar-22	123.5	53.1	4.4	(1.5)	(0.5)	0.1	(13.1)
Budweiser*	1876 HK	BUY	27.20	23.30	17%	308,571	Dec-22	34.1	29.4	3.5	8.4	1.9	1.3	(5.1)
Tsingtao*	168 HK	BUY	86.00	84.50	2%	149,337	Dec-22	24.7	21.7	3.6	15.7	2.0	2.2	9.6
CR Beer*	291 HK	BUY	71.00	60.25	18%	195,462	Dec-22	31.5	26.0	5.6	16.9	1.6	1.3	10.4
Dali Foods	3799 HK	NR	n/a	3.16	n/a	43,273	Dec-22	11.2	10.2	1.8	15.8	1.1	4.9	(11.2)
Avg.								33.6	23.6	4.6	15.8	3.5	3.3	(2.9)
Med.								21.8	18.6	3.5	15.8	1.4	2.0	(4.4)

Source: Bloomberg, Company data, CMBIGM estimates, *covered by Joseph Wong

Figure 5: Forward 12M P/E valuation band

Source: Bloomberg, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (US\$ mn)						
Revenue	8,263	9,853	9,569	11,069	12,411	13,934
Cost of goods sold	(2,342)	(2,812)	(2,836)	(3,224)	(3,607)	(4,040)
Gross profit	5,921	7,041	6,733	7,845	8,803	9,894
Operating expenses	(5,245)	(6,298)	(6,010)	(6,553)	(7,296)	(8,022)
Selling expense	0	0	0	0	0	0
Admin expense	(591)	(663)	(704)	(786)	(856)	(934)
Staff costs	(1,730)	(2,258)	(2,389)	(2,633)	(2,951)	(3,285)
Other rental related expenses	(814)	(968)	(984)	(1,061)	(1,171)	(1,293)
Others	(1,660)	(1,893)	(1,390)	(1,500)	(1,699)	(1,846)
Operating profit	961	1,386	629	1,313	1,544	1,914
Other income	285	643	(94)	22	37	42
Share of (losses)/profits of associates/JV	0	0	0	0	0	0
EBITDA	1,411	1,902	1,172	1,887	2,164	2,578
Depreciation	(431)	(505)	(478)	(513)	(563)	(625)
Other amortisation	(19)	(11)	(65)	(60)	(57)	(40)
Interest income	43	60	84	88	116	143
Interest expense	0	0	0	0	0	0
Net Interest income/(expense)	43	60	84	88	116	143
Other income/expense	104	(54)	(26)	(30)	(34)	(38)
Pre-tax profit	1,108	1,392	687	1,372	1,627	2,019
Income tax	(295)	(369)	(209)	(412)	(407)	(505)
After tax profit	813	1,023	478	960	1,220	1,514
Minority interest	(29)	(33)	(36)	(55)	(65)	(81)
Net profit	784	990	442	905	1,155	1,433

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (US\$ mn)						
Current assets	4,936	4,716	3,940	5,288	6,524	7,810
Cash & equivalents	1,158	1,136	1,130	2,352	3,479	4,641
Restricted cash	3,105	2,860	2,022	2,022	2,022	2,022
Account receivables	99	67	64	76	85	95
Inventories	398	432	417	483	540	605
Prepayment	176	221	307	355	398	447
Other current assets	0	0	0	0	0	0
Non-current assets	5,939	8,507	7,886	7,499	7,405	7,508
PP&E	1,765	2,251	2,118	2,324	2,506	2,648
Right-of-use assets	2,164	2,612	2,219	2,219	2,219	2,219
Investment in JVs & assos	85	292	266	266	266	266
Intangibles	246	272	159	99	42	2
Goodwill	832	2,142	1,988	1,455	1,237	1,237
Other non-current assets	847	938	1,136	1,136	1,136	1,136
Total assets	10,875	13,223	11,826	12,787	13,930	15,318
Current liabilities	2,067	2,383	2,166	2,369	2,560	2,778
Short-term borrowings	0	0	0	0	0	0
Account payables	708	830	830	944	1,056	1,182
Tax payable	72	51	68	68	68	68
Other current liabilities	1,287	1,502	1,268	1,357	1,437	1,527
Non-current liabilities	2,337	2,918	2,500	2,500	2,500	2,500
Long-term borrowings	0	0	0	0	0	0
Other non-current liabilities	2,337	2,918	2,500	2,500	2,500	2,500
Total liabilities	4,404	5,301	4,666	4,869	5,060	5,278
Share capital	4,829	4,967	4,291	4,291	4,291	4,291
Retained earnings	2,105	2,892	2,191	2,625	3,437	4,445
Other reserves	(463)	63	678	1,002	1,141	1,305
Total shareholders equity	6,471	7,922	7,160	7,918	8,869	10,040
Minority interest	0	0	0	0	0	0
Total equity and liabilities	10,875	13,223	11,826	12,787	13,930	15,318

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (US\$ mn)						
Operating						
Profit before taxation	1,108	1,392	687	1,372	1,627	2,019
Depreciation & amortization	450	516	543	573	620	664
Tax paid	111	160	(20)	(412)	(407)	(505)
Change in working capital	69	53	0	77	82	93
Others	(624)	(990)	203	533	218	0
Net cash from operations	1,114	1,131	1,413	2,144	2,140	2,271
Investing						
Capital expenditure	(419)	(689)	(679)	(719)	(745)	(766)
Acquisition of subsidiaries/ investments	(288)	(115)	(23)	0	0	0
Others	(2,402)	(51)	180	0	0	0
Net cash from investing	(3,109)	(855)	(522)	(719)	(745)	(766)
Financing						
Dividend paid	(95)	(203)	(202)	(202)	(269)	(343)
Net borrowings	0	0	0	0	0	0
Proceeds from share issues	2,195	0	0	0	0	0
Share repurchases	(8)	(75)	(466)	0	0	0
Others	(34)	(35)	(176)	0	0	0
Net cash from financing	2,058	(313)	(844)	(202)	(269)	(343)
Net change in cash						
Cash at the beginning of the year	1,046	1,158	1,136	1,130	2,352	3,479
Exchange difference	40	15	(53)	0	0	0
Others	72	(37)	47	1,222	1,127	1,162
Cash at the end of the year	1,158	1,136	1,130	2,352	3,479	4,641
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	(5.8%)	19.2%	(2.9%)	15.7%	12.1%	12.3%
Gross profit	(6.0%)	18.9%	(4.4%)	16.5%	12.2%	12.4%
Operating profit	6.7%	44.2%	(54.6%)	108.8%	17.6%	23.9%
EBITDA	6.2%	34.8%	(38.4%)	61.0%	14.7%	19.1%
Net profit	10.0%	26.3%	(55.4%)	104.8%	27.5%	24.1%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	71.7%	71.5%	70.4%	70.9%	70.9%	71.0%
Operating margin	11.6%	14.1%	6.6%	11.9%	12.4%	13.7%
EBITDA margin	17.1%	19.3%	12.2%	17.0%	17.4%	18.5%
Return on equity (ROE)	16.3%	13.8%	5.9%	12.0%	13.8%	15.2%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Current ratio (x)	2.4	2.0	1.8	2.2	2.5	2.8
Receivable turnover days	4.1	3.1	2.5	2.5	2.5	2.5
Inventory turnover days	60.6	53.9	54.6	54.6	54.6	54.6
Payable turnover days	103.7	99.8	106.8	106.8	106.8	106.8
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	25.8	26.2	45.0	28.1	22.6	18.2
P/E (diluted)	25.8	26.2	45.0	28.1	22.6	18.2
P/B	3.1	3.3	2.6	3.3	2.9	2.6
P/CFPS	18.1	22.9	14.1	11.9	12.2	11.5
Div yield (%)	0.5	0.8	1.1	1.1	1.3	1.6

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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