招银国际 CMB INTERNATIONAL
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Yum China (9987 HK)

Digital, delivery, Pizza Hut reform driven growth

Initiate BUY on YUMC, as we forecast 14% NP CAGR in FY19-22E (even under drags by COVID-19) vs 13% in FY16-19, driven by: 1) near term favorable food, staff and rental costs, 2) more new stores and better locations, 3) various longer-term benefits yield from digital upgrades and 4) Pizza Hut reforms. Our TP of HK$ 562.71 is based on 36x FY21E P/E, 5% discount to leading China peer's avg. but 16% higher than Int'l peers' avg.. YUMC's valuation is attractive at 29x FY21E P/E and 3.3x PEG, well below HDL's 51x and 5.9x, JMJ's 45x and 9.1x.

- **A restaurant empire with leading product, digital and delivery quality.** Yum China ("YUMC") is the largest restaurant group in China by sales in 2019 (~1.4% market share). It owned 9,200 restaurants in China (6,534 KFC/ 2,281 Pizza Hut/ 385 others) and recorded USD 8.8bn sales and USD 700mn NP in FY19.
- **Multiple near-term catalysts and too conservative consensus.** We expect SSSG to turn positive to 14% YoY in FY21E, thanks to: 1) consumption recovery, 2) low base, 3) favourable food and staff cost trends, 4) superior digital and delivery upgrades and 5) better store locations and rental terms. More importantly, we believe our forecast is prudent while consensus is too conservative (CMBI's FY21E sales is only 10-13% higher vs FY19 and sales per average store for KFC/ Pizza Hut are just 3% higher / 1% lower vs FY19).
- **Digital and delivery upgrades to boost frequency and ASP.** YUMC has vast customer base for big data. We expect the growth drivers to be: 1) customer acquisitions by better user experience and convenience, 2) increase in purchasing frequency from more members, 3) ASP increases thru more upselling and 4) brands' cross-selling through membership reward system.
- **Industry leading product quality and Pizza Hut reform.** Backed by leading customer satisfaction rating among fried chicken brands, KFC should gain market shares in all tier cities in China. We also see Pizza Hut's reform successful (menu innovations, return of value for money, stores revamps, etc. since 2017) and yield an impressive 13% restaurant OP CAGR in FY19-22E.
- **We forecast 8% sales and 14% NP att. CAGR in FY20E-22E.** Key drivers are: 1) delivery, 2) increases in members and purchasing frequency, 3) easing food, staff and rental costs, and 4) Pizza Hut's reform and operating leverage.
- **Initiate BUY with TP of HK$ 562.71, based on 36x FY21E P/E, 5% discount to leading peers' average.** We find YUMC attractive given a 14% NP CAGR in FY19-22E (impressive enough given drags from COVID-19 and vs 14% in FY17-19). It is trading at 29x FY21E P/E and 3.3x PEG (based on FY20E P/E and FY19-22E NP CAGR), vs HDL's 53x and 6.2x, JMJ's 47x and 9.7x.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (USD mn)	8,415	8,776	8,127	9,818	10,930
YoY growth (%)	8.3	4.3	(7.4)	20.8	11.3
Net income (USD mn)	708	713	728	878	1,057
Diluted EPS (USD)	1.78	1.81	1.76	2.02	2.41
YoY growth (%)	77.9	1.8	(2.6)	14.4	19.6
Consensus EPS (USD)	n/a	n/a	1.47	2.02	2.33
P/E (x)	32.1	31.7	32.7	28.6	23.9
P/B (x)	7.3	6.8	4.0	3.6	3.2
Yield (%)	0.8	0.8	0.3	0.9	1.0
ROE (%)	23.8	22.5	12.2	12.9	13.7
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Initiation)

Target Price	**HK$562.71**
Up/Downside	**+25.9%**
Current Price	**HK$447.00**

China Catering Sector

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Stock Data

Mkt Cap (HK$ mn)	187,447
Avg 3 mths t/o (HK$ mn)	NA
52w High/Low (HK$)	482.4/385.6
Total Issued Shares (mn)	419.3

Source: Bloomberg

Shareholding Structure

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

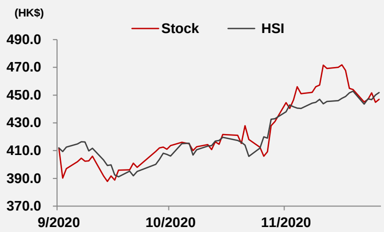
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	9.2%	1.3%
3-mth	n/a	n/a
6-mth	n/a	n/a
12-mth	n/a	n/a

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

Contents

Investment Thesis

■ **A restaurant empire with leading product, digital and delivery quality.**
Yum China ("YUMC") is the largest restaurant group in China, in terms of sales in 2019, with 1.4% market share. It owned 9,200 restaurants in China (6,534 KFC/ 2,281 Pizza Hut/ 385 Others) and generated USD 8.8bn sales and USD 713mn net profit in FY19.

■ **Multiple near-term catalysts and too conservative consensus.**
We expect SSSG to turn positive in FY21E, thanks to macro factors like: 1) domestic consumption recovery, 2) low base, 3) favorable food and staff cost trends, plus company specific factors, including: 1) superior digital and delivery upgrades that bring more seamless O2O customer experience and 2) better new store location and rental terms. More importantly, we believe the consensus is too conservative and our forecasts for FY21E-22E sales are 1-2% higher. CMBI's FY21E sales is only based on 10-13% growth vs FY19 while CMBI's FY21E sales per average store for KFC/ Pizza Hut are just 3% higher/ 1% lower vs FY19.

■ **Digital and delivery upgrades to boost frequency and ASP.**
YUMC has a vast customer base, which is excellent for customer analytics through big data, in order to better suit the customer demand. We expect the growth drivers to be: 1) more customer and member acquisitions with better users' experiences (digital orderings and payments) and convenience (easier delivery), 2) increase in purchasing frequency as more customers joining as members, 3) ASP increases thru more effective upselling and 4) cross-selling between brands thru the member's reward system.

■ **Industry leading product quality and Pizza Hut reform.**
Backed by leading customer satisfaction rating among fried chicken brands in China, we are confident that KFC can gain market shares in T1 and below cities. We also see Pizza Hut's initial transformation (menu innovations, return of value for money, store revamps, etc.) since 2017 successful and should yield a faster growth and higher margins onwards.

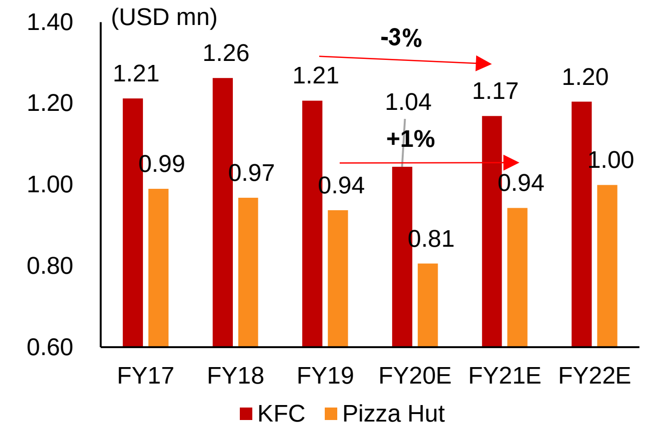
■ **Ample room for growth – doubling stores in 10 years is achievable**
We see more upside for YUMC's store expansions (vs consensus). We concur with its long-term target of 21,000 stores (both KFC and Pizza Hut) in China, derived from 15 stores per 1mn population. For KFC alone, its store counts can reach 12,000/ 27,000 if we use Japan/ China tier-1 cities as benchmarks, derived from density of 9/ 19 stores per 1 mn population. If this is done in 10 years, the implied CAGR would be 9.1%, much higher than our forecast of 5.8%, based on about 600/ 100 net new stores per year for KFC/ Pizza Hut. Also, we believe KFC can still expand in Tier-1 and Tier- 2 cities, because: 1) its ASP is similar vs peers and 2) its store counts are only the largest in 2 tier-1 cities (out of 4) and 3 tier-2 cities (out of 15), where CNHLS and Zhengxin Chicken Steak have more stores.

■ **We project 8% sales and 14% net profit att. CAGR in FY20E-22E.**
We expect sales drivers in FY20-22E to be: 1) rapid delivery growth, 2) increases in membership and purchasing frequency and 3) better Pizza Hut SSSG after its menu and store upgrades; while margin drivers are: 1) favourable food and staff costs , 2) better rental terms after pandemic and 3) operating leverage yield from successful Pizza Hut reform.

■ **We initiate BUY on YUMC with a TP of HK$ 562.71, based on 36x FY21E P/E.**
We find YUMC attractive given a 14% NP CAGR in FY19-22E (impressive enough given drags from COVID-19, vs 14% in FY17-19). It is trading at 29x FY21E P/E and 3.3x PEG (based on FY20E P/E and FY19-22E NP CAGR), undemanding compared to Haidilao's 53x and 6.2x, as well as Jiumaojiu's 47x and 9.7x, and industry's avg. of 38x and 3.3x.

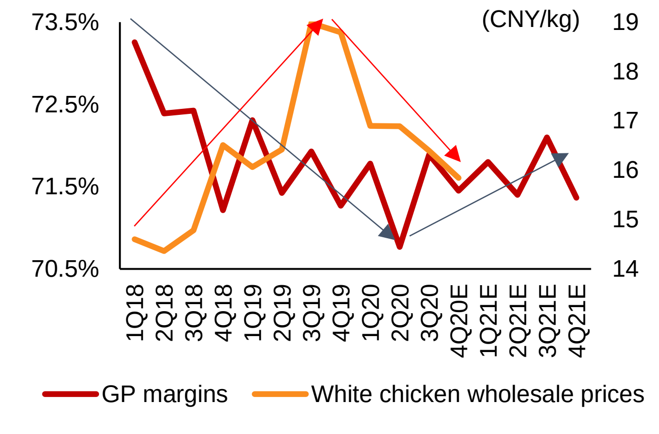
Focus Charts and Tables

Figure 1: Sales per average store by brand



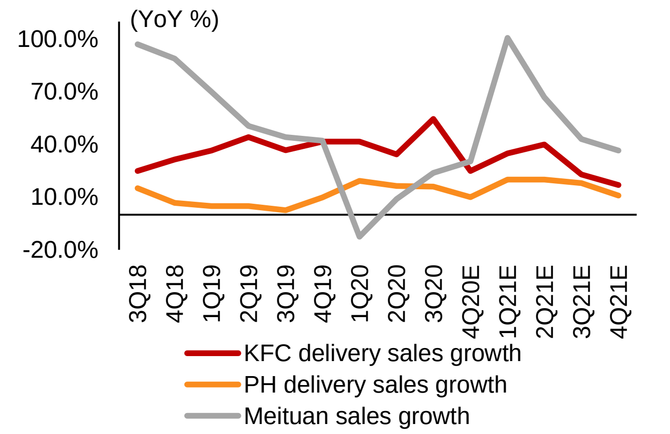
Source: Company data, CMBIS estimates

Figure 2: China chicken prices and YUMC's GPM



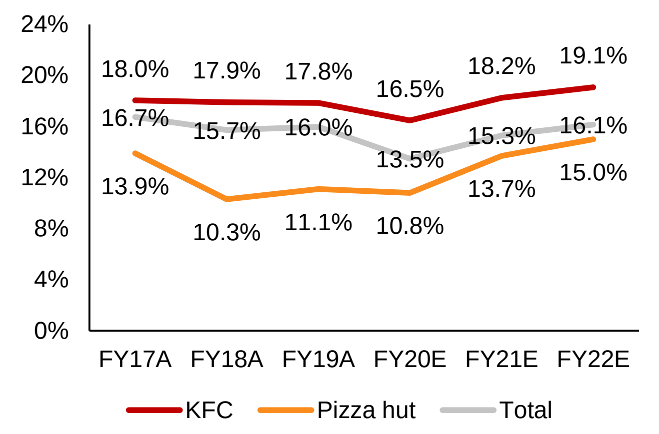
Source: Ministry of Agriculture, Company data, CMBIS estimates

Figure 3: KFC, PH, Meituan delivery sales growth



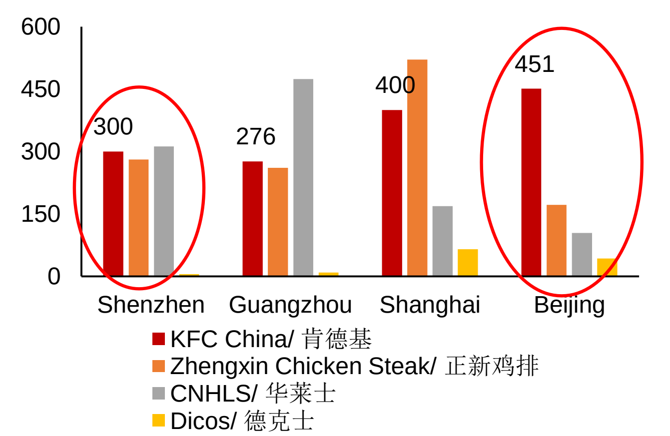
Source: Ministry of Agriculture, Company data, CMBIS estimates

Figure 4: Restaurants OP margin by brand



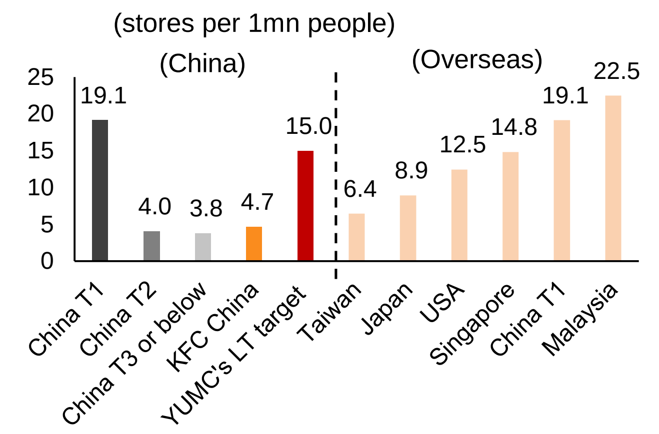
Source: Company data, CMBIS estimates

Figure 5: Number of stores by brand in tier-1 cities



Source: dianping.com, Company data, CMBIS estimates, as at Nov 2020

Figure 6: KFC's store density by region



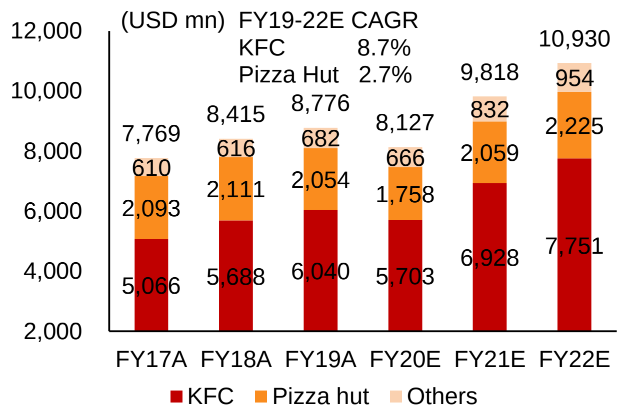
Source: dianping.com, Company data, CMBIS estimates

Company Overview

A restaurant empire with leading product, digital and delivery quality.

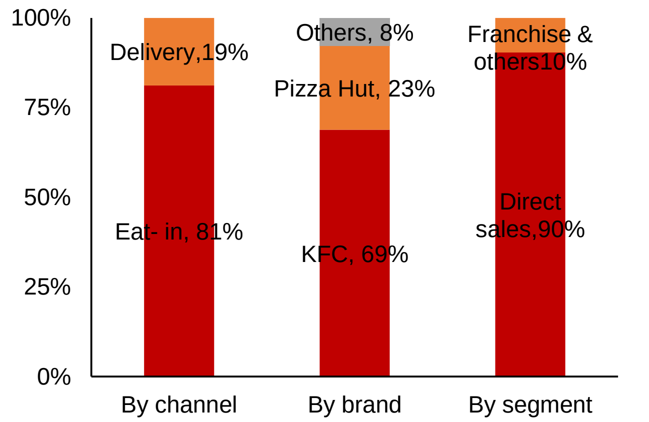
Yum China (YUMC US/ 9987 HK) or "YUMC", is the largest restaurant company in China in terms of 2019 system sales, taking up 1.4% market share, according to Frost & Sullivan. YUMC operates restaurants under various brands, including the flagship KFC and Pizza Hut, and emerging ones such as Little Sheep, Huang Ji Huang, COFFii & JOY, East Dawning, Taco Bell and Lavazza. As at FY19, it had 9,200 restaurants in China (6,534/ 2,281/ 385 for KFC/ Pizza Hut/ Others) and generated USD 8.8bn sales and USD 713mn net profit. Note that in FY16-19, sales, net profit and restaurant numbers CAGR were 7%, 13% and 7%, and we forecast 8%, 14% and 9% in FY19-22E.

Figure 7: Sales by brand



Source: Company data, CMBIS estimates

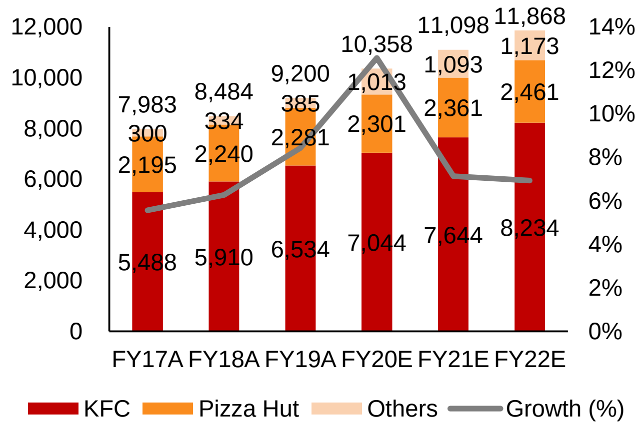
Figure 8: Sales mix by channel, brand and segment



Source: Company data, CMBIS estimates, for FY19

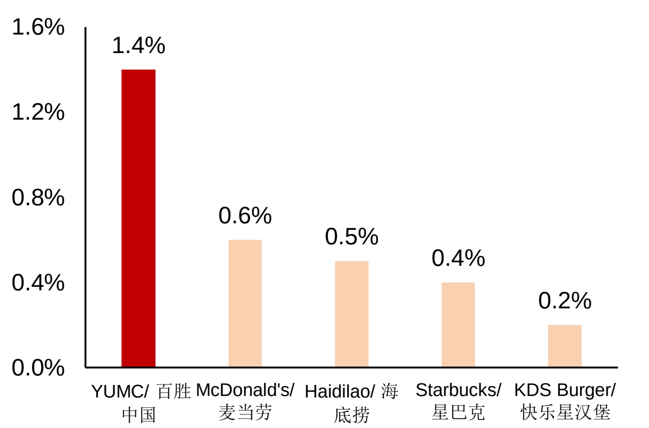
■ **Relationship with YUM Group – an annual licenses fees of 3% system sales.** YUMC was a subsidiary of YUM (YUM US), which is one of the largest fast food corporations in the world, with over 50,000 restaurants in over 190 countries. But YUMC was spun off back in Oct 2016 and has a 50-year master license agreement for exclusive right to operate and sub-license the KFC, Pizza Hut and Taco Bell brands in China (excluding Hong Kong, Taiwan and Macau). There is also an automatic renewal for another 50 years, but subject to being in "good standing". It has to pay an annual license fees to YUM of 3% net System sales for both its Company-owned and franchise restaurants.

Figure 9: Number of restaurants by brand



Source: Company data, CMBIS estimates

Figure 10: China catering market share by brand



Source: Frost & Sullivan, Company data, CMBIS, in 2019

- **KFC and Pizza hut being the flagships plus a few Chinese cuisine like Little sheep and Huang Ji Huang**

KFC is a fast food brand found in Kentucky in US in 1939 and entered China as early as 1987. It offers an extensive menu featuring chicken, pork, seafood, vegetables, desserts, etc. Pizza Hut is a casual dining brand found in 1958 and entered China in 1990. It has a menu that offers a broad variety of pizzas, steaks, pastas, desserts, etc. Little Sheep is a hot pot brand found in Inner Mongolia, China in 1999 and was acquired by YUM for USD 587mn in 2011. Huang Ji Huang is a simmer pot brand found in China in 2004 and was acquired by YUMC for USD 185mn in 2019.

Figure 11: Brand details, as at 1H20

Brands	KFC/ 肯德基	Pizza Hut/ 必胜客	Little Sheep/ 小肥羊	Huang Ji Huang/ 黄记煌	COFFii & JOY	East Dawning/ 东方既白	Taco Bell	Lavazza
Logo(s)								
Year Found	1939, 1987 (1st in China)	1958, 1990 (1st in China)	1999, 2011 (bought by YUM)	2004, 2019 (brought by YUM)	2018	2004	1962, 2016 (1st in China)	1895
Theme cuisines/ dishes	Fast food/ fried chicken	Causal dining/ Pizza	Causal dining/ Hot pot	Causal dining/ Simmer pot	Handcrafted specialty coffee	Causal dining/ Jiangnan-style	Fast food/ Mexican-style	Italian coffee
Average spending per customer	RMB 30-50	RMB 100-120	RMB 90-140	RMB 80-120	RMB 25-35	RMB 40-50	RMB 50-60	RMB 40-60
Number of restaurants, as at 1H20	Self-operated: 5,321 Franchised: 1,518	Self-operated: 2,150 Franchised: 108	Franchised: 260	Franchised: 600	Self-operated: 55	Self-operated: 11	Self-operated: 9	Self-operated: 1
FY19 Revenue	USD 6,040mn	USD 2,054mn	n/a	n/a	n/a	n/a	n/a	n/a
FY19 SSSG	4.0%	1.0%	n/a	n/a	n/a	n/a	n/a	n/a

Source: Company data, CMBIS estimates

- **YUMC is the clear leader in Quick Service Restaurant ("QSR") and Casual Dining Restaurant ("CDR").**

YUMC is certainly a leader, with 1.4% market share in China catering sector (vs no.2's 0.6% and no.3's 0.5%) and 4.9% market share in China QSR market (vs no.2's 2.7% and no.3's 1.0%) in 2019, while Pizza Hut and Huang Ji Huang are also the leaders in China CDR market, with 2.7% and 0.5% market share (vs no.3's 0.3% and no.4's 0.3%) in 2019, according to Frost & Sullivan.

Figure 12: Market share in China catering sector by company, in 2019

Rank	Company	Company Description	System Sales (RMB bn)	Market shares	Number of restaurants by year end
1	YUMC/ 百胜中国	The Group	67.6	1.4%	9,200
2	McDonald's/ 麦当劳	A multinational QSR brand that entered China in the 1990s, mainly focused on burgers.	29.0	0.6%	~3,300
3	Haidilao/ 海底捞	A domestic Chinese cuisine brand established in 1994. mainly focused on hot pot.	23.4	0.5%	~700
4	Starbucks/ 星巴克	A multinational chain coffee brand that entered China in the late 1990s, mainly focused on coffee.	20.3	0.4%	~4,300
5	KDS Burger/ 快乐星汉堡	A domestic QSR brand in China established in 2003, mainly focused on burgers	10.7	0.2%	~2,600

Source: Frost & Sullivan, CMBIS estimates

Figure 13: Yum China's Milestones

Year	Milestones
1987	First KFC restaurant opened in Beijing
1990	First Pizza Hut restaurant opened in Beijing
1996	100th KFC restaurant in China
2001	First Pizza Hut Delivery restaurant opened
2004	1,000th KFC restaurant in China
2005	First East Dawning restaurant opened
2010	Established our own delivery platform and app for KFC
2012	Acquired Little Sheep
2013	1,000th Pizza Hut restaurant in China
2015	5,000th KFC restaurant in China
2016	First Taco Bell restaurant opened in Shanghai
	Launched "KFC Super App" and rolled out loyalty program for KFC & Pizza Hut
	Separated from YUM and listed on the NYSE as an independent company
2017	120 million+ members at KFC and Pizza Hut as of year-end
	Implemented facial recognition Smile to Pay
	Listed as a Fortune 500 company
2018	180 million+ members at KFC and Pizza Hut as of year-end
	Launched privilege memberships at KFC and Pizza Hut
	First COFFii & JOY store opened in Shanghai
2019	240 million+ members at KFC and Pizza Hut as of year-end
	Launched YUMC Pay
	Opened an innovation center in Shanghai
2020	Acquired a controlling interest in Huang Ji Huang
	10,000th restaurant in China
	First Lavazza store opened in Shanghai

Source: Company data, CMBIS estimates

Company's key positives and growth drivers

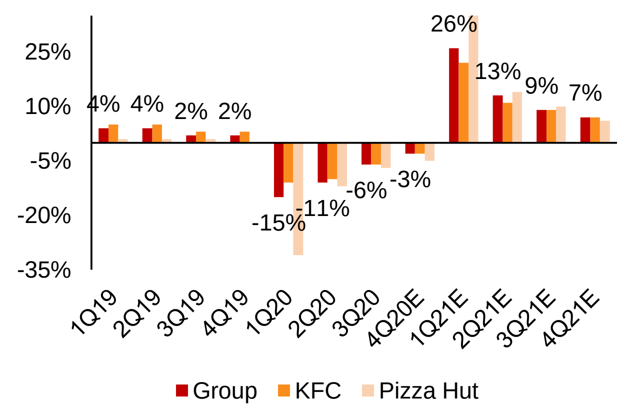
1) Multiple near-term catalysts and too conservative consensus

There are macro positives, such as: 1) healthy recovery of domestic consumption (with the help from re-shoring), 2) low base, and 3) favourable raw materials trend (e.g. chicken and pork prices) & less pressure for wage increases. In addition, there are company specific positives, namely: 1) superior digital and delivery upgrades for seamless O2O customer experience and 2) ability to secure more and better store locations and rental terms. More importantly, consensus forecasts are not at all aggressive.

■ **1.1 SSSG will soon turn positive, due to YUMC's edge on digital and delivery.**

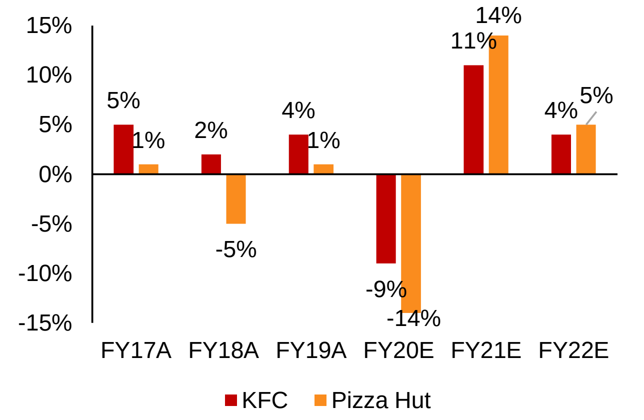
We are still optimistic on Yum China's turnaround ahead in 4Q20E and FY21E and expect -3%/ 26%/ 13%/ 5%/ 7% SSSG for KFC and -3%/ 22%/ 11%/ 4%/ 7% SSSG for Pizza Hut in 4Q20E/ 1Q21E/ 2Q21E/ 3Q21E/ 4Q21E, benefiting from the low base due to COVID-19 outbreak and market shares gain from more digital and delivery demand.

Figure 14: Quarterly SSSG by brand



Source: Company data, CMBIS estimates

Figure 15: Yearly SSSG by brand

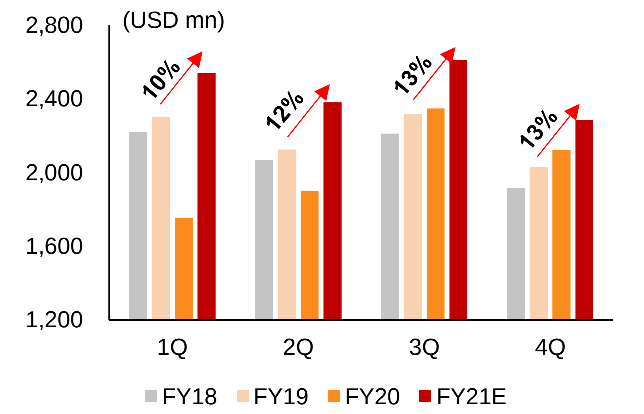


Source: Company data, CMBIS estimates

■ **1.2 Investors' expectation for FY21E, in our view, is too conservative.**

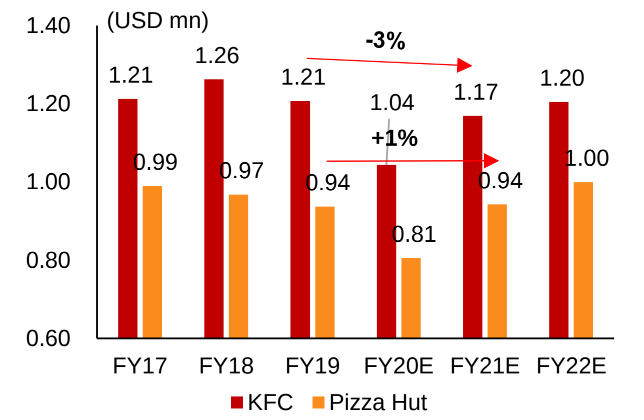
We think both consensus and our forecast conservative (BBG est. for sales growth in FY21E/ 22E are 20%/ 9% and CMBI est. are 1%/ 2% above that), as our FY21E sales is only 10-13% higher vs FY19 (equal to about 5-6% CAGR). Moreover, in terms of KFC/ Pizza Hut sales per average store, our forecasts for FY21E is 3% lower /1% higher vs FY19.

Figure 16: Quarterly sales (21E vs 19 in red)



Source: Company data, CMBIS estimates

Figure 17: Sales per avg. store (21E vs 19 in red)

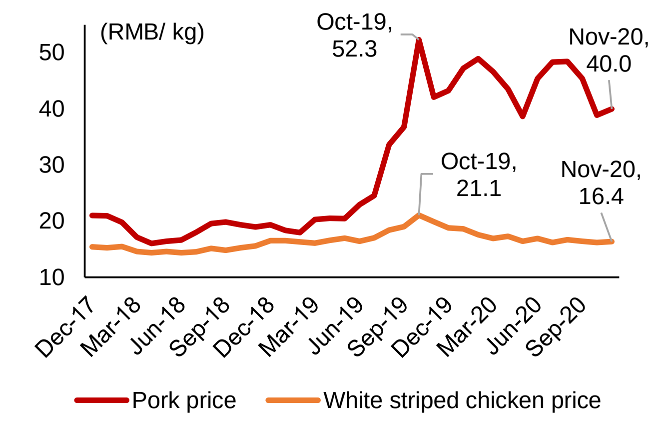


Source: Company data, CMBIS estimates

■ **1.3 Both raw material and staff costs pressure are easing.**

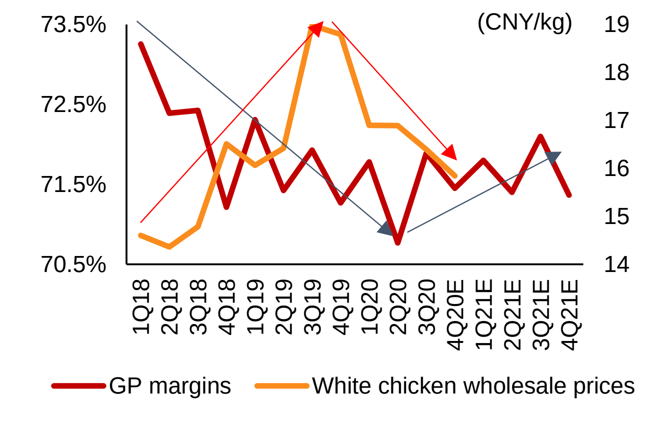
Poultry and hogs are major food ingredients for YUMC, which accounted for ~30% and ~5% of COGS, by our estimates. According to the Ministry of Agriculture, pork price has been surging and even tripled since the beginning of 2019 as demand tightened after outbreak of African swine fever in mainland China, while the chicken price also began to climb in 2H19. However, these prices started to ease after 2020 CNY, due to: 1) lower demand during pandemic, 2) African swine came under control and 3) boost of overall production and import volume. By Nov 2020, the chicken price had already fell by 18% and pork price was up only by 5% YoY. We expect YUMC's GP margin to at least stay stable or slowly increase under this favorable trend, which should sustain into 4Q20E and FY21E.

Figure 18: China chicken and pork prices



Source: Ministry of Agriculture, CMBIS estimates

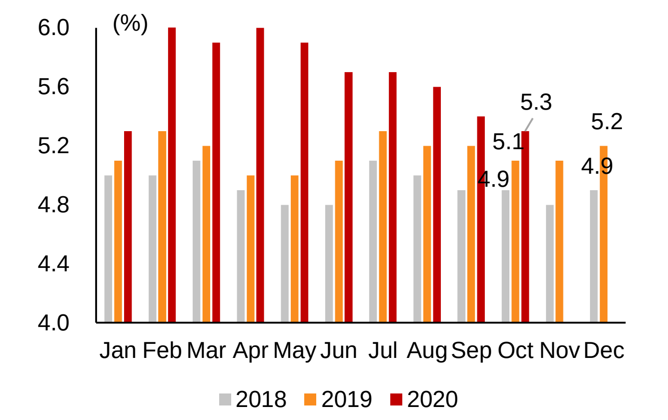
Figure 19: China chicken prices and YUMC's GPM



Source: Ministry of Agriculture, Company data, CMBIS estimates

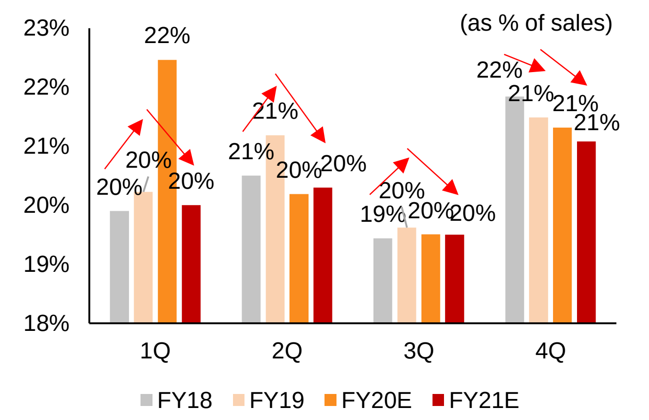
Staff costs is another major expense for YUMC, accounting for ~20.6% of total sales in FY19, risen from 19.9% in FY17. We believe this was driven by wage inflation of 7-8% per year, from 2014 to 2019, according to NBS. Due to pandemic in 1Q20, staff costs even jumped to 22% of sales. However, thanks to timely response and costs control: 1) labour shortage, 2) better allocation of working hours and 3) less payment to social securities fund, etc.), staff costs mix already fell to 20% in both 2Q-3Q20. Going forward, YUMC guided for low to mid-single-digit wage inflation and we expect labour cost mix to be stable in FY20E, thanks to: 1) industry consolidation as many smaller restaurants went bankrupt, 2) relatively high unemployment rate (at 5.3% in Oct 2020, vs 5.1% in Oct 2019) and 3) frozen of min. wages and reduction of social securities fund contributions in many provinces. This, in our view, should help YUMC's overall opex in 4Q20E and FY21E and drive a better OP margin.

Figure 20: China survey unemployment rate



Source: NBS, CMBIS estimates

Figure 21: YUMC's labour costs as % of sales



Source: Company data, CMBIS estimates

2) Digital and delivery upgrades to boost frequency and ASP.

Yum China is the largest restaurant group in China, with massive restaurant network and enormously large customer base. We believe that this lays the foundation for more upgrades in both digital and delivery sides, including improvements in: 1) customer experience (e.g. digital orderings and payments) and convenience (easier delivery), 2) increase in purchasing frequency as more customers joining as members, 3) upselling the right product at the right time, thru effective and targeted marketing, and 4) cross-selling potential between brands, etc. These will drive up both sales volume (customer acquisitions and purchasing frequency) and ASP (up selling).

■ **2.1 Digital experiences upgrades can acquire customers and drive frequency.**
In fact, YUMC understands the importance of digitalization and has been actively investing. Therefore, it has launched different functions, such as: 1) SUPER APP since 2015 (for both KFC and Pizza Hut), and 2) V-gold loyalty programme (membership and privilege programme) since 2016, which aim to provide more throughout services to customers and drive better customer engagements.

Figure 22: Yum China's digital ecosystem in FY20

Source: Company data, CMBIS

Figure 23: YUMC's digital transformation from FY15 to FY19

	2015	2016	2017	2018	2019
Omnichannel virtual store	KFC Super APP	KFC Tmall	Pizza Hut Super APP Pizza Hut Tmall	KFC/Pizza Hut Koubei	
Digital ordering		KFC Pre-order		Pizza Hut Tableside order	KFC Mobile-order AI Personalized Menu
Digital Payment	Alipay 1st chain store	Wechatpay			YUMC Pay
Membership		KFC Member Program	Pizza Hut Member Program	KFC/Pizza Hut Privilege Program	
Delivery	KFC pioneer from 2007 美团 饿了么 Aggregator partnerships			Delivery2.0 Auto Dispatch	Delivery3.0 Trade zone & multi-brand platform

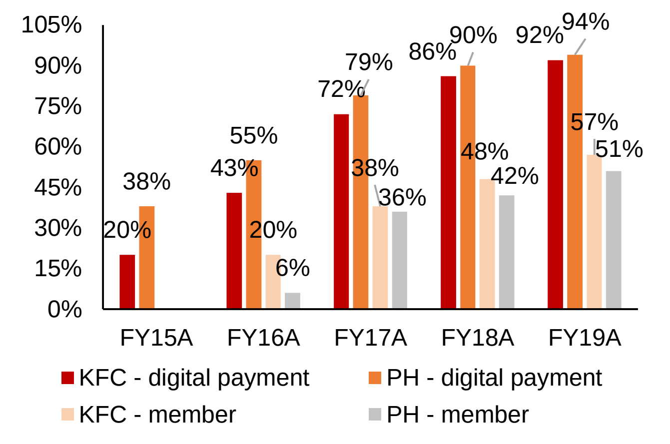
Source: Company data, CMBIS

Figure 24: Membership programme offered by KFC

Source: Company data, CMBIS

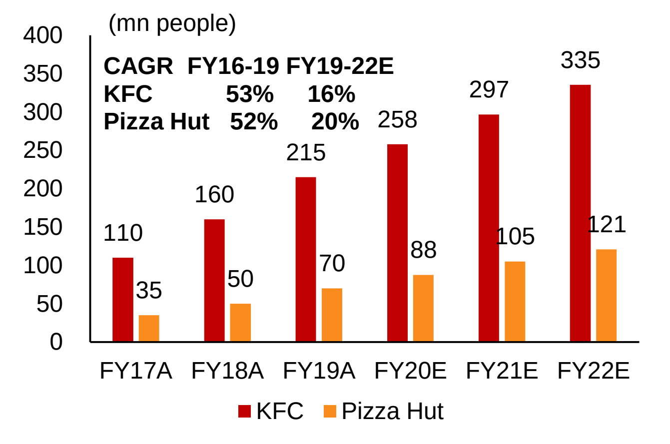
These membership programmes have been highly successful, as the number of members for KFC and Pizza Hut acquired rose from 110mn+ and 35mn+ in FY17 to 215mn+ and 70mn+ in FY19, registering a 53%+ and 52%+ CAGR. We believe there is still ample room for further growth as the penetration is still low, where member sales only accounted for 63% and 49% of total sales for KFC and Pizza Hut in 1H20. YUMC has recently launched more types of memberships programmes, which in our view, is a decent growth driver in FY20E-22E. We believe number of members for KFC and Pizza Hut to reach 335mn+ and 121mn+ by FY22E, equal to about 16% and 20% CAGR during FY19-22E.

Figure 25: Digital payment and member sales mix



Source: Company data, CMBIS estimates

Figure 26: Number of members by brand

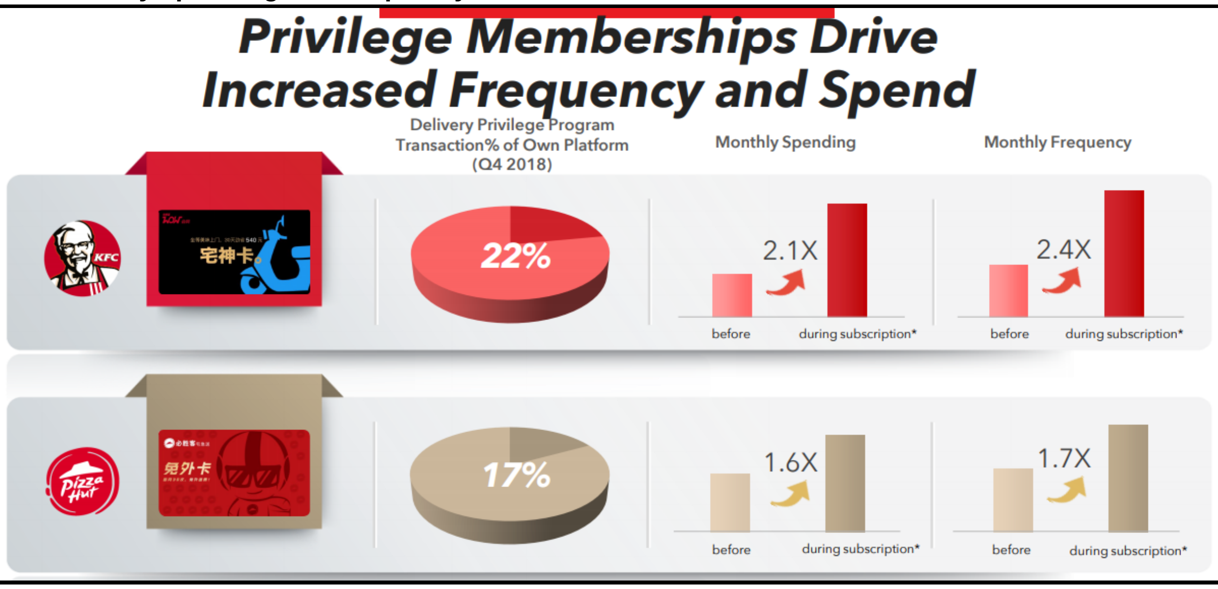


Source: Company data, CMBIS estimates

Having only one loyalty programme (for both KFC and Pizza Hut brand), YUMC can grow its revenue by promoting more cross-selling across brands. Also, its potential is still high, as there were only 15% of membership points redeemed across brands (10% KFC points were spent on Pizza Hut while 50% Pizza Hut points were spent on KFC), as at 1H20.

Promoting membership can certainly drive faster growth for YUMC. Apart from greater loyalty, having a higher purchasing frequency is also the key. According to YUMC's study back in 4Q18, the monthly buying frequency for a customer increased by 2.4x and 1.7x after subscribing to membership or privilege programme of KFC and Pizza Hut.

Figure 27: Monthly spending and frequency will increase once a customer becomes a member

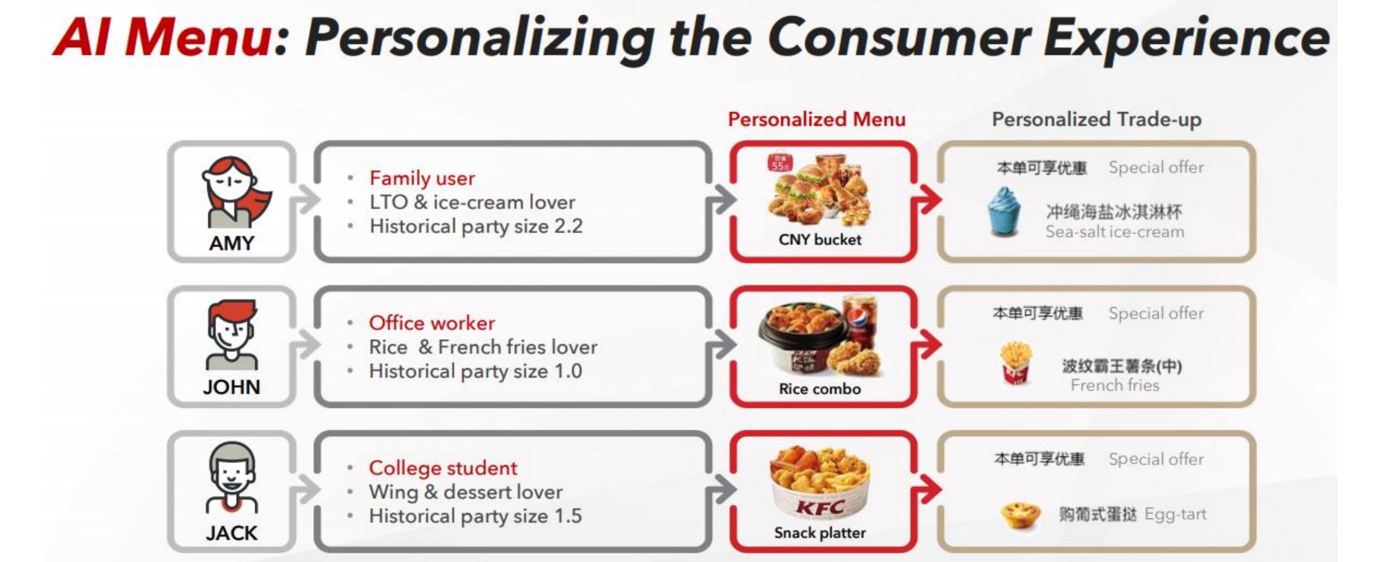


Source: Company data, CMBIS

■ 2.2 Digitalization can also boost ASP and drive cost savings.

Big-data analysis can enable personalized marketing and increase up-selling opportunities. Average spending per person (ASP) is certainly one of the main drivers for SSSG and that can be split into: 1) items per person and 2) average selling price for each item. In order to boost the items per person, knowing what the customer would likely consider is critical. By analysing customer data (buying habit, preference for different age groups, etc.), a set of more suitable products can be shown on the menu of the Kiosks or SUPER APP. This would also increase the chance of up selling.

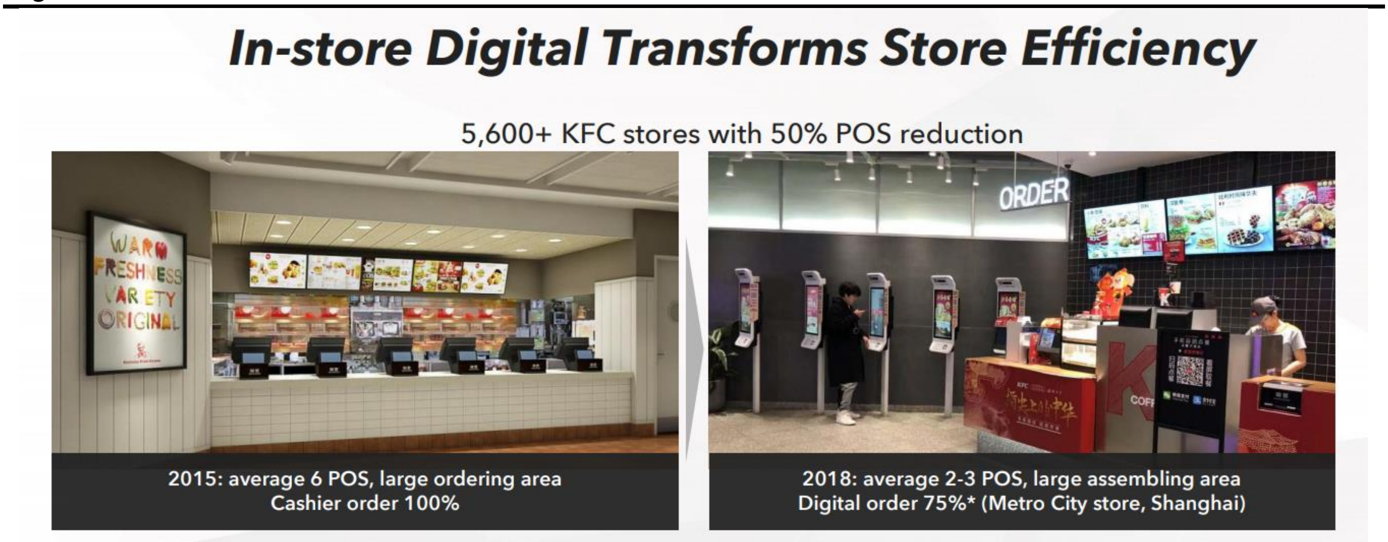
Figure 28: More targeted marketing and upselling can boost ASP



Source: Company data, CMBIS

Digitalization at the store level can also improve efficiency and reduce costs. A good example would be the adoption of Kiosks at stores, which can effectively reduce the use of POS and staff, as well as freeing up more spaces for other businesses. Back in 2015, a typical store may have 6 POS on average, but by 2018, number of POS per store can be reduced to just 2 to 3. By 2018, Over 5,600 KFC stores had recorded a 50% reduction on overall POS.

Figure 29: Greater use of Kiosk from 2015 to 2018

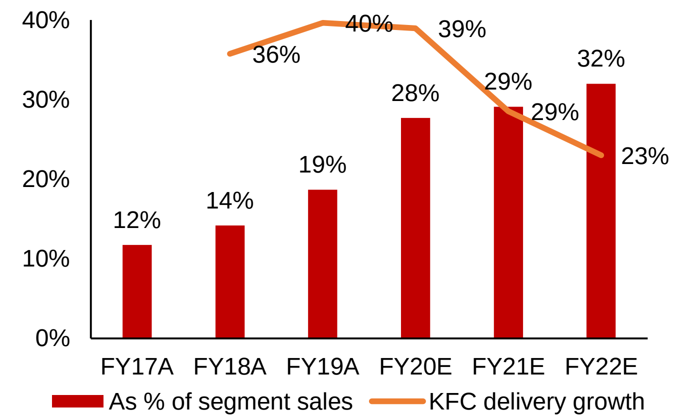


Source: Company data, CMBIS

■ 2.3 Delivery can increase services coverage and productivity.

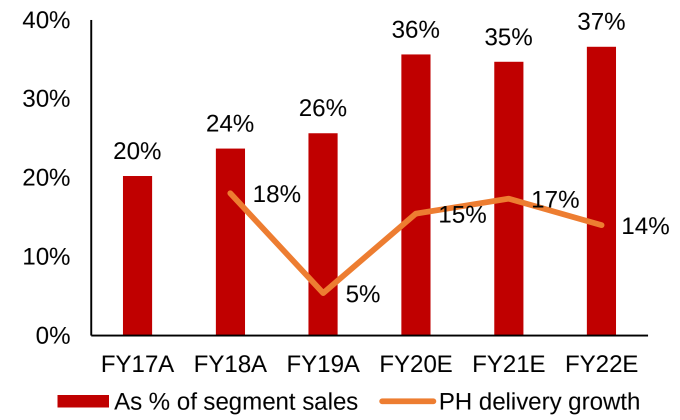
As Chinese consumers become more adapted to mobile and internet, they would eventually use more online-based services, such as food delivery through mobile app. Moreover, with urbanization accelerating in China, consumers tend to live a fast-paced lifestyle, hence boosting food ordering demand.

Figure 30: KFC delivery sales mix and growth



Source: Company data, CMBIS estimates

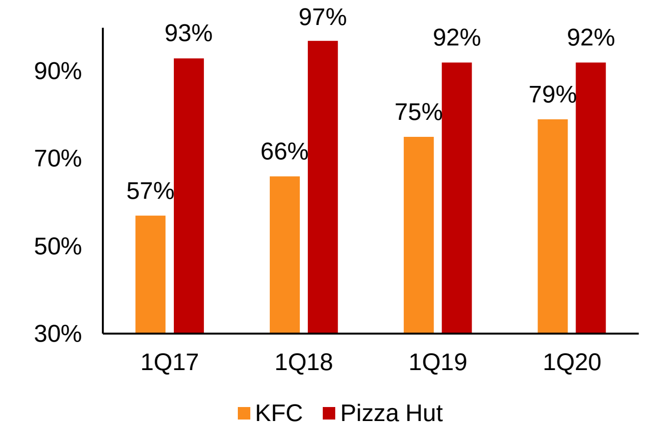
Figure 31: Pizza Hut delivery sales mix and growth



Source: Company data, CMBIS estimates

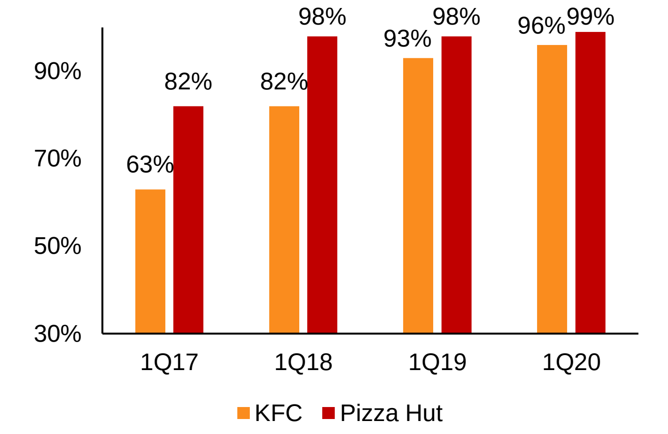
More importantly, YUMC has made its overall ordering experience user-friendly enough to acquire more customers, by allowing delivery orderings in various channels such as SUPER APP, Wechat mini-programmes, or even the virtual KFC stores (operated by ordinary members). According to Frost & Sullivan, food delivery sales CAGR in China was 33% in 2014-2019 and will continue to be fast at 16% in 2019-2024E. We believe YUMC will outperform and be able to generate a 23% CAGR during FY19-22E, thanks to: 1) more upgrades in the delivery experience, 2) faster than peers store openings and 3) successful reform on Pizza Hut's products and services.

Figure 32: Delivery store coverage



Source: Company data, CMBIS estimates

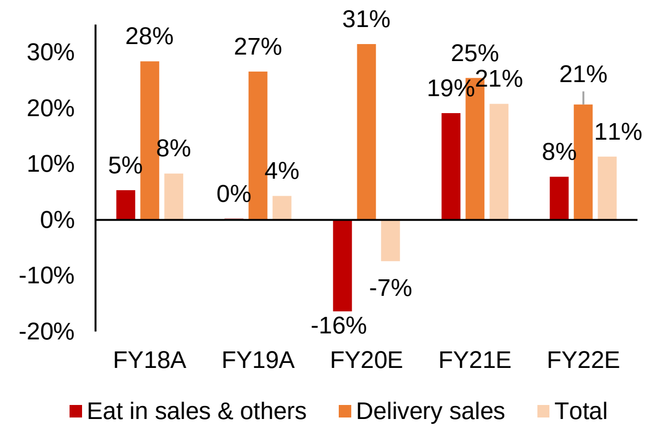
Figure 33: Delivery city coverage



Source: Company data, CMBIS estimates

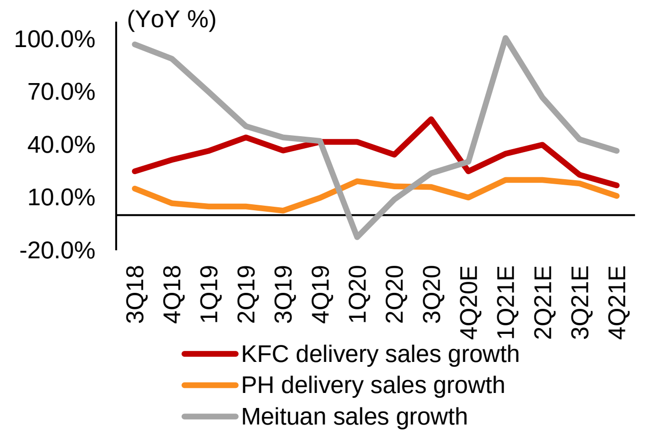
Also, if we refer to Meituan's sales growth in FY21E, it is going to accelerate to 50% or above, and that might indicate that our KFC's 29% and Pizza Hut's 17% delivery sales growth estimate in FY21E are rather undemanding. Under the Delivery 3.0 initiative, Pizza Hut successfully took its last mile delivery team in-house and taking pilot test of merging its delivery team with the KFC's team. This would help driving down the overall delivery costs and boost margins in the future.

Figure 34: Dine-in and delivery sale growth



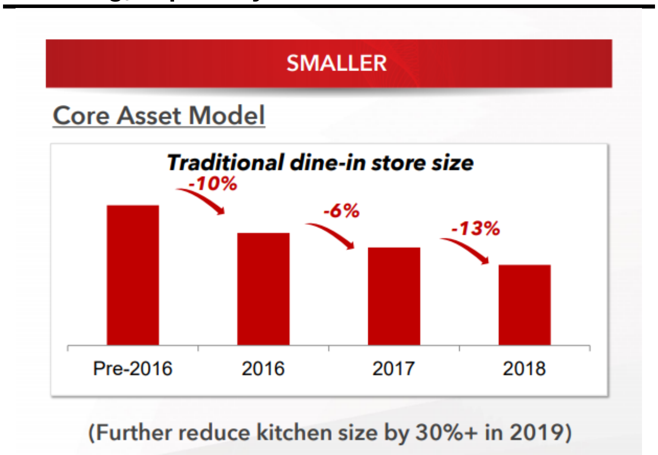
Source: Company data, CMBIS estimates

Figure 35: KFC, PH, Meituan delivery sales growth



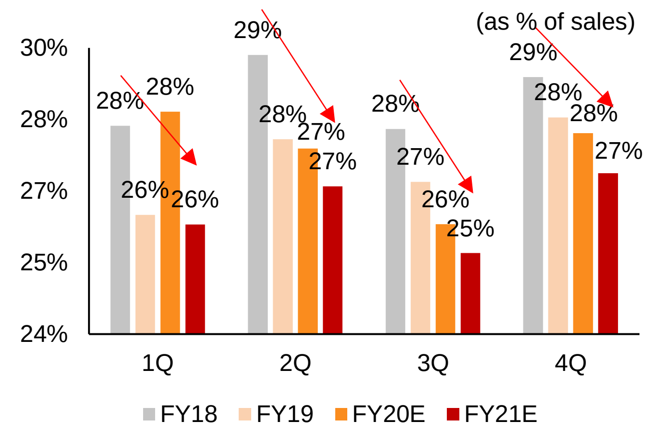
Source: Bloomberg, Company data, CMBIS estimates

Figure 36: Size of Pizza Hut stores had been declining, especially with the satellite store model



Source: Company data, CMBIS

Figure 37: Rental and other expenses (including A&P, licenses fees, D&A expenses) as % of sales



Source: Company data, CMBIS estimates

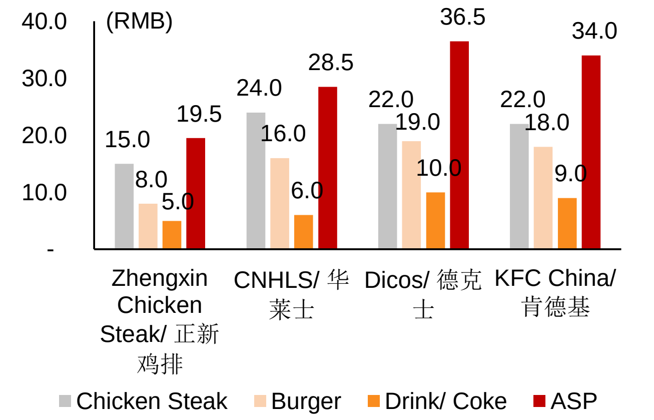
3) Industry leading product quality and Pizza Hut reform

According to customer rating on dianping.com, given KFC's current product pricing, product and service quality, its customer satisfaction is the best among the fried chicken brands in the Tier-1 cities, hence we are confident that KFC can compete effectively and gradually win shares in the future. Pizza Hut's transformation is rather successful so far since 2017, where dine-in traffic started to increase in FY19 after years of decline since FY15. Backed by 1) menu innovation, 2) return of value for money and 3) store revamp, we remain confident on a faster growth and better margin in a mid to long term horizon.

- **3.1 Competitive products, services and store format can win shares from peers.**

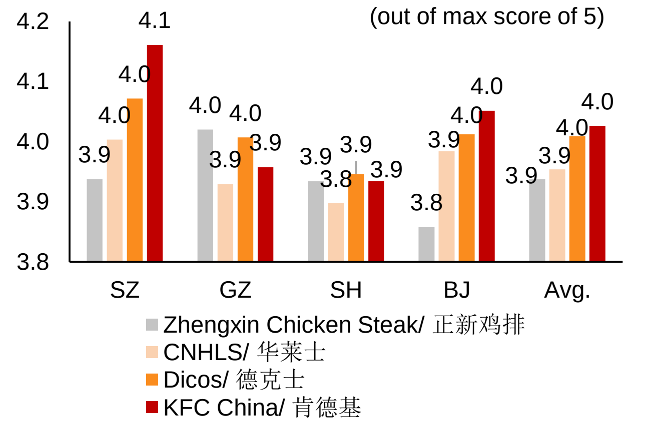
We studied consumer satisfaction on KFC brand based on consumer rating on dianping.com in Tier-1 cities and made comparison with the local brands (e.g. Zhengxin Chicken Steak, CNHLS and Dicos). KFC has the highest average rating at 4.0 in Tier-1 cities, however, it performed much better in SZ and BJ but had a slightly lower rating in SH and GZ. In fact, when we look at the number of restaurants, KFC is not the leader in SH and GZ, where Zhengxin Chicken Steak and CNHLS are the leaders.

Figure 38: KFC's ASP is similar to others in Beijing



Source: dianping.com, CMBIS estimates, as at Nov 2020

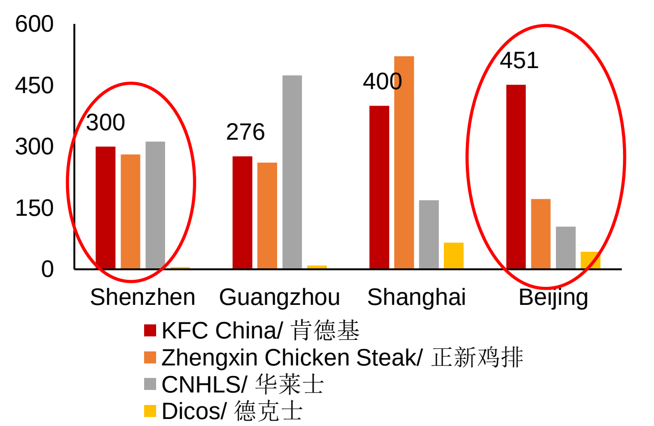
Figure 39: KFC's customer rating is the highest



Source: dianping.com (avg. rating from top 5 commented stores), CMBIS estimates, as at Nov 2020

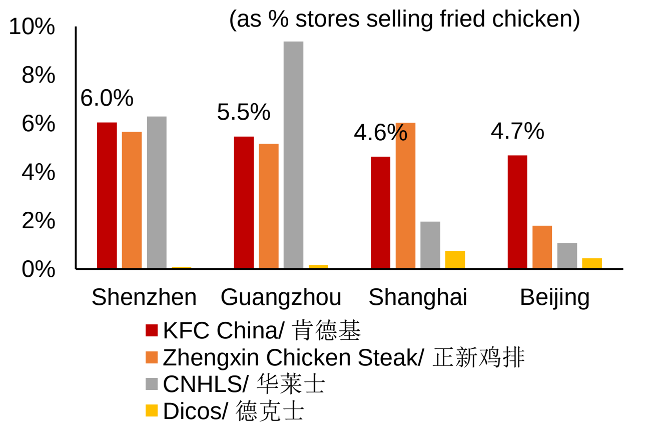
We also researched the total number of restaurants that offer fried chickens, and observed that KFC accounted for only 4% to 6% in those Tier-1 cities. Therefore, we are highly confident and certain there exists ample room for more improvements and future growth in these Tier-1 cities (as well as Tier-2 or below, in our view), as KFC is more competitive.

Figure 40: Number of stores by brand in Tier-1 cities



Source: dianping.com, CMBIS estimates, as at Nov 2020

Figure 41: Market share by brand in Tier-1 cities



Source: dianping.com, CMBIS estimates, as at Nov 2020

■ **3.2 Product innovations (localization & plant-based food) remains the edge.**

There are reasons that YUMC can be the largest catering brand in China, even though it is a foreign brand. We believe one of the keys is its superior food quality and excellent match of local tastes, where innovation and localization are extremely important. A localized menu has been a long-term strategy adopted by YUMC and there are many famous examples for KFC, such as the highly successful Chinese style products like Old Beijing Chicken Roll/老北京鸡肉卷 back in 2000 and the Sichuan Spicy Tender Beef Wrap/川辣嫩牛五方 in 2008. Since 2017, both KFC and Pizza Hut had double down on its localization, examples include Crayfish Grilled Chicken Burger/小龙虾烤鸡堡 in 2017, Sichuan Spicy Boiled Skewers/川香燃辣撸串桶 and Master Stock Marinated Series/香卤系列 in 2019.

Figure 42: Examples of KFC's localized products

Year launched	2000	2008	2017	2019	2019
Product name	Old Beijing Chicken Roll 老北京鸡肉卷	Sichuan Spicy Trender Beef Warp 川辣嫩牛五方	Crayfish Grilled Chicken Burger/Roll 小龙虾烤鸡堡/卷	Siuchuan Spicy Boiled Skewers 川香燃辣撸串桶	Master Stock Marinated Series 香卤系列
Images					

Source: Company data, CMBIS

From 2020, we believe YUMC could further accelerate its product localization by launching not only Chinese style but also more provincial level localized products, as well as some packaged food. In Oct 2020, YUMC officially registered the trademark "Kai Feng Cai", a Chinese nickname for KFC in China and launched a series of packaged food, including a super local food Luosifen/螺蛳粉 (stinky sour snail noodles) as well as Chicken soup noodles and fried rice.

Figure 43: Localized items - Luosifen/螺蛳粉

Source: Company data, CMBIS

Figure 44: Plenty of seasoning packages

Source: Company data, CMBIS

Figure 45: Various favours for KFC's packaged food

Source: Company data, CMBIS

Food innovation is another key for YUMC to stay competitive, where they will introduce about 50 to 60 new SKUS per year. Because of rising demand on healthier diet, more environmental friendly productions as well as the trendy images, more consumers shift to meatless food in recently years. In fact, YUMC already partnered with Beyond Meat, and had a test launch of Beyond Burger (a cheese burger with plant-based meat) in Jun 2020 in 5 locations in Beijing, Chengdu, Hangzhou and Shanghai. We believe YUMC will bring in more similar items (chicken or others) into its menu in order to capture this trend, and together with greater marketing input, it should eventually become a driver for SSSG.

Figure 46: Plant based items - Beyond Burger

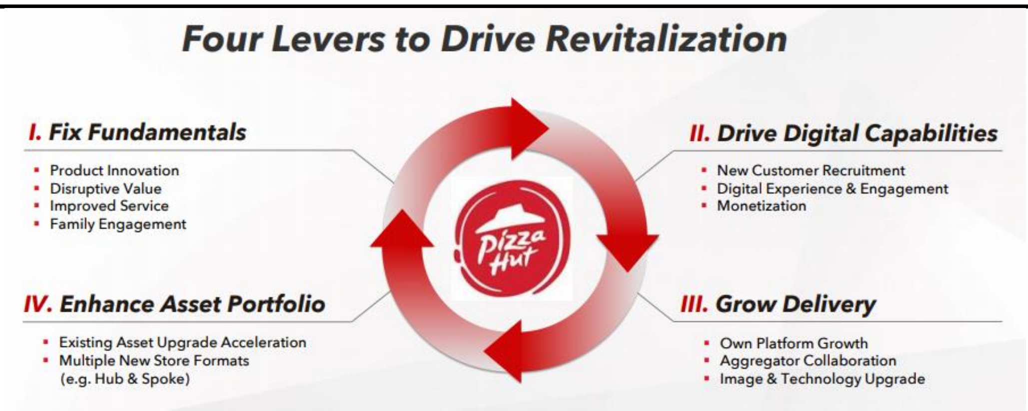
Source: Company data, CMBIS

Figure 47: Plant based items - Beyond Nachos

Source: Company data, CMBIS

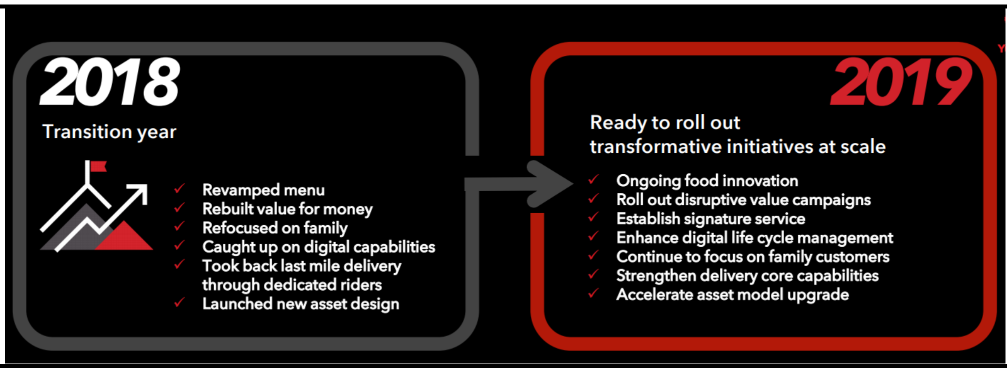
■ **3.3 Successful Pizza Hut revitalization can drive growth and long-term margin.** Pizza Hut had started its reform since 2017, and listed out the 4 pillars: 1) Fix fundamentals, including new menu and bringing back value for money; 2) Digitalization, including member acquisitions; 3) Delivery, such as merging the in-house delivery team with KFC; and 4) Enhancing asset portfolio, such as revamping the stores with more modern, brighter and trendier designs. According to management, Pizza Hut restaurant level operating margin could return to a better than previous level (i.e. 14% in FY17), and we forecast a 10.6%/ 13.5%/ 15.7% in FY20E/ 21E/ 22E.

Figure 48: List of Pizza Hut's reforms since 2017



Source: Company data, CMBIS

Figure 49: List of Pizza Hut's reforms in FY18 and FY19



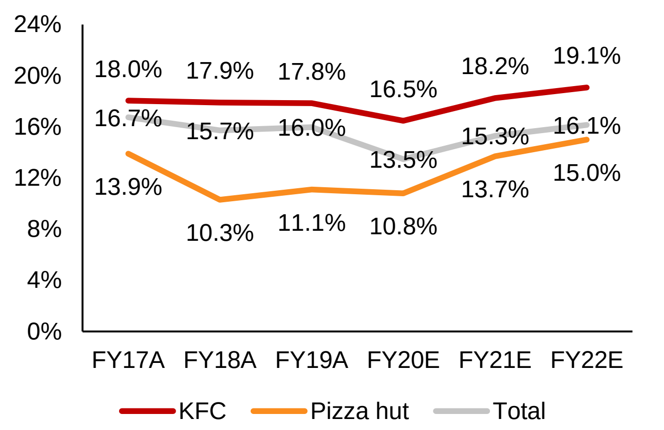
Source: Company data, CMBIS

Figure 50: YUMC long term target laid out in FY17

Long term financial target	
Systems sales growth, excluding FX changes	High single digit
YUMC blended restaurant margin	17%
Operating profit growth, excluding FX changes	double digit

Source: Company data, CMBIS

Figure 51: Restaurant OP margin by brand



Source: Company data, CMBIS estimates

#1. Pizza Hut reform – "Fix Fundamentals"

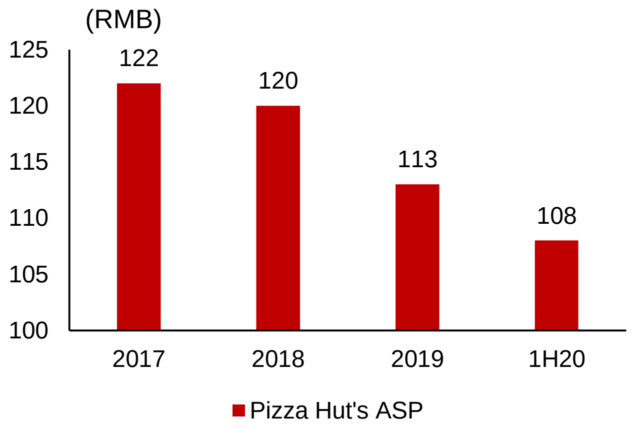
We believe Pizza Hut's had underperformed in the past 5 years, because of its overexpansion in store network, mismatch of product and value, greater competition from the rising delivery providers, etc.. In order to have a dramatic change in business since 2018, a massive change in the fundamentals is needed. In 2018, the management started with a cut in ASP (from RMB 122 in FY17 to RMB 113 in FY19), in order to boost the price to quality ratio for its products. Also in 2018, it decided to cut the number of SKUs from about 200 into 70 and changed over 70% of the existing products. Moreover, other than the signature product - Pizza, it had brought in various categories, such as steak, dessert as well as more seafood, etc.

Figure 52: New food - dessert and steak since FY18

Source: Company data, CMBIS

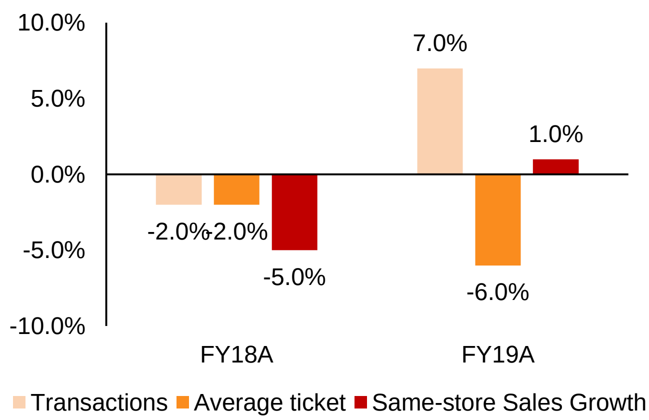
The performance in FY19 was great, where the sales of steak was strong with double digit sales growth and now account for roughly 13% of total sales. The reception of dessert was also good, thanks to the more Instagram-able nature. More importantly, we believe the reform for Pizza Hut was successful so far because of the return of dine-in traffic in FY19, which is highly critical. It was also the first time for Pizza to record positive traffic growth in 5 years, since FY14. We continue to be positive on Pizza Hut's traffic growth, thanks to its commitment of not increasing ASP for 3 years (FY19-21E).

Figure 53: Pizza Hut's ASP



Source: Company data, CMBIS

Figure 54: Pizza Hut's SSSG, by ASP and volume

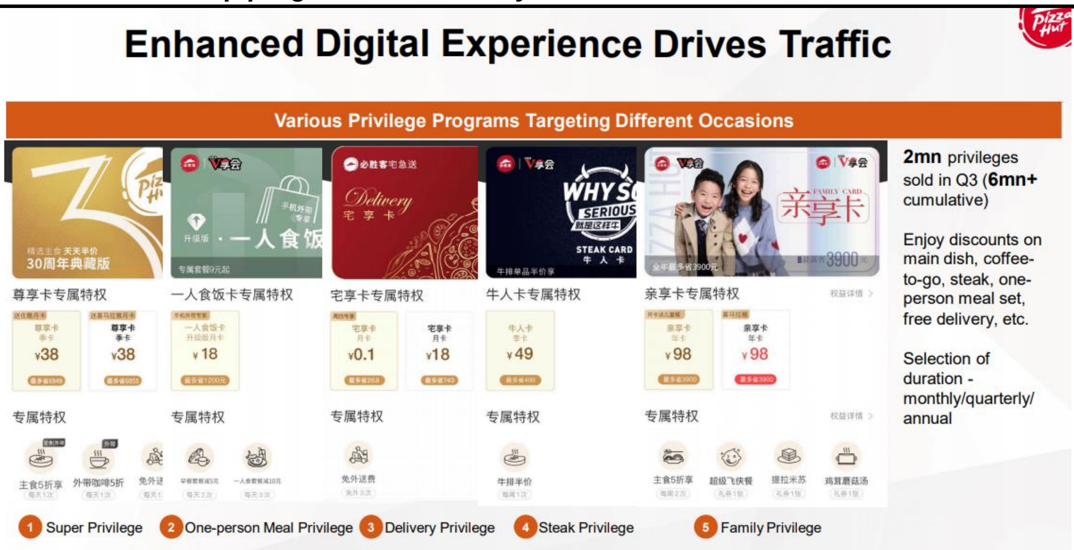


Source: Company data, CMBIS estimates

#2. Pizza Hut reform – "Drive Digital Capabilities"

YUMC, without doubt, has a great emphasis on digitalization as it is working hard to serve its modern consumers better, but the development pace would be faster for KFC in the past few year. However, once the system is well adopted and practised, Pizza Hut will also become more digitalized. In fact, Pizza Hut has also begun its transformation since 2017, through the Pizza Hut Super APP, digital orderings and membership management, etc. We believe YUMC will further enhance its privilege programme, personalized marketing and try to boost more cross-selling between brands in 2019 and beyond, which will be positive for volume (number of customers and buying frequency) growth.

Figure 55: Various membership programme offered by Pizza Hut

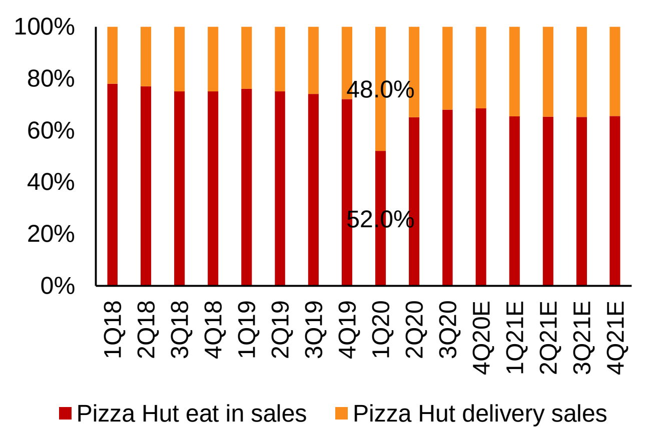


Source: Company data, CMBIS

#3. Pizza Hut reform – "Grow Delivery"

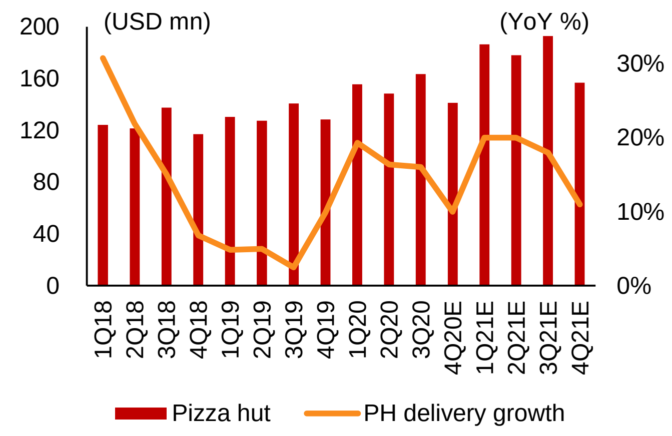
Pizza Hut's delivery growth slowed down in FY18-19 perhaps due to brand transformation. However, we are more confident on its delivery growth ahead in FY20E-22E, thanks to: 1) more attractive products after menu renewal, 2) better value for money after ASP adjustments, 3) greater delivery growth momentum built since 1Q20 due to pandemic and 4) more efforts on memberships promotions. As YUMC begun its Delivery 3.0 initiatives, with last mile delivery becoming in-house, delivery services ring expanded, multi-brand platform formed, costs and efficiency for Pizza Hut brand will certainly increase.

Figure 56: Pizza Hut's eat in and delivery sales mix



Source: Company data, CMBIS estimates

Figure 57: Pizza Hut's delivery sales and growth

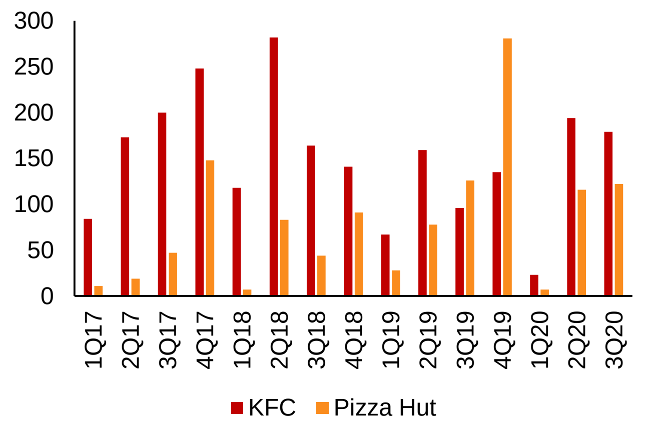


Source: Company data, CMBIS estimates

4. Pizza Hut reform – "Enhance Asset Portfolio"

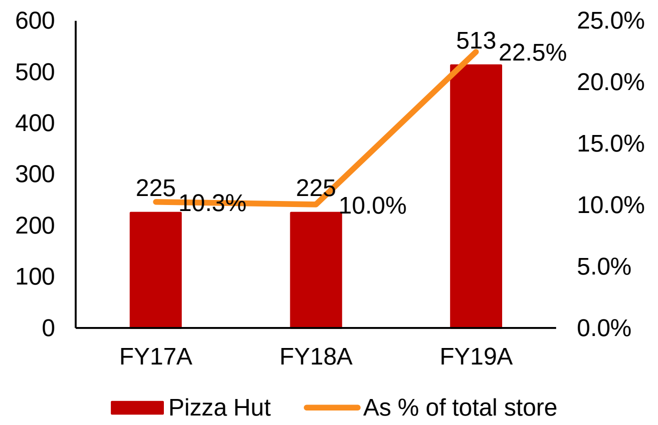
The management understand that a suitable store design or store format is a key to attract customers, which is an element that Pizza Hut lacks. Ever since 2017, YUMC has accelerated store format updates in two base ways, such as revamping the stores with more modern and brighter designs, together with an open kitchen which may fit better for the younger and family-type customers. Another direction is to remodel more delivery friendly stores, which are small in size but with better workflow layout and equipment.

Figure 58: Stores re-modelled - KFC & Pizza Hut



Source: Company data, CMBIS estimates

Figure 59: Stores re-modelled - Pizza Hut



Source: Company data, CMBIS estimates

A good example was the 15 themed stores opened across China in 2018, where the employees will wear a customized uniform designed by Anna Sui. These new stores of more fashionable designs received excellent feedbacks from the customers, therefore the management is confident on the on-going revamps. Therefore, the number of re-modelled store significantly accelerated to about 500 stores in FY19, from only about 220 stores in FY17 and FY18. We expect the expansion to remain fast and have a strong push for both dine-in and delivery traffic as well as SSSG in FY20E-22E.

Figure 60: New Pizza Hut theme store

Source: Company data, CMBIS

Figure 61: Newly re-modelled Pizza Hut store

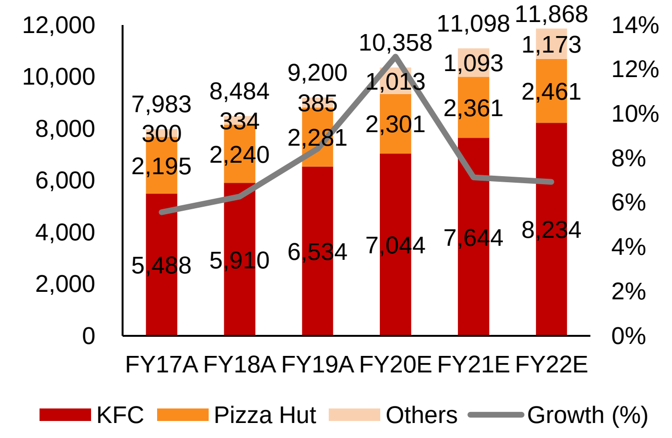
Source: Company data, CMBIS

4) Ample room for growth – doubling stores in 10 years is achievable

YUMC already had a net open of 2,240 (1,531/ 709 for KFC/ Pizza Hut) stores in the last 4 years, from 6,575 (5,003/1,572) in FY15 to 8,815 (6,534/ 2,281) in FY19, representing 7.6% (6.9%/ 9.8%) store CAGR. Back in 2017 investor day, YUMC's management was confident to have its store counts reaching ~21,000 on a long-term perspective, based on 15 YUMC stores per million population.

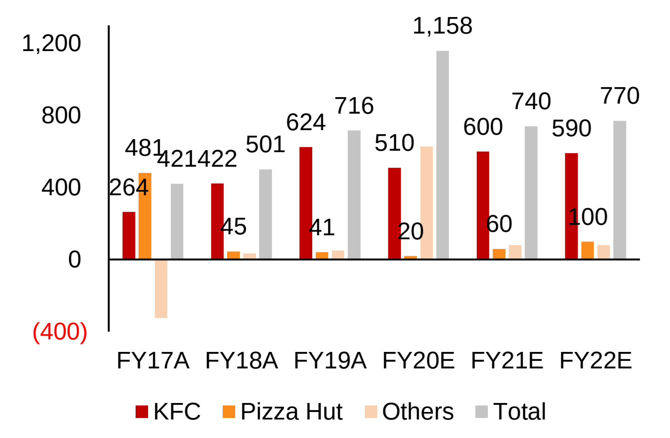
We believe the target of reaching 21,000 YUMC stores is achievable in the mid to long term horizon, as KFC and Pizza Hut are still under penetrated in China, even in the Tier-1 cities. These new stores, in our view, could come from expansion into more cities or taking market shares from peers, driven by greater urbanization, GDP and income growth.

Figure 62: Number of stores growth by brand



Source: Company data, CMBIS estimates

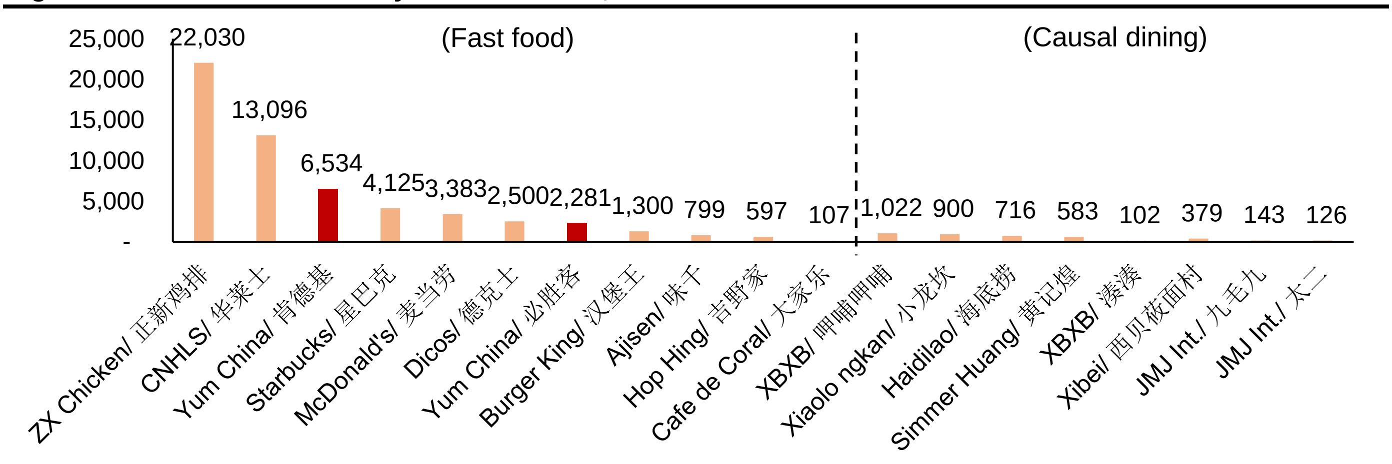
Figure 63: Number of net stores added by brand



Source: Company data, CMBIS estimates

■ **4.1 KFC and Pizza Hut China are still under penetrated by peers comparison.**
YUMC is the largest group in China in terms of sales in FY19. Even though it already had 6,534 KFC and 2,281 Pizza Hut stores in FY19, we are still confident that there is ample room for expansion based on peers comparison. According to our research, Zhengxin Chicken Steak and CNHLS had around 22,000 and 13,100 stores in FY19, which are far more than what YUMC has right now, especially when both of their ASPs are arguably affordable and similar (RMB 20 for Zhengxin Chicken Steak, RMB 29 for CNHLS and RMB 34 for KFC).

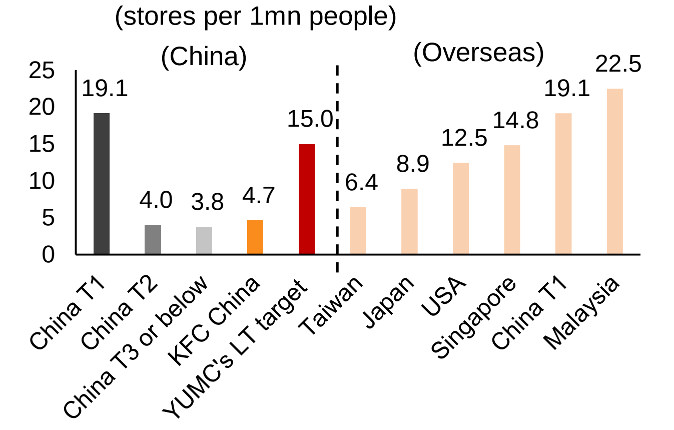
Figure 64: Number of stores by brand in China, as at FY19



Source: dianping.com, map.baidu.com, Company data, CMBIS

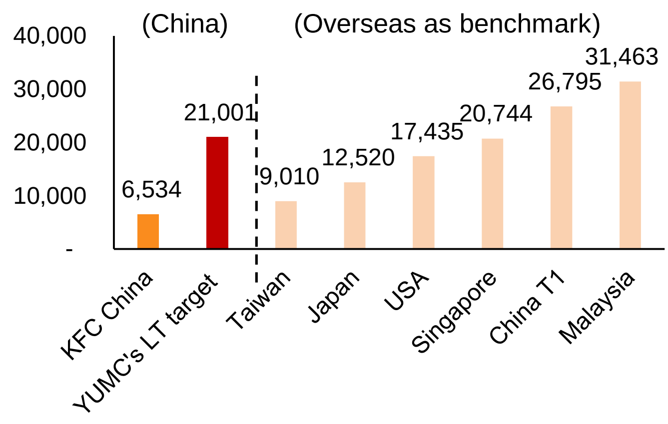
■ **4.2 KFC can have 12,000/ 27,000 stores if we benchmark Japan/ Tier-1 cities.** Similarly, we can also assess YUMC's store number potential by comparing it with the more developed overseas countries, as well as the Tier-1 cities in China. According to our research, KFC's density is still low in China. It has only around 4 stores per 1mn population, compared to Japan's 9 stores, USA's 13 stores, China Tier-1 cities' 19 stores, as well as YUMC's long-term target of 15 YUMC stores per 1 mn population. Therefore, if we benchmark the potential KFC stores with Japan/ USA/ YUMC's long-term target/ China Tier-1 cities' density, the total number of KFC stores can reach as high as 12,520/ 17,435/ 21,001/ 26,795.

Figure 65: KFC's store density by region



Source: NBS, dianping.com, Company data, CMBIS estimates

Figure 66: Potential stores for KFC in China



Source: NBS, dianping.com, Company data, CMBIS estimates

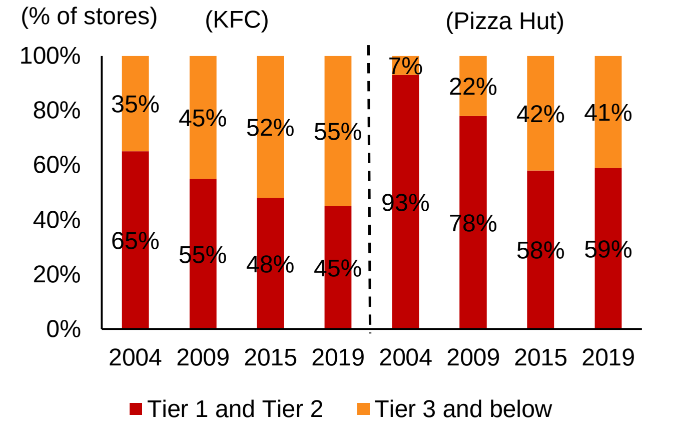
Figure 67: Store density (per 1 mn population), by region in FY19 (red/ green as in more/ less dense)

	Number of stores					Store per 1mn people			
	KFC	McDonald's	Pizza Hut	Avg.	Population (mn)	KFC	McDonald's	Pizza Hut	Avg.
China	6,534	3,383	2,249	4,055	1,400.1	4.7	2.4	1.6	2.9
China T1	1,427				74.6	19.1			
China T2	1,513				374.7	4.0			
China T3 or below	3,594				950.8	3.8			
Malaysia	718	282	400	467	31.9	22.5	8.8	12.5	14.6
Singapore	86	130	76	97	5.8	14.8	22.4	13.1	16.8
Hong Kong	94	259	109	154	7.5	12.5	34.4	14.5	20.5
Thailand	717	240	140	366	69.6	10.3	3.4	2.0	5.3
Japan	1,131	2,909	412	1,484	126.5	8.9	23.0	3.3	11.7
Taiwan	153	413	234	267	23.8	6.4	17.4	9.8	11.2
South Korea	190	409	334	311	51.2	3.7	8.0	6.5	6.1
Philippines	332	669	182	394	108.1	3.1	6.2	1.7	3.6
Indonesia	689	224	460	458	270.6	2.5	0.8	1.7	1.7
Vietnam	136	22	83	80	96.5	1.4	0.2	0.9	0.8
Canada	639	1,478	428	848	37.4	17.1	39.5	11.4	22.7
UK	909	1,323	668	967	67.5	13.5	19.6	9.9	14.3
USA	4,098	13,846	7,447	8,464	329.1	12.5	42.1	22.6	25.7
France	248	1,485	151	628	65.1	3.8	22.8	2.3	9.6
Germany	173	1,484	78	578	83.5	2.1	17.8	0.9	6.9
Russia	772	732	66	523	145.9	5.3	5.0	0.5	3.6
India	395	400	430	408	1,366.4	0.3	0.3	0.3	0.3
Brazil	60	1,023	187	423	211.0	0.3	4.8	0.9	2.0

Source: NBS, dianping.com, Company data, CMBIS estimates

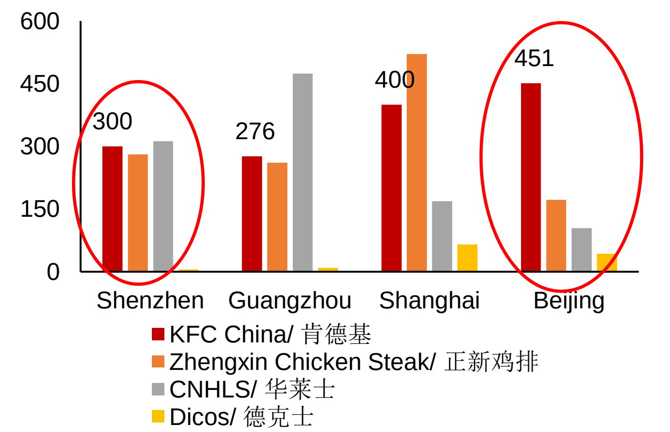
For Tier-1 cities, we think the penetration is still low, as there are only 276 and 400 KFC stores in GZ and SH, which are somehow lower than 474 CNHLS stores in GZ and 521 Zhengxin Chicken Steak in SH.

Figure 68: Store mix by brand and tier cities



Source: Company data, CMBIS estimates

Figure 69: Stores by brand in Tier-1 cities in China

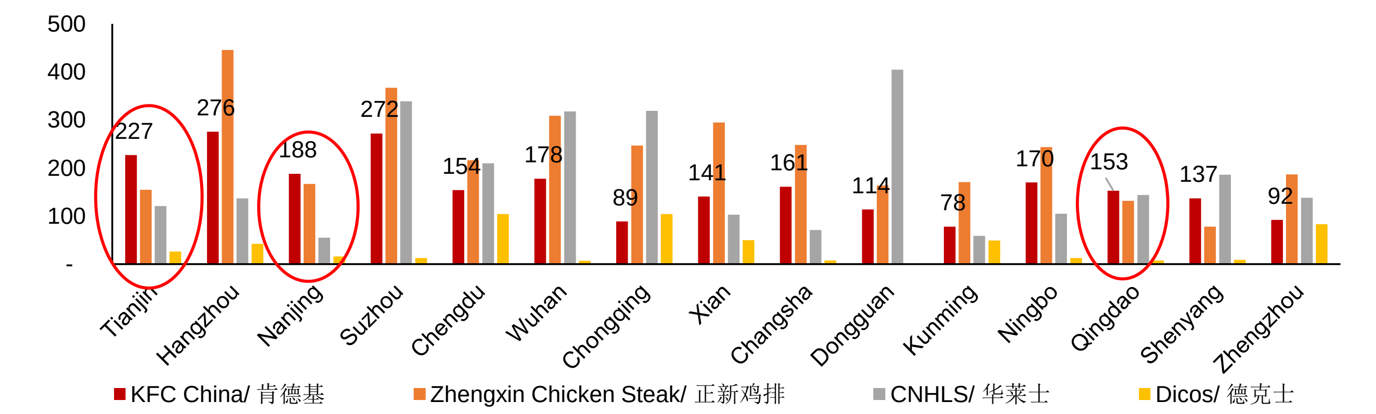


Source: dianping.com, CMBIS estimates

For Tier-2 cities, according to our research, there are only 3 cities (out of 15 tier cities) that KFC has the highest number of stores among all 4 brands selling fried chickens. This is clearly an indication of under penetration and future potential.

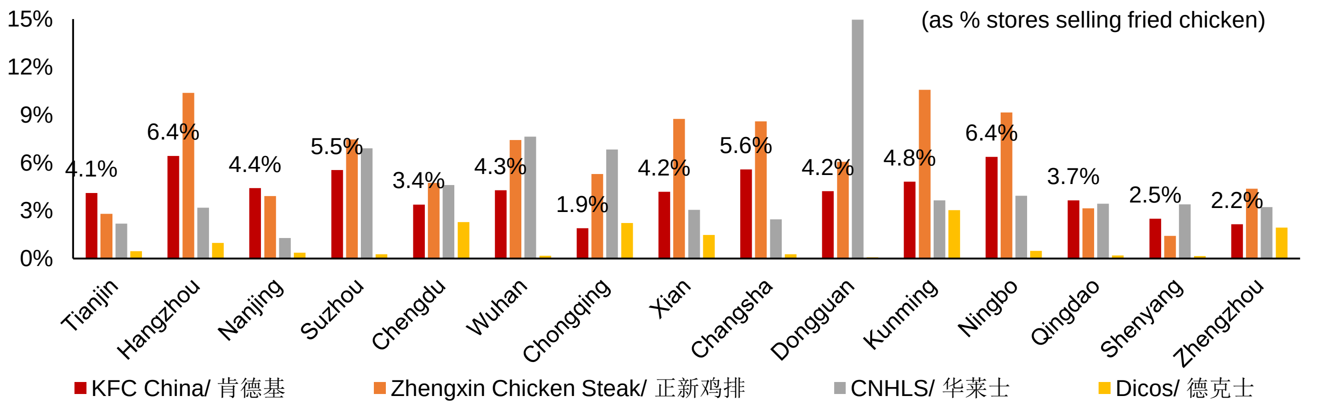
As a result, we are highly optimistic about the growth potential for KFC and YUMC in the mid to long run.

Figure 70: Stores by brand in Tier-2 cities in China



Source: dianping.com, CMBIS estimates

Figure 71: Market share by brand in Tier-2 cities in China

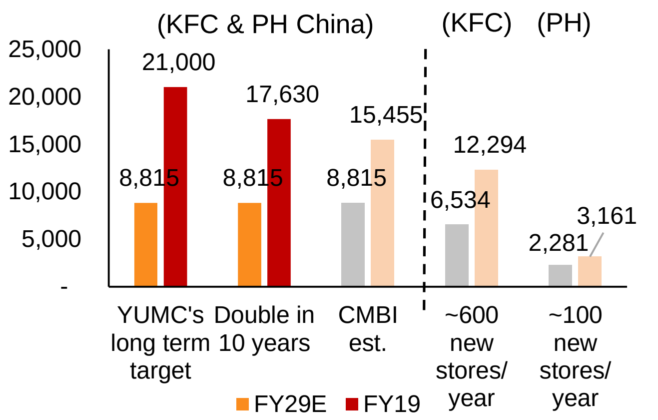


Source: dianping.com, CMBIS estimates

■ **4.3 Overly conservative consensus estimates and there is room for acceleration.** Moreover, the expectation of store expansion is low enough, in our view, which can provide a reasonably excellent margin of safety and potential upside surprises for investors.

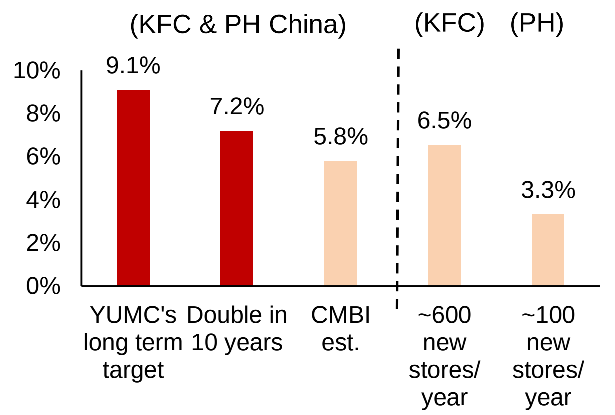
We forecast only a 4.6% store CAGR for KFC + Pizza Hut China (based on about 600 KFC and 100 Pizza Hut net new store openings per year), which is way below the 7.2% store CAGR (assuming store number to double in 10 years by FY29E) and 9.1% CAGR (assuming YUMC's long-term target to be achieved in 10 years).

Figure 72: Number of stores in FY19 and FY29E



Source: Company data, CMBIS estimates

Figure 73: FY19-29E number of restaurants CAGR



Source: Company data, CMBIS estimates

Industry Analysis

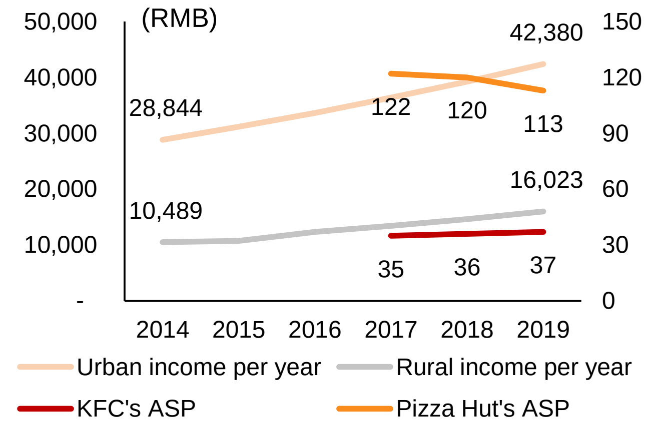
1) Income growth and urbanization will drive consumption upgrade

Thanks to China's solid economic growth, we expect the disposable income growth to remain fast and urbanization rate continues to increase (rising urban population). Therefore, as income growth is likely to be faster than YUMC's ASP growth, more people will be able to afford and become YUMC's target customers. Similarly, as more people will live in an urban area, demand for KFC will also increase.

■ **1.1 Benefit from income growth, more people can afford.**

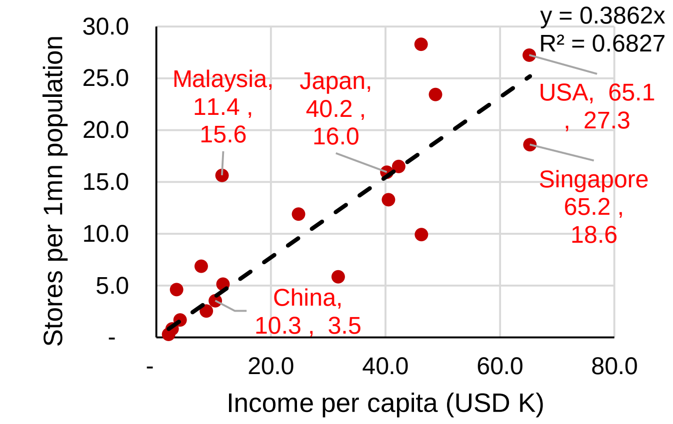
Based on the data from NBS, disposable income for those in urban and rural area was growing at 8-9% CAGR during 2017 to 2019, while the ASP CAGR for KFC and Pizza Hut were 3% and -4%, effectively implying a rising affordability. Moreover, according to our research on income per capita and KFC & McDonalds stores per 1mn population cross various regions, the positive correlation is fairly strong.

Figure 74: Income level and ASP



Source: NBS, Company data, CMBIS estimates

Figure 75: Income per capita vs KFC & MCD stores

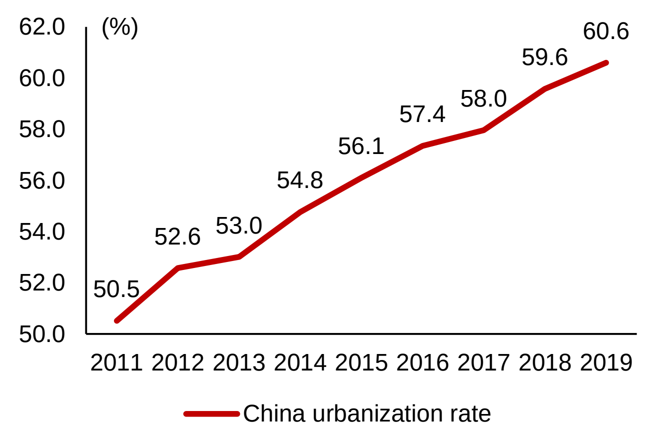


Source: World Bank, Company data, CMBIS estimates

■ **1.2 Benefit from urbanization, more urban population.**

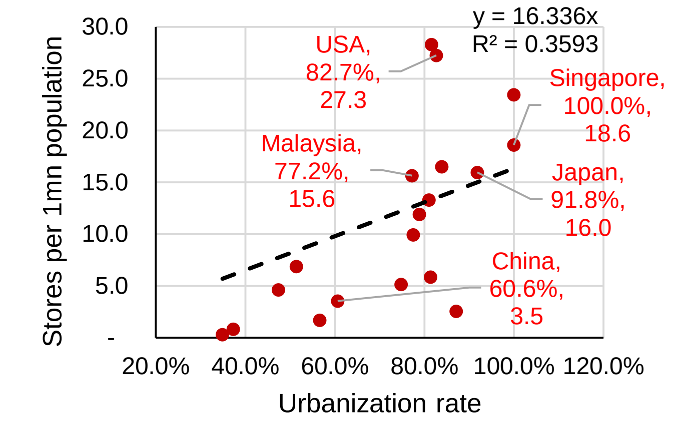
Similarly, according to our research, positive correlation between urbanization rate and KFC & McDonalds stores per 1 mn population for various regions is also high. Hence, we are not surprised to see KFC store numbers to grow as China becomes more urbanized.

Figure 76: China urbanization rate



Source: NBS, CMBIS estimates

Figure 77: Urbanization vs KFC & MCD stores



Source: World Bank, Company data, CMBIS estimates

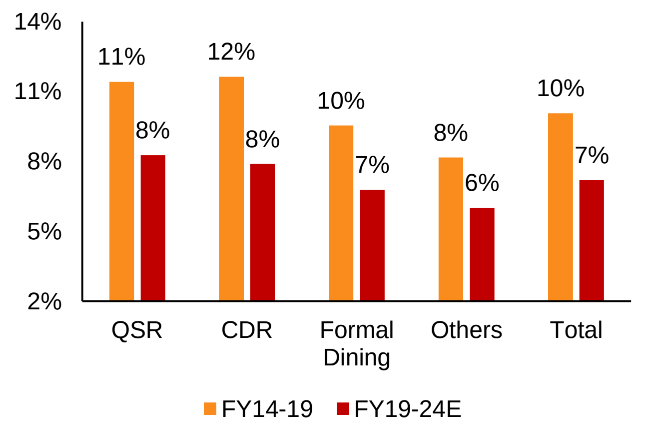
2) QSR, CDR, chains and western cuisine are taking market shares

As Chinese young people live a more fast-paced lifestyle, especially those urban population, the demand for QSR should outperform others. With China becomes more wealthy and worldly, demand for and CDR and Non-Chinese (esp. western) cuisine should also increase at a faster rate. Moreover, since chain restaurants are able to benefit from its greater capital, branding and technology backing, it is able to gain more market shares.

- **2.1 QSR, CDR and chain stores could grow faster as China urbanized.**

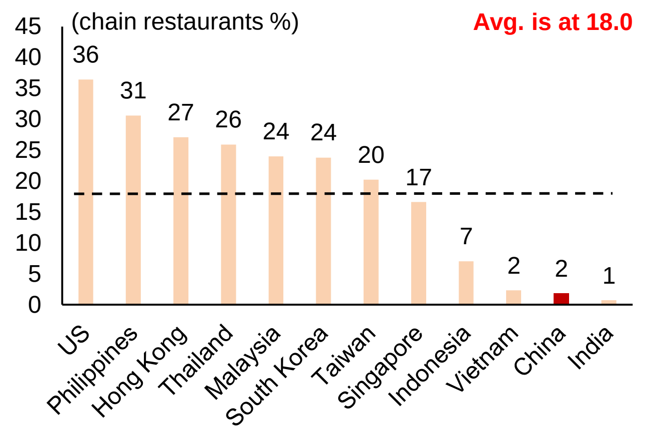
According to Frost & Sullivan, coffee product sales in China was still little at RMB 69bn in 2019, only ~1.4% of China Catering sales. However, sales CAGR was rapid at 25%, vs RMB 22bn sales in 2014. We believe the fast growth was driven by: 1) higher income growth, 2) greater demand from the younger generation as they have a higher standard of living, and 3) greater supply of coffee shops and variety of coffee based beverage. According to Frost & Sullivan, coffee product sales in China could surge to about RMB 206bn by FY24E, representing a 25% CAGR during FY19-24E.

Figure 78: QSR/ CDR/ Formal Dining sales CAGR



Source: Frost & Sullivan, CMBIS estimates

Figure 79: Chain restaurants market share, 2018

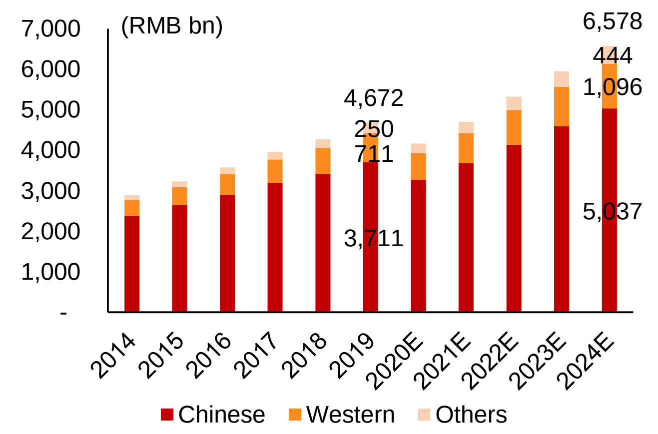


Source: Euromonitor, CMBIS

- **2.2 Demand for western cuisine to grow as China internationalized.**

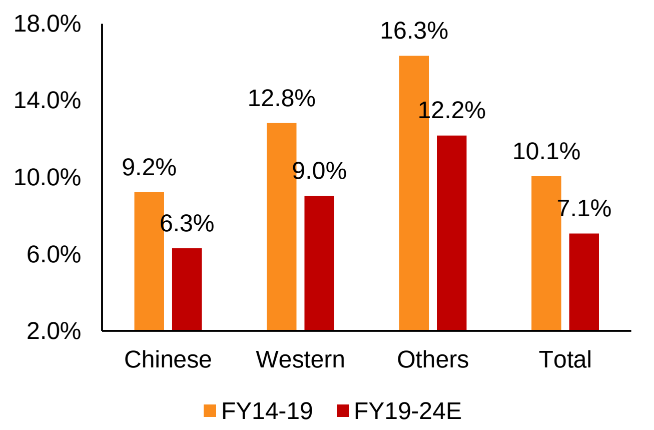
Since more Chinese are able to travel aboard with increasing income level, their interest on western food products and cuisine would also increase accordingly.

Figure 80: Sales by Chinese/ Western cuisine



Source: Frost & Sullivan, CMBIS estimates

Figure 81: Sales CAGR by Chinese/ Western cuisine



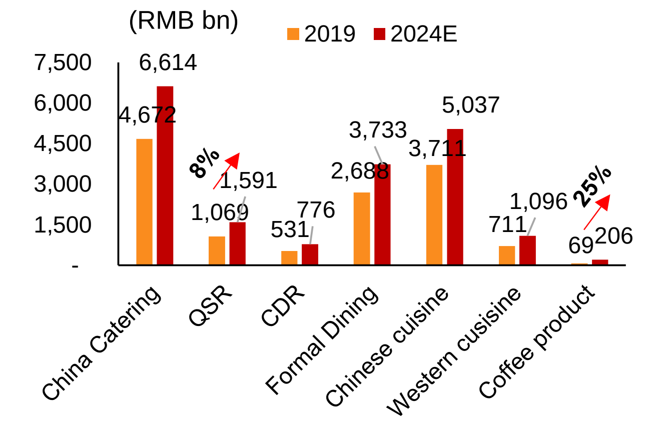
Source: Frost & Sullivan, CMBIS estimates

3) Huge room for the coffee business to grow fast

Coffee sales has been growing rapidly in China, and we expect that to remain fast, because: 1) consumption per capita is still low in China, vs other more developed regions, 2) the rising working population and longer working hours and 3) of growing demand on better lifestyle (where drinking coffee is often perceived as a middle class interests).

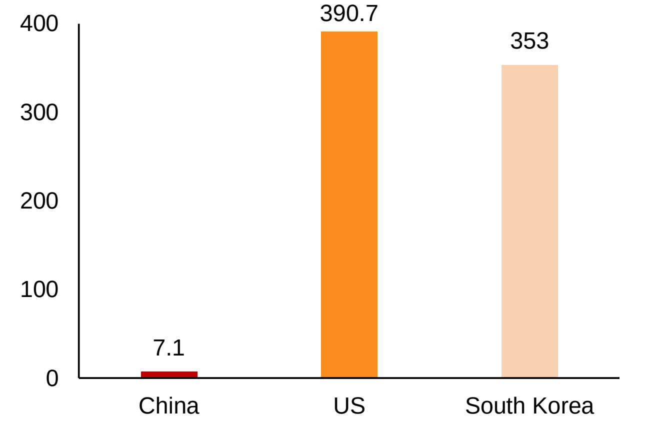
■ **3.1 Coffee consumption likely to rise as China urbanized and internationalized.** According to Frost & Sullivan, coffee product sales was only RMB 69bn in 2019 (~1.4% of China Catering sales). However, sales CAGR was rapid at 25%, vs RMB 22bn in 2014. We believe the growth are driven by: 1) income growth and improved affordability, 2) greater demand from the younger generation as they usually have a higher standard of living, 3) greater supply of coffee shops and variety of coffee. China coffee product sales could reach RMB 206bn by FY24E, implying a 25% CAGR during FY19-24E.

Figure 82: Industry sales and CAGR by segment



Source: Frost & Sullivan, CMBIS

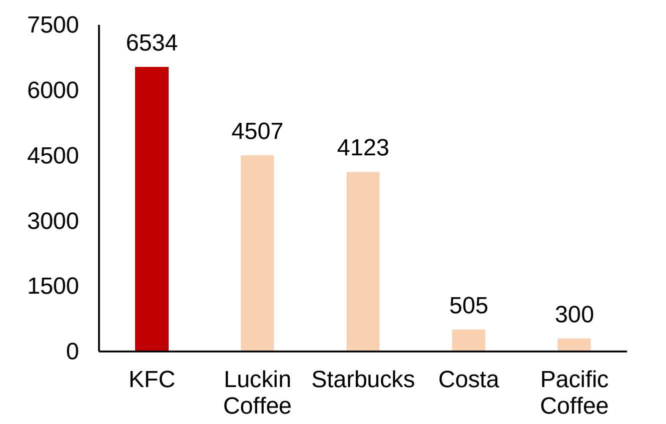
Figure 83: Coffee penetration (cups per capita)



Source: Company data, CMBIS

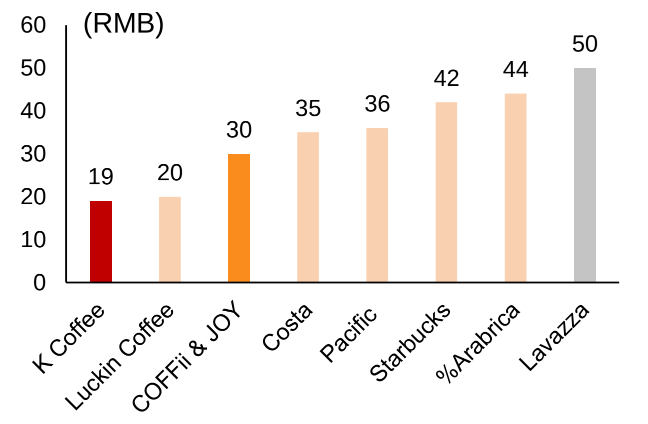
■ **3.2 Lots of room for K-coffee to grow, vs Starbucks and Luckin Coffee.** We believe that there is huge potential in the coffee market for KFC to tap into, even though KFC had sold over 137 million cups of coffee in FY19. Based on ASP of RMB 19, the K-coffee sales could be ~RMB 2.6bn, ~4.2% of YUMC's sale in FY19. Also, assuming 70% of Starbuck international sales in FY19 from China (because there are 4,125 China stores of 5,860 international stores, ~70%), Starbuck's China sales could be ~RMB 27.0bn, which is 9.4 times greater than the K-coffee sales.

Figure 84: Number of shops by coffee brand, FY19



Source: Company data, Meituan Dianping, CMBIS estimates

Figure 85: Number of ASP by coffee brand



Source: Meituan Dianping, CMBIS estimates

Assumptions

Figure 86: CMBIS' assumptions

Major assumptions	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E
Sales by segment (RMB mn)						
KFC - eat in sales	4,471	4,882	4,911	4,093	4,911	5,271
KFC - delivery sales	595	808	1,129	1,569	2,016	2,480
PH - eat in sales	1,669	1,611	1,527	1,099	1,344	1,411
PH- delivery sales	424	500	527	609	715	815
Others	610	614	682	757	832	954
Total	7,769	8,415	8,776	8,127	9,818	10,930
Sales by segment growth (%)						
KFC - eat in sales		9.2%	0.6%	-16.7%	20.0%	7.3%
KFC - delivery sales		35.8%	39.7%	39.0%	28.5%	23.0%
PH - eat in sales		-3.5%	-5.2%	-28.0%	22.3%	4.9%
PH- delivery sales		18.1%	5.4%	15.5%	17.4%	14.0%
Others		0.7%	11.1%	11.0%	9.8%	14.8%
Total		8.3%	4.3%	-7.4%	20.8%	11.3%
Sales network by brand						
KFC	5,488	5,910	6,534	7,044	7,644	8,234
Pizza Hut	2,195	2,240	2,281	2,301	2,361	2,461
Others	300	334	385	1,013	1,093	1,173
Total	7,983	8,484	9,200	10,358	11,098	11,868
Restaurant profit margin by brand						
KFC	18.0%	17.9%	17.8%	16.5%	18.2%	19.1%
Pizza hut	14.0%	10.2%	11.1%	10.8%	13.7%	15.0%
Others	0.3%	0.0%	-0.4%	-0.4%	0.0%	0.2%
Total	16.7%	15.7%	16.0%	13.5%	15.3%	16.1%
Costs breakdown						
Food and paper/ sales	26.2%	27.6%	28.2%	28.5%	28.3%	28.0%
Payroll and employee benefits/ sales	19.9%	20.4%	20.6%	20.8%	20.2%	19.9%
Rental and other operating expenses/ sales	28.9%	28.4%	27.0%	27.2%	26.1%	25.9%
G & A expenses/ sales	6.4%	5.4%	5.5%	6.0%	5.5%	5.3%
Franchisees expenses/ sales	7.6%	7.1%	7.3%	7.5%	7.5%	7.6%
Effective tax rate	47.2%	22.5%	25.9%	26.5%	26.0%	25.5%
NP att. margin	**5.1%**	**8.4%**	**8.1%**	**9.0%**	**8.9%**	**9.7%**
NP att. growth (%)	**-20.1%**	**77.9%**	**0.7%**	**2.1%**	**20.6%**	**20.3%**

Source: Company data, CMBIS estimates

Figure 87: CMBIS estimates vs consensus

	CMBIS			Consensus			Diff (%)		
US$ mn	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	8,115	9,795	10,901	8,114	9,747	10,675	0.0%	0.5%	2.1%
Operating Profit	911	1,080	1,317	759	1,093	1,268	20.0%	-1.3%	3.8%
Net profit	724	871	1,048	656	837	953	10.4%	4.1%	10.0%
EPS (US$ cents)	1.752	2.001	2.393	1.468	2.020	2.326	19.4%	-0.9%	2.9%
Gross Margin	71.5%	71.7%	71.8%	69.9%	70.0%	69.8%	1.6ppt	1.7ppt	1.9ppt
Operating Margin	11.2%	11.0%	12.1%	9.4%	11.2%	11.9%	1.9ppt	-0.2ppt	0.2ppt
Net Margin	8.9%	8.9%	9.6%	8.1%	8.6%	8.9%	0.8ppt	0.3ppt	0.7ppt

Source: Company data, CMBIS estimates

Financial Analysis

We forecast sales growth of -7%/ 21%/ 11% YoY in FY20E/ 21E/ 22E

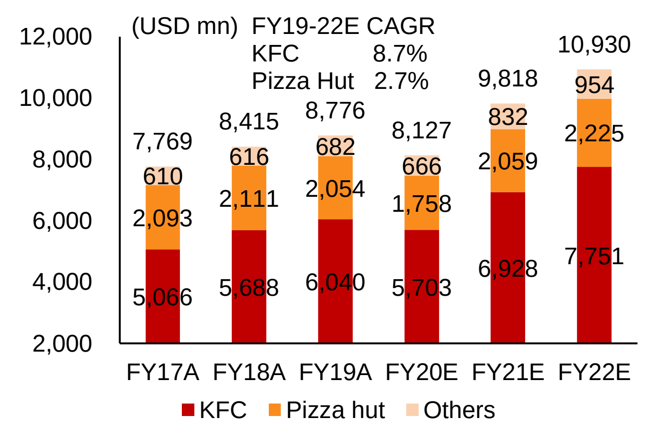
- **We expect sales to decline by 7.4% YoY in FY20E, due to drags by pandemic.**

We project the sales to drop by 7.4% YoY to USD 8,127mn in FY20E, due to: 1) 5.6% drop for KFC sales, 14.4% drop for Pizza Hut sales and -2.3% drop for other segment sales, OR 2) 16.4% drop in dine-in sales and 31.5% growth for delivery sales, OR 3) 17.7% drop in sales per store and 12.6% increases in number of restaurants.

- **We also project a 7.6% sales and 14.0% net profit att. CAGR in FY20E-22E.**

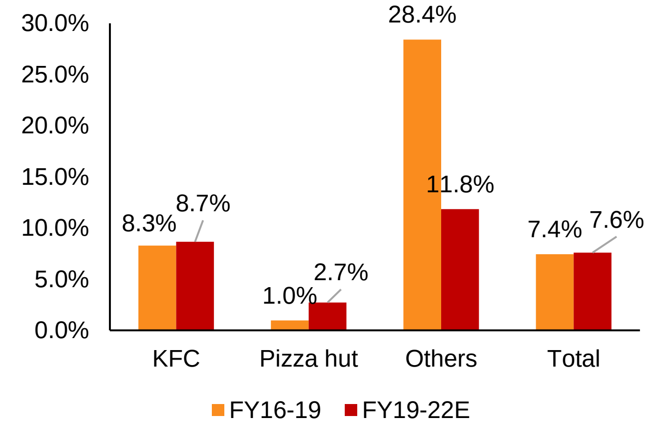
We also expect a 7.6% sales and 14.0% NP att. CAGR during FY20E-22E, driven by: 1) 8.7% KFC, 2.7% Pizza Hut and 11.8% other segment sales CAGR OR, 2) 2.4% dine-in sales and 25.8% delivery sales CAGR OR, 3) 1.2% drop in sales per store and 8.9% number of restaurant CAGR.

Figure 88: Sales by brand



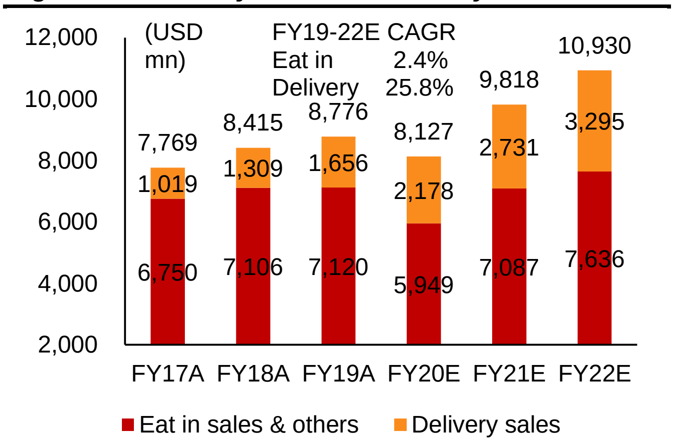
Source: Company data, CMBIS estimates

Figure 89: Sales CAGR by brand



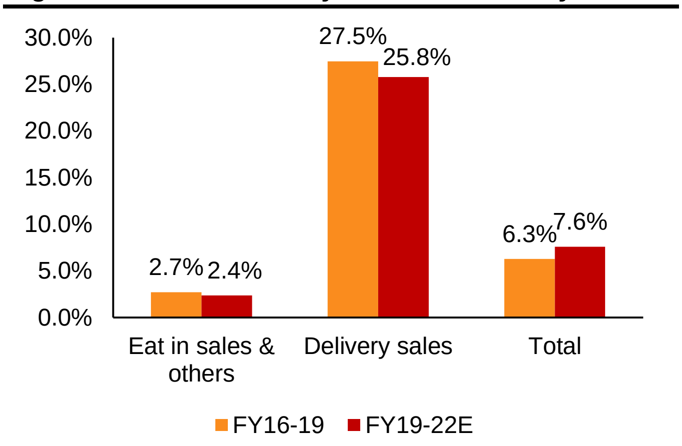
Source: Company data, CMBIS estimates

Figure 90: Sales by dine-in or delivery



Source: Company data, CMBIS estimates

Figure 91: Sales CAGR by dine-in or delivery



Source: Company data, CMBIS estimates

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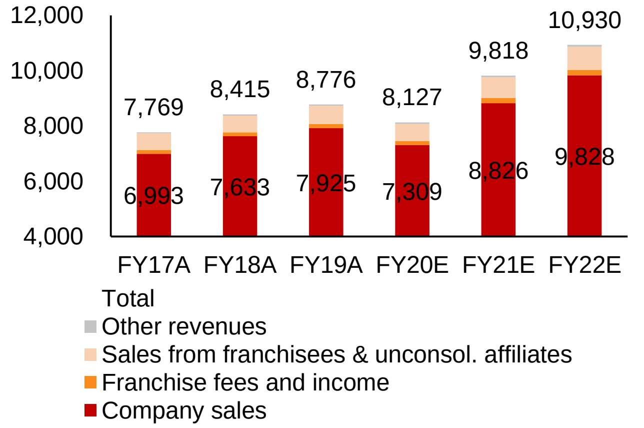
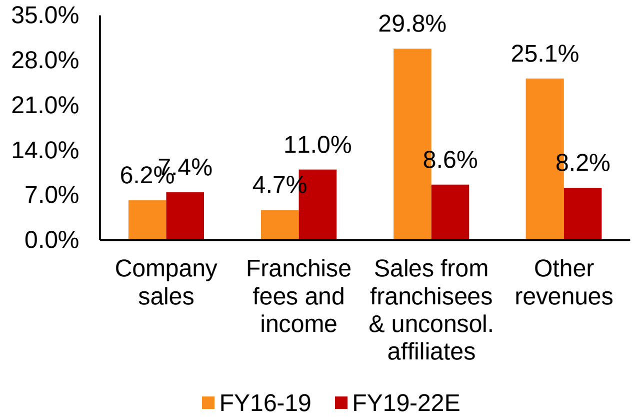
Figure 92: Sales by self-owned & franchised



Source: Company data, CMBIS estimates

Figure 93: Sales CAGR by self-owned & franchised



Source: Company data, CMBIS estimates

Figure 94: CMBI's assumptions for KFC

KFC's PnL	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E
Company sales	**4,863**	**5,495**	**5,839**	**5,513**	**6,701**	**7,503**
Food and paper	(1,455)	(1,679)	(1,835)	(1,745)	(2,121)	(2,330)
Payroll and employee benefits	(1,013)	(1,167)	(1,245)	(1,201)	(1,429)	(1,595)
Occupancy and other opex	(1,518)	(1,665)	(1,717)	(1,659)	(1,928)	(2,148)
Restaurant profit	**877**	**984**	**1,042**	**908**	**1,223**	**1,431**
Company sales growth (%)	***6.4%***	***13.0%***	***6.3%***	***-5.6%***	***21.5%***	***12.0%***
Food and paper/ KFC company sales	-29.9%	-30.6%	-31.4%	-31.6%	-31.6%	-31.0%
Staff costs and benefits/ KFC company sales	-20.8%	-21.2%	-21.3%	-21.8%	-21.3%	-21.3%
Occupancy and opex/ KFC company sales	-31.2%	-30.3%	-29.4%	-30.1%	-28.8%	-28.6%
Restaurant profit margin	18.0%	17.9%	17.8%	16.5%	18.2%	19.1%
Restaurant profit growth (%)	***18.0%***	***12.2%***	***5.9%***	***-12.8%***	***34.6%***	***17.0%***

Source: Company data, CMBIS estimates

Figure 95: CMBI's assumptions for Pizza Hut

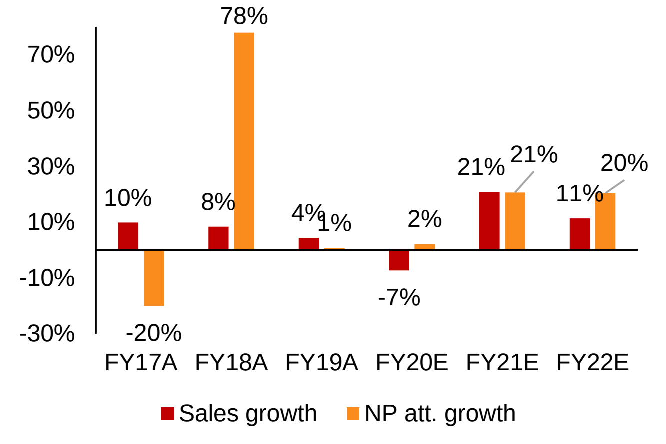
Pizza Hut's PnL	FY17A	FY18A	FY19A	FY20E	FY21E	FY22E
Company sales	**2,090**	**2,106**	**2,045**	**1,747**	**2,044**	**2,206**
Food and paper	(566)	(637)	(633)	(559)	(638)	(695)
Payroll and employee benefits	(519)	(538)	(549)	(472)	(527)	(543)
Occupancy and other opex	(713)	(716)	(636)	(527)	(599)	(638)
Restaurant profit	**292**	**215**	**227**	**189**	**280**	**331**
Company sales growth (%)	***4.9%***	***0.8%***	***-2.9%***	***-14.6%***	***17.0%***	***8.0%***
Food and paper/ Pizza Hut sales	-27.1%	-30.2%	-31.0%	-32.0%	-31.2%	-31.5%
Staff costs and benefits/ Pizza Hut sales	-24.8%	-25.5%	-26.8%	-27.0%	-25.8%	-24.6%
Occupancy and opex/ Pizza Hut sales	-34.1%	-34.0%	-31.1%	-30.2%	-29.3%	-28.9%
Restaurant profit margin	14.0%	10.2%	11.1%	10.8%	13.7%	15.0%
Restaurant profit growth (%)	***9.8%***	***-26.4%***	***5.6%***	***-16.9%***	***48.4%***	***18.2%***

Source: Company data, CMBIS estimates

We forecast NP att. growth of 2%/ 21%/ 20% YoY in FY20E/ 21E/ 22E

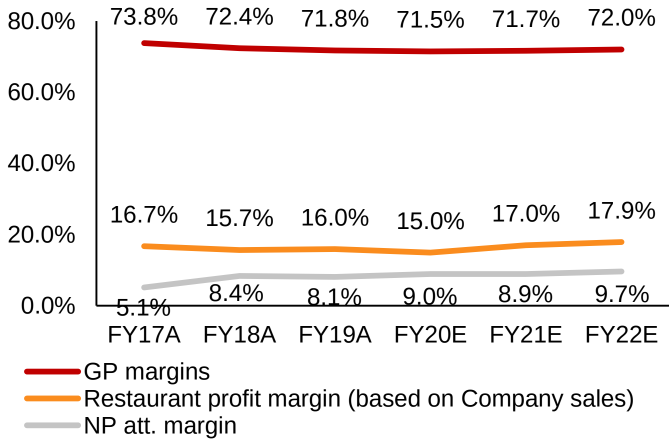
■ **GP margin shall drop slightly in FY20E but gradually improve in FY21E-22E.** We expect GP margin to fall slightly to 71.5% in FY20E, from 71.8% in FY19. The GP margin was still low at 71.3% in 1H20, as YUMC was still digesting the relatively high cost inventories locked last year, where both pork and chicken prices were surging a lot. Since these prices had all started to ease, we expect much less pressure onwards, hence forecasting GP margin to pick up slightly to 71.7% and 72.0% in FY21E and FY22E

Figure 96: YUMC's sales / NP att. growth



Source: Company data, CMBIS estimates

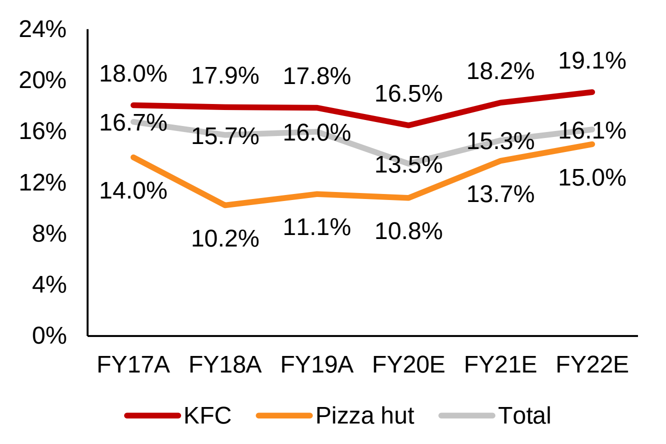
Figure 97: GP/ Restaurant OP/ NP att. margin



Source: Company data, CMBIS estimates

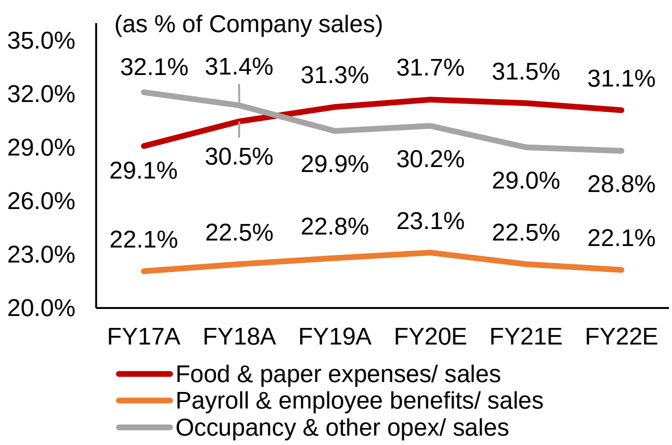
■ **OP margin may fall to 15.0% in FY20E but rebound strongly in FY21E-22E.** We expect the OP margin to drop to 15.0%, mainly due to significant operating deleverage during the COVID-19 pandemic in 1Q20. But thanks to YUMC's rapid response towards the pandemic, effective costs control and refinement of labour productivity were imposed. Therefore, OP margin already returned to above last year level in 2Q-3Q20. And together with positive improvements yield from the Pizza Hut reforms, we are optimistic to see OP margin to jump to 17.0% and 17.9% in FY21E and FY22E.

Figure 98: Restaurant OP margin by brand



Source: Company data, CMBIS estimates

Figure 99: Costs breakdown



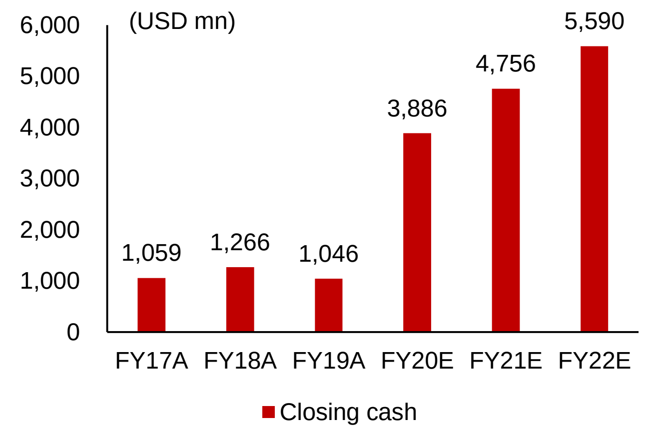
Source: Company data, CMBIS estimates

Balance sheet and Cash flow

- **YUMC's cash flow from operation has been strong but was recently affected by Pizza Hut reform and COVID-19. We expect that to improve in FY20E-22E.**

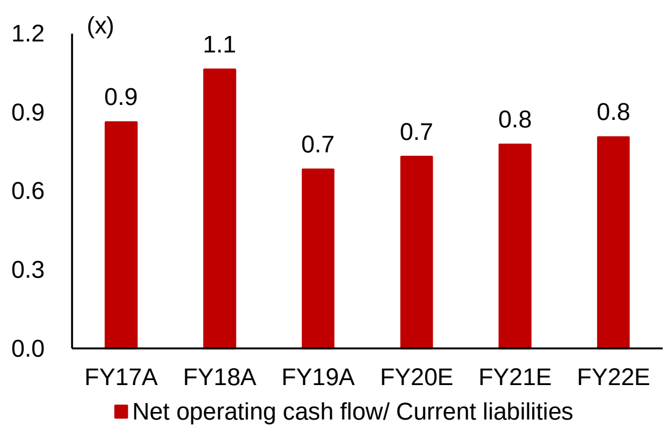
The Company's net cash flow from operation ("CFO") were USD 884mn/ 1,333mn/ 1,185mn in FY17/ FY18/ FY19 and we expect that to grow as net profit improves. Cash level was down in FY19 due to acquisition of Huang Ji Huang, but will surge in FY20E after the secondary IPO in Hong Kong. Capex was fairly stable in FY17-19, but it shall gradually increase as store expansion for KFC and Pizza Hut accelerates in FY20E-22E.

Figure 100: Closing cash balance



Source: Company data, CMBIS estimates

Figure 101: Net operating cash flow ratio

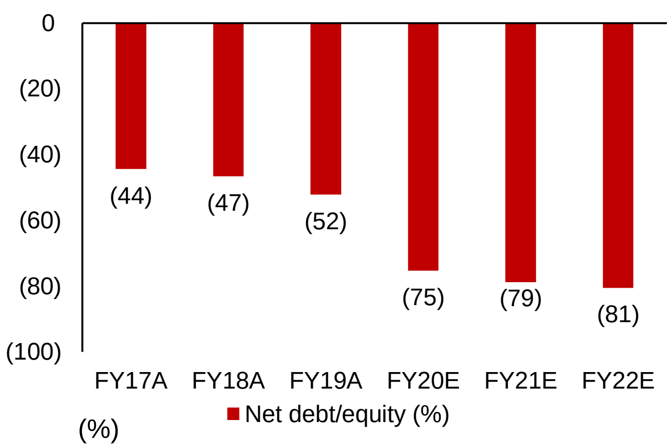


Source: Company data, CMBIS estimates, Net operating cash flow ratio = dividing net operating cash flow divided by current liabilities

- **YUMC's cash conversion cycle had been shortened due to longer payable, but should be stable at negative 35-40 days in FY20E-22E.**

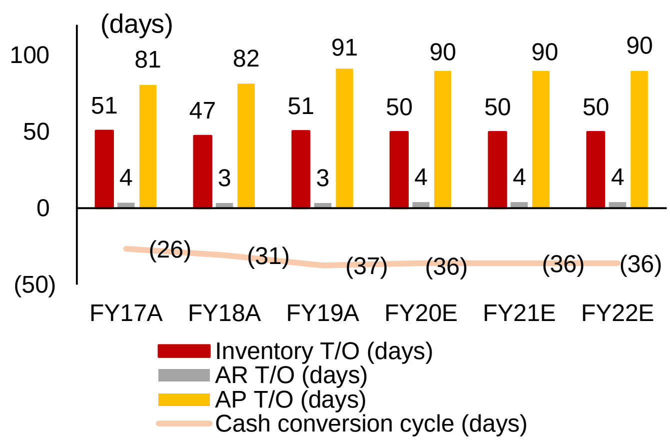
Inventory days was highly stable at 47 to 51 in FY17-19, despite the surge in pork and chicken prices, thanks to its highly efficient supply chain control. Receivable days was low at about 3-4 days in FY17-19, as its customers are mostly retail based. Payable days increased from 81 days in FY17 to 91 days in FY19, due to greater bargaining power over its suppliers. We expect the CCC to be stable at negative 35-40 days in FY20E-22E.

Figure 102: Net debt or (cash) to equity



Source: Company data, CMBIS estimates

Figure 103: Working capital (days)



Source: Company data, CMBIS estimates

Valuation

Figure 104: Peers valuation table

Company	Ticker	Rating	12m TP (LC)	Price (LC)	Up/ Down-side	Mkt. Cap (HK$mn)	Year End	P/E (x) FY1E	P/E (x) FY2E	P/B (x) FY1E	P/B (x) FY2E	ROE (%) FY1E	3yrs PEG (x) FY1E	Yield (%) FY1E
Leading Greater China Catering														
Yum China	9987 HK	BUY	562.71	447.00	26%	187,447	Dec-19	32.7	28.6	4.0	3.6	23.2	3.3	0.3
Jiumaojiu	9922 HK	BUY	20.88	18.48	13%	26,859	Dec-19	445.0	47.2	10.0	8.3	101.4	9.7	0.1
Haidilao	6862 HK	BUY	53.56	55.40	-3%	293,620	Dec-19	247.1	53.4	20.2	14.6	5.2	6.2	0.2
Cafe De Coral	341 HK	BUY	18.37	17.42	5%	10,203	Mar-20	21.8	22.1	3.4	3.2	3.0	0.2	2.6
Xiabuxiabu	520 HK	NR	n/a	18.30	n/a	19,792	Dec-19	n/a	32.4	7.0	5.9	(6.0)	37.4	0.3
Yihai	1579 HK	NR	n/a	95.00	n/a	99,456	Dec-19	80.8	58.8	23.1	17.4	34.3	2.2	0.3
Gourmet Master	2723 TT	NR	n/a	146.00	n/a	7,218	Dec-19	27.7	21.3	2.4	2.3	8.1	1.6	1.9
							Avg.	**142.6**	**37.8**	**10.0**	**7.9**	**24.2**	**8.7**	**0.8**
							Med.	**57.1**	**32.4**	**7.0**	**5.9**	**8.1**	**3.3**	**0.3**
Other Greater China Catering														
Fairwood	52 HK	NR	n/a	18.34	n/a	2,376	Mar-20	39.9	13.3	3.5	2.9	9.3	n/a	1.7
Tai Hing	6811 HK	NR	n/a	1.40	n/a	1,403	Dec-19	36.8	8.8	2.8	2.7	11.5	1.1	1.5
Hop Hing	47 HK	NR	n/a	0.05	n/a	504	Dec-19	n/a	n/a	n/a	n/a	(4.2)	n/a	n/a
Ajisen China	538 HK	NR	n/a	1.17	n/a	1,277	Dec-19	5.2	n/a	n/a	n/a	(1.2)	n/a	n/a
							Avg.	**27.3**	**11.0**	**3.1**	**2.8**	**3.9**	**1.1**	**1.6**
							Med.	**36.8**	**11.0**	**3.1**	**2.8**	**4.0**	**1.1**	**1.6**
Greater China Catering														
							Avg.	**104.2**	**31.8**	**8.5**	**6.8**	**16.8**	**7.7**	**1.0**
							Med.	**36.8**	**29.1**	**4.1**	**3.6**	**8.1**	**2.8**	**0.3**
International Catering														
Yum! Brands	YUM US	NR	n/a	105.32	n/a	246,250	Dec-19	30.7	26.4	n/a	n/a	n/a	38.6	1.8
Mcdonald'S	MCD US	NR	n/a	213.02	n/a	1,230,171	Dec-19	34.4	25.6	n/a	n/a	n/a	8.9	2.4
Starbucks	SBUX US	NR	n/a	101.80	n/a	926,060	Sep-20	36.3	31.1	n/a	n/a	n/a	0.5	1.8
Rest. Brands	QSR US	NR	n/a	59.49	n/a	216,025	Dec-19	27.4	21.4	10.1	9.9	23.8	3.3	3.5
Wingstop	CMG US	NR	n/a	1310.3	n/a	284,158	Dec-19	119.6	61.4	19.1	15.9	13.8	3.9	0.0
Shake Shack	DRI US	NR	n/a	114.29	n/a	115,333	May-20	27.2	18.6	5.5	4.9	(7.9)	(0.1)	1.2
Chipotle	DPZ US	NR	n/a	383.53	n/a	117,118	Dec-19	30.8	29.5	n/a	n/a	n/a	2.2	0.8
Darden	DNKN US	NR	n/a	106.41	n/a	67,973	Dec-19	37.8	33.2	n/a	n/a	n/a	7.1	0.8
Domino'S Pizza	WEN US	NR	n/a	21.96	n/a	38,146	Dec-19	38.3	30.9	8.7	9.1	18.0	3.4	1.3
Dunkin' Brands	SHAK US	NR	n/a	87.38	n/a	28,066	Dec-19	n/a	462.3	9.1	9.1	(7.0)	n/a	0.0
Wendy'S	WING US	NR	n/a	124.01	n/a	28,530	Dec-19	102.1	87.2	n/a	n/a	n/a	2.9	0.4
Jollibee Foods	JFC PM	NR	n/a	206.40	n/a	36,871	Dec-19	n/a	61.8	4.0	3.8	(19.4)	n/a	0.4
							Avg.	**48.5**	**74.1**	**9.4**	**8.8**	**3.6**	**7.1**	**1.2**
							Med.	**35.3**	**31.0**	**8.9**	**9.1**	**3.4**	**3.3**	**1.0**
H-shares Consumer Staples														
UPC	220 HK	NR	n/a	7.30	n/a	31,531	Dec-19	17.1	16.3	1.9	1.9	10.8	1.7	5.6
Tingyi	322 HK	NR	n/a	13.66	n/a	76,829	Dec-19	16.6	16.5	3.2	3.1	22.6	1.7	5.4
Want Want*	151 HK	BUY	7.36	5.54	33%	67,741	Mar-20	13.9	13.4	3.6	3.5	28.8	1.4	6.2
China Mengniu*	2319 HK	BUY	42.00	43.15	-3%	170,293	Dec-19	41.7	27.7	4.5	3.9	11.5	2.7	0.5
Vitasoy	345 HK	NR	n/a	31.95	n/a	34,023	Mar-20	48.9	44.2	9.7	8.7	19.7	2.8	1.3
Budweiser	1876 HK	NR	n/a	27.05	n/a	358,234	Dec-19	69.8	42.0	4.6	4.2	9.0	7.4	0.5
Tsingtao*	168 HK	BUY	78.10	78.20	-0%	132,210	Dec-19	41.0	34.4	4.3	3.9	10.9	2.3	1.0
CR Beer	291 HK	NR	n/a	63.65	n/a	206,492	Dec-19	64.5	45.5	8.2	7.4	7.2	1.1	0.6
Dali Foods	3799 HK	NR	n/a	4.92	n/a	67,375	Dec-19	14.7	13.2	3.3	3.0	22.1	1.8	4.6
							Avg.	**36.5**	**28.1**	**4.8**	**4.4**	**15.8**	**2.5**	**2.9**
							Med.	**41.0**	**27.7**	**4.3**	**3.9**	**11.5**	**1.8**	**1.3**

Source: Bloomberg, Company data, CMBIS estimates, *cover by another analyst - Albert Yip

Initiate BUY on Yum China with TP of HK$ 562.71 (36x FY21E)

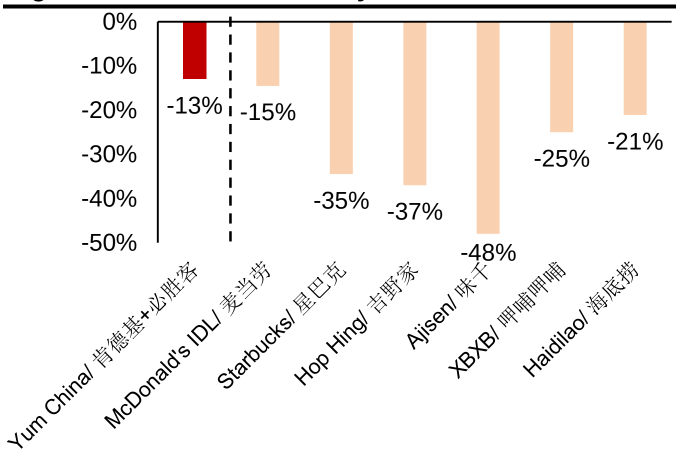
We initiate on Yum China with a BUY rating and a target price of HK$ 562.71, based on a 36.0x FY21E P/E, given its 1) leadership in fastfood, in terms of revenue and store counts, 2) superior resilience proven during the pandemic and 3) industry leading digital maturity.

Our target price has a 5% discount to leading Greater China peers' average of 37.8x FY21E P/E and a 16% premium over International peers' median of 31.0x FY21E P/E. We believe that can be justified by:

#1 Largest in scale and number of restaurants, in the China catering sector.
YUMC has generated about RMB 61.1bn sales in FY19, which is already 1.3x higher than Haidilao's RMB 26.6bn, 9.1x higher than XiabuXiabu's RMB 6.0bn and 21.7x higher than Jiumaojiu's RMB 2.7bn. YUMC also had 9,200 stores in FY19, which is 7.2 greater than XiabuXiabu's 1,124, 11.8x higher than Haidilao's 716 and 33.2x more than Jiumaojiu's 269.

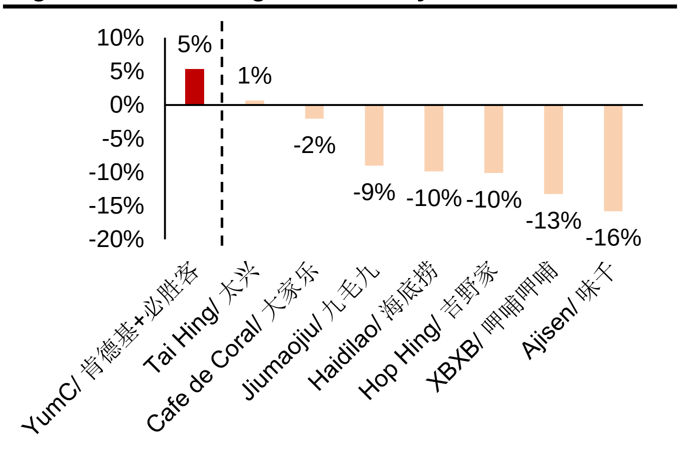
#2 Superior resilience proven during the pandemic, in terms of SSSG and margins.
YUMC delivered the industry leading SSSG (just a 13% decline) and profit (at 5% NP margin) in 1H20, even amid the pandemic. Thanks to :1) more flexible staff costs and 2) fast food nature, which fit well for all take away, dine-in and delivery, and 3) affordable pricing. We believe YUMC deserves a meaningful credit for such an excellent performance.

Figure 105: SSSG in 1H20 by brands



Source: Company data, CMBIS estimates

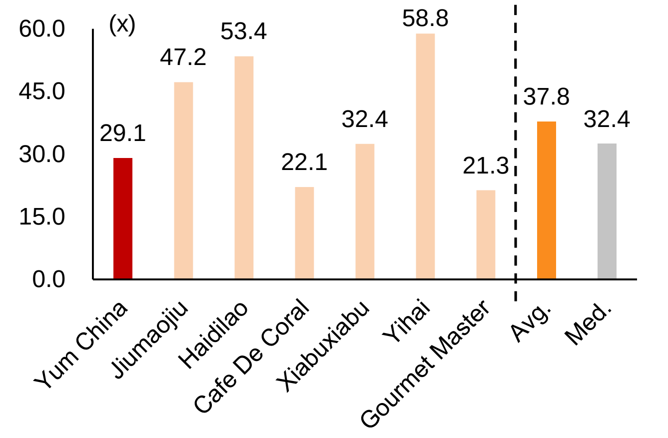
Figure 106: NP margin in 1H20 by brands



Source: Company data, CMBIS estimates

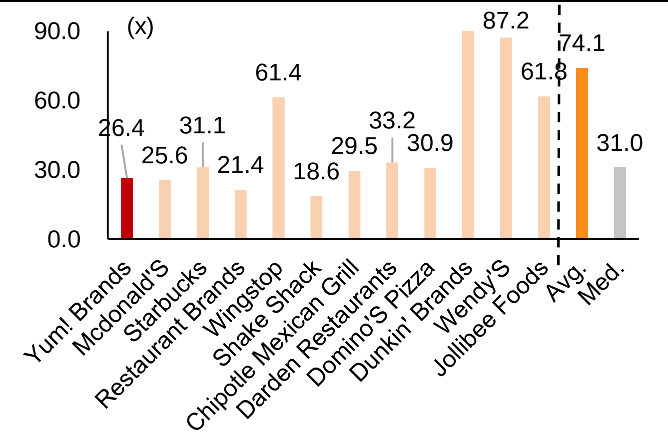
#3 Industry leading digital maturity, a key for future market consolidations.
YUMC had already acquired over 215mn and 70mn members for KFC and Pizza Hut in China, achieved close to 100% delivery coverage for its restaurants, recorded about 70% sales from digital orderings in FY19. These digital and delivery achievements are certainly the result of significant investments on IT systems, and we believe the big data and IT knowhow can not only generate more sales and profit for the group, but also create a meaningful entry barriers for its competitors in the future.

Figure 107: China peers valuation - Forward 2 yrs P/E



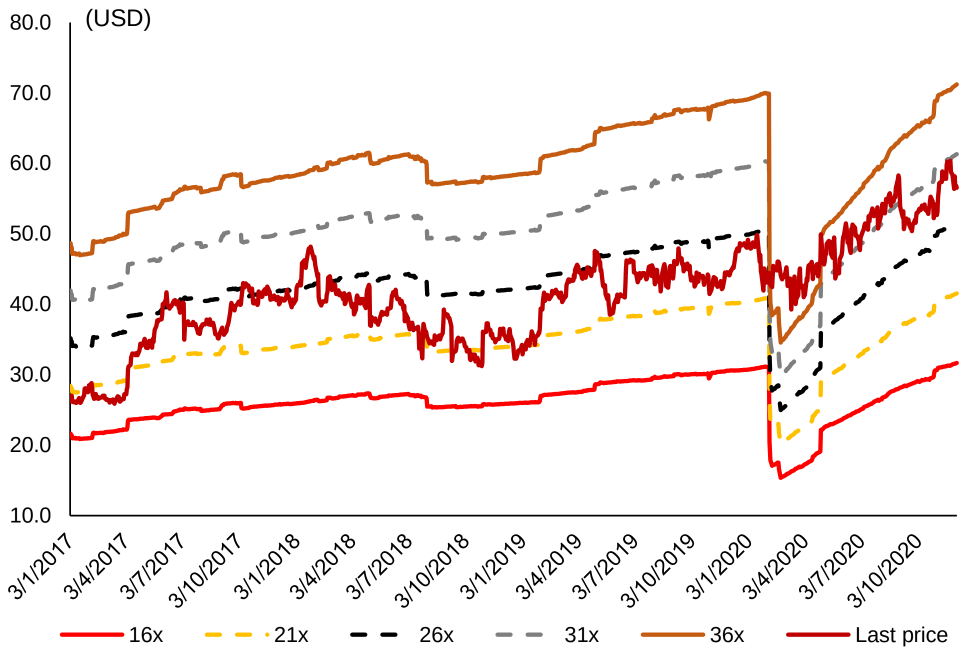
Source: Bloomberg, Company data, CMBIS estimates

Figure 108: Int'l peers valuation - Forward 2 yrs P/E



Source: Bloomberg, Company data, CMBIS estimates

Figure 109: Valuation – Forward 2 yrs P/E band



Source: Bloomberg, Company data, CMBIS estimates, as at 4 Dec 2020

■ **DCF method derives a valuation of HK$ 554.26 per share (~36x FY21E P/E).**

We also crosscheck our valuation estimates using the DCF method, deriving a valuation of HK$ 554.26 per share, based on a 6.5% WACC and 3.0% terminal growth. This valuation implies a 35.5x FY21E P/E and is reasonably close to our target price of HK$ 562.71, based on 36x FY21E P/E.

Figure 110: Valuation - DCF method in HK$ mn

DCF	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E	FY24E
EBITDA	1,386	1,329	1,321	1,496	1,763	2,003	2,285
Chg in w orking cap	213	74	(13)	91	56	62	64
Adjusted tax	(214)	(260)	(274)	(322)	(377)	(426)	(489)
Capex & product dev	(561)	(435)	(406)	(491)	(547)	(605)	(664)
Unleveraged FCF	**824**	**708**	**628**	**775**	**896**	**1,034**	**1,196**
YoY%							
DCF 20E-24E			3,692				
PV (Terminal value)			25,786				
EV (End-20E)			29,478				
Cash from options/w arrants conv			0				
Yer-end net cash/(debts)			1,657				
Fully diluted equity value (End-20E, USD mn)			**31,135**				
Fully diluted no. of shares (m)			435				
Fully diluted equity value (End-18E, HK$ mn)			**241,302**				
Exchange rate			7.75				
Fully diluted equity value/share (HK$)			**554.26**				
Risk-free rate			3.0%				
Risk premium			7.0%				
Unleveraged industry beta			0.70				
Gearing			0.0%				
Tax			25.0%				
Beta			0.70				
Cost of equity			**7.9%**				
Cost of debt			3.0%				
Tax rate			25.0%				
After-tax cost of debt			2.3%				
Debt to total capital			25.0%				
WACC			**6.5%**				
Terminal grow th			3.0%				
Terminal value (US$ mn)			35,308				

Source: Bloomberg, Company data, CMBIS estimates, as at 30 Nov 2020

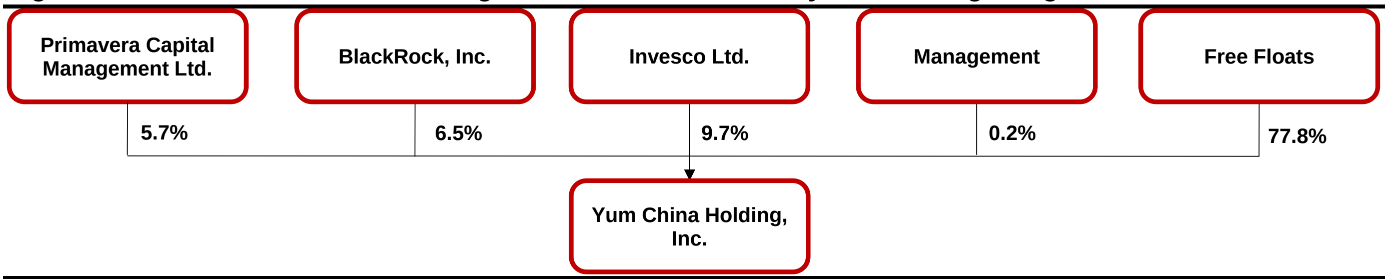
Figure 111: Sensitivity test for the target price, in HK$

		WACC (%)				
Terminal growth (%)		5.5%	6.0%	6.5%	7.0%	7.5%
	2.0%	573.8	503.3	448.5	404.8	369.0
	2.5%	656.3	563.9	494.8	441.0	398.1
	3.0%	771.9	644.8	554.3	486.4	433.8
	3.5%	945.7	758.3	633.7	544.8	478.3
	4.0%	1,236.4	928.9	745.0	622.8	535.6

Source: Bloomberg, Company data, CMBIS estimates, as at 30 Nov 2020

Shareholding Structure

Figure 112: Yum China's shareholding structure after secondary IPO in Hong Kong



Source: Company data, HKEX, CMBIS estimates

Management Profile

Figure 113: Yum China's management profile

Name	Age	Joined the group since	Date of appointment	Position	Responsibility and backgrounds
Mr. HU Zuliu HU Fred (胡祖六)	57 years old	2016	Nov-2016	Chairman of the Board, Independent Director	Dr. Hu brings to the Board extensive expertise in international affairs and the Chinese economy, and also valuable business, strategic development and corporate leadership experience as well as expertise in economics, finance and global capital markets. He is also the chairman and founder of Primavera, a Chinabased global investment firm, since its inception in 2011. Prior to Primavera, Dr. Hu served in various roles at Goldman Sachs from 1997 to 2010, including as partner and chairman of Greater China at Goldman Sachs Group, Inc. From 1991 to 1996, he served as an economist at the International Monetary Fund (IMF) in Washington D.C.
Ms. Wat Chui Yung Joey (屈翠容)	49 years old	2014	Mar-2018	Chief Executive Officer (CEO)	Ms. Wat brings to the Board extensive knowledge of the Company's business and her industry acumen acquired in the course of a career that included several leadership roles in retail companies. She is the Chief Executive Officer since March 2018, and was the President and Chief Operating Officer from February 2017 to February 2018 and the KFC Chief Executive Officer from August 2015 to February 2017. Ms. Wat joined in September 2014 as President of KFC China. Before joining YUM, Ms. Wat served in both management and strategy positions at A.S. Watson Group ("Watson"), an international health, beauty and lifestyle retailer, in the U.K. from 2004 to 2014. Before joining Watson, Ms. Wat spent seven years in management consulting including with McKinsey & Company's Hong Kong office from 2000 to 2003.
Mr.YEUNG Ka Wai Andy (楊家威)	47 years old	2019	Oct-2019	Chief Financial Officer (CFO)	Prior to joining, Mr. Yeung served as the chief financial officer of Smart Finance International Limited, a financial technology company, from April 2017 to August 2019. Between January 2014 and March 2017, he served as the chief financial officer of Cheetah Mobile Inc., a NYSE-listed mobile internet company (NYSE: CMCM) where he led its successful IPO. From 2009 to 2013, Mr. Yeung worked at Oppenheimer & Co. Inc. as director, executive director and then managing director, responsible for research coverage of the internet and media sectors in China. From 2004 to 2009, Mr. Yeung was an associate in equity research at Thomas Weisel Partners. He has been a Chartered Financial Analyst charterholder since 2001. Mr. Yeung received a master's degree in business administration (MBA) from Yale University in 1999.
Mr. CHAN Wing Kin Joseph (陳永堅)	51 years old	2019	Jun-2019	Chief Legal Officer	Prior to joining, Mr. Chan was a partner at Sidley Austin, a U.S. based international law firm, in Shanghai, from November 2010 to May 2019, where he managed and executed large complex multi-jurisdictional legal matters with a focus on mergers and acquisitions and corporate finance transactions across a variety of industries. In addition, Mr. Chan spent over a decade with Pillsbury Winthrop Shaw Pittman, a U.S. based international law firm, in San Francisco and Shanghai, initially as an associate and then a partner. He established the Shanghai office of Pillsbury Winthrop Shaw Pittman in 2006 and served various leadership positions, including serving as its inaugural managing partner. Mr. Chan is admitted to the bar in California and Pennsylvania in the U.S. and British Columbia in Canada. For many consecutive years he was ranked and recommended by Chambers Asia, IFLR and Legal 500 as a leading lawyer in Asia. He obtained his juris doctor degree from George Washington University in 1994.
Mr. HUANG Ching Shuan Johnson (黃進栓)	58 years old	2006	Feb-2019	General Manager, KFC	Mr. Huang has been the key architect of Yum! Restaurants China's digital strategy and information technology roadmap in China. Mr. Huang served as General Manager, KFC since February 2017, and served as the Chief Information and Marketing Support Officer from September 2014 to February 2017. Mr. Huang joined YUM in 2006 to lead the information technology department in China. He served as vice president of information technology from September 2008 to January 2013 and Chief Information Officer from January 2013 to September 2014. Prior to joining YUM, Mr. Huang held various information technology and business leadership positions with Capgemini Asia Pacific Pte, Ltd. in Taiwan and the greater China region. He obtained a master's degree in business administration from the University of Tennessee.
Mr. KUAI Jun Jeff (蒯俊)	40 years old	2003	Nov-2017	General Manager, Pizza Hut	Mr. Kuai served as the General Manager, Pizza Hut since November 2017, and previously served as the General Manager, Pizza Hut Home Service from March 2017 to October 2017 and as the Brand General Manager, Pizza Hut Home Service from October 2016 to March 2017, a position he held at Yum! Restaurants China from January 2015 to October 2016. From March 2012 to August 2013, Mr. Kuai was Director of Delivery Support Center for Yum! Restaurants China, where he was instrumental in building its online ordering and e-commerce capabilities. Prior to that, Mr. Kuai spent nine years in the information technology department of Yum! Restaurants China, enhancing its information technology infrastructure and productivity. He obtained a master's degree in information technology from Shanghai Jiao Tong University in 2007 and a master's degree in business administration (MBA) from Booth School of Business at the University of Chicago in 2014.

Source: Company data, CMBIS

Figure 114: Yum China's management profile

Name	Age	Joined the group since	Date of appointment	Position	Responsibility and backgrounds
Mr. BASSI A. Peter	71 years old	2016	Oct-2016	Independent Director	He brings to the Board knowledge of the restaurant industry and global franchising, as well as financial expertise and extensive public company board and corporate governance experience.
Mr. CAMPBELL L. Christian	69 years old	2016	Oct-2016	Independent Director	Mr. Campbell brings to the Board expertise in corporate governance and corporate compliance of publicly traded companies. In addition, Mr. Campbell brings to the Board extensive knowledge of the QSR industry, global franchising and corporate leadership.
Mr. CHAN Yiu Cheong Ed (陳耀昌)	57 years old	2016	Oct-2016	Independent Director	He brings to the Board knowledge of the food and beverage industry in Asia and extensive public company board and corporate governance experience.
Mr. ETTEDGUI Elias, Edouard (倪德祈)	68 years old	2016	Oct-2016	Independent Director	He brings to the Board senior management experience in various international consumer-product industries, extensive financial expertise and public company board experience.
Mr. HAN Xinyi Cyril (韓歆毅)	43 years old	2016	May-2019	Independent Director	He brings to the Board deep knowledge and insights in the fields of finance and technology.
Mr. HSIEH T. Louis (謝東螢)	55 years old	2016	Oct-2016	Independent Director	He brings to the Board corporate leadership and public company board experience as well as his extensive financial and international business experience.
Ms. LU Rong Ruby (盧蓉)	49 years old	2016	Oct-2016	Independent Director	She brings to the Board public company board experience as well as extensive financial and global market experience.
Mr. SHAO Zili Stephen (邵子力)	61 years old	2016	Oct-2016	Independent Director	Mr. Shao brings to the Board extensive professional experience in Asia and public company board and corporate governance experience.
Mr. WANG Yang William (汪洋)	45 years old	2016	Nov-2017	Independent Director	He brings to the Board deep knowledge and investment insights of the Chinese market.

Source: Company data, CMBIS

Key Risks

- **Outbreak of viruses or other illnesses that may have material adverse effect on the business**
- **Greater than expected increase in raw material costs**
- **Level of competition intensify, or fail to remain competitive in product, service, branding quality**
- **Lower than expected positive yield from the Pizza Hut transformation**
- **Failure to keep up with store expansion plan, or new store performance is as good as expected**
- **Labour shortage or faster than expected increase in labour costs**
- **Involvement in lethal or other severe food safety scandal**
- **Involvement in fraud or other misconduct committed by employees or third parties**

Financial Summary

Income statement

YE 31 Dec (USD mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	**8,415**	**8,776**	**8,127**	**9,818**	**10,930**
Company sales	7,633	7,925	7,309	8,826	9,828
Franchise fees and income	141	148	147	185	202
Fran. & uncol. affiliates sales	603	654	619	751	838
Other revenues	38	49	52	56	62
Cost of goods sold	**(2,326)**	**(2,479)**	**(2,317)**	**(2,780)**	**(3,056)**
Gross profit	**6,089**	**6,297**	**5,810**	**7,038**	**7,874**
Other net income	**152**	**60**	**260**	**69**	**77**
Operating expenses	**(5,300)**	**(5,456)**	**(5,153)**	**(6,018)**	**(6,622)**
Staff costs	(1,714)	(1,807)	(1,688)	(1,982)	(2,176)
Admin	(526)	(560)	(577)	(648)	(689)
Property rent & related	(852)	(877)	(804)	(971)	(1,081)
D & A	(445)	(428)	(404)	(407)	(434)
Other operating expenses	(1,763)	(1,784)	(1,680)	(2,009)	(2,242)
EBIT	**941**	**901**	**917**	**1,089**	**1,329**
Finance costs, net	36	39	68	109	127
JV & associates	-	-	-	-	-
Exceptional	(27)	63	49	39	22
Pre-tax profit	**950**	**1,003**	**1,033**	**1,237**	**1,478**
Income tax	(214)	(260)	(274)	(322)	(377)
Less: Minority interests	28	30	31	37	44
Net profit	**708**	**713**	**728**	**878**	**1,057**

Cash flow summary

YE 31 Dec (USD mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income	**941**	**901**	**917**	**1,089**	**1,329**
D&A	429	419	385	396	425
Change in working capital	213	74	(13)	91	56
Income tax paid	33	16	(274)	(322)	(377)
Others	(283)	(225)	192	185	158
Net cash from operating	**1,333**	**1,185**	**1,207**	**1,439**	**1,591**
Capex & investments	(470)	(435)	(406)	(491)	(547)
Associated companies	-	-	-	-	-
Interest received	-	-	-	-	-
Others	(82)	(475)	-	-	-
Net cash from investing	**(552)**	**(910)**	**(406)**	**(491)**	**(547)**
Equity raised	(307)	(265)	2,220	-	-
Change of Debts	-	-	-	-	-
Dividend paid	(161)	(181)	(181)	(77)	(211)
Others	(50)	(34)	-	-	-
Net cash from financing	**(518)**	**(480)**	**2,039**	**(77)**	**(211)**
Net change in cash	**263**	**(205)**	**2,840**	**871**	**833**
Beginning cash balance	1,059	1,266	1,046	3,886	4,756
Exchange difference	(56)	(15)	-	-	-
Cash at the end of the year	**1,266**	**1,046**	**3,886**	**4,756**	**5,590**

Balance sheet

YE 31 Dec (USD mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	**2,658**	**4,691**	**4,637**	**4,695**	**4,808**
Fixed asset	1,615	1,594	1,615	1,710	1,832
Intangible assets & goodwill	116	94	75	64	54
Prepaid lease payments	-	-	-	-	-
Interest in asso. & JV	81	89	89	89	89
Others	846	2,914	2,858	2,832	2,833
Current assets	**1,952**	**2,259**	**5,027**	**6,006**	**6,906**
Cash and cash equivalents	1,266	1,046	3,886	4,756	5,590
Inventories	307	380	317	381	419
Trade and other receivables	80	88	89	108	120
Prepayments	177	134	124	150	167
Others	122	611	611	611	611
Current liabilities	**1,253**	**1,736**	**1,652**	**1,850**	**1,974**
Borrowings	-	-	-	-	-
Trade payables	619	623	571	686	754
Accruals & other payables	369	437	405	489	544
Tax payables	54	45	45	45	45
Others	211	631	631	631	631
Non-current liabilities	**380**	**2,039**	**2,039**	**2,039**	**2,039**
Borrowings	-	-	-	-	-
Deferred income	144	-	-	-	-
Deferred tax	136	136	136	136	136
Others	100	1,903	1,903	1,903	1,903
Minority Interest	**-**	**-**	**-**	**-**	**-**
Total net assets	**2,977**	**3,175**	**5,973**	**6,811**	**7,701**
Shareholders' equity	**2,977**	**3,175**	**5,973**	**6,811**	**7,701**

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Company sales	90.7	90.3	89.9	89.9	89.9
Franchise fees and income	1.7	1.7	1.8	1.9	1.9
Fran. & uncol. affiliates sales	7.2	7.5	7.6	7.7	7.7
Other revenues	0.5	0.6	0.6	0.6	0.6
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
P&L ratios (%)					
Gross margin	72.4	71.8	71.5	71.7	72.0
Operating margin	11.2	10.3	11.3	11.1	12.2
Pre-tax margin	11.3	11.4	12.7	12.6	13.5
Net margin	8.4	8.1	9.0	8.9	9.7
Effective tax rate	22.5	25.9	26.5	26.0	25.5
Balance sheet ratios					
Current ratio (x)	1.6	1.3	3.0	3.2	3.5
Quick ratio (x)	1.3	1.1	2.9	3.0	3.3
Cash ratio (x)	1.0	0.6	2.4	2.6	2.8
Inventory turnover days	47	51	50	50	50
Trade receivables days	3	3	4	4	4
Trade payables days	82	91	90	90	90
Total debt / total equity ratio (%)	-	-	-	-	-
Net debt / equity ratio (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Returns (%)					
ROE	23.8	22.5	12.2	12.9	13.7
ROA	15.4	10.3	7.5	8.2	9.0
Per share					
EPS (USD)	1.79	1.84	1.76	2.02	2.41
DPS (USD)	0.44	0.48	0.19	0.50	0.60
BVPS (USD)	7.85	8.44	14.30	16.21	18.22

Source: Company data, CMBIS estimates

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