



Rating
Buy

Asia
China

Consumer
Food & Beverage

Company
Yum China

Reuters
YUMC.N

Bloomberg
YUMC US

Exchange
NYS

Ticker
YUMC

Date
24 February 2017

Initiation of Coverage

Price at 22 Feb 2017 (USD)	26.77
Price target - 12mth (USD)	31.48
52-week range (USD)	29.98 - 24.24
HANG SENG INDEX	24,202

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East meets West - a match of brand and taste: initiating with a Buy

Target price of USD31.48 implies total return potential of 17%

As an early mover, Yum China (YUMC) has strong brand equity in China. Continuous investments in penetration, store efficiency and menu should ensure YUMC will likely improve its asset turn and stay relevant to Chinese consumers (with fast-changing preferences). Investors should be rewarded with steady EPS growth of 8% backed by strong operating cashflow growth at an 11% CAGR for 16-19F. We initiate coverage with a Buy.

Penetration, store efficiency and right menu drive sales growth and scale

With a favorable macro environment combined with the low penetration (urbanization and infrastructure developments) of five KFC stores per million people in China vs. 25 in HK, 37 in Australia and 57 in the U.S, we expect YUMC to continue to deliver attractive returns in the next couple of years. As the largest fast food chain in China, YUMC's continuous remodeling effort and expansion into lower-tier cities will likely allow the group to deliver 4% store growth and 3% SSSg p.a. for KFC (70% of sales and 82% earnings in 2017).

Steady EPS growth backed by strong cashflow

We expect a three-year EPS CAGR of 8% for FY16-19 (fully diluted). This is backed by an operating profit CAGR of 12% on a sales CAGR of 4% for the same period, factoring in a 3.0% RMB depreciation in 2017. System sales for the period are around 6% p.a. in LCY. Given the strong cashflow, we expect YUMC to return part of it to investors via a dividend payout and continuous share buyback (USD300m share buy-back program was announced in Feb17).

Our target price of USD31.48 offers 17% upside potential

Our primary valuation methodology is DCF, employing a COE of 9.2%, beta of 0.95 and a terminal growth rate of 2%. This produces a fair value estimate of USD31.48/share, implying a 17/18E PE of 24x/22x. Key downside risks are intense competition, consumer preference changes, failure to pass on cost increases and failure in optimizing its store portfolio.

Price/price relative



Performance (%)	1m	3m	12m
Absolute	2.8	-10.7	-
HANG SENG INDEX	5.8	6.7	24.3

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
EBITDA (USDm)	857.0	988.0	1,105.6	1,174.0	1,250.0
Reported NPAT (USDm)	323.0	502.0	530.3	581.6	642.9
DB EPS FD (USD)	0.89	1.27	1.31	1.45	1.62
DB EPS growth (%)	-	42.7	3.2	10.6	11.5
PER (x)	-	21.0	20.4	18.5	16.6
EV/EBITDA (x)	-	9.0	8.4	7.7	6.9
Yield (net) (%)	-	0.0	1.3	1.7	1.9

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items

² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close



Model updated: 23 February 2017

Fiscal year end 31-Dec

2015 2016 2017E 2018E 2019E

Running the numbers

Asia

China

Food & Beverage

Yum China

Reuters: YUMC.N

Bloomberg: YUMC US

Buy

Price (22 Feb 17) USD 26.77

Target Price USD 31.48

52 Week range USD 24.24 - 29.98

Market Cap (m) EURm 10,048
USDm 10,584

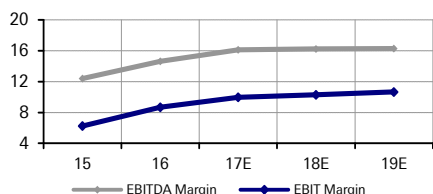
Company Profile

The company is a subsidiary of Yum! Brands (YUM.N) and holds the franchise for Yum! Brands in China.

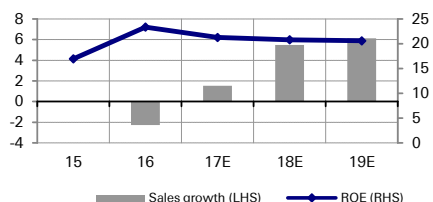
Price Performance



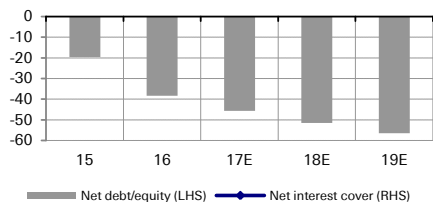
Margin Trends



Growth & Profitability



Solvency



Financial Summary

DB EPS (USD)	0.89	1.27	1.31	1.45	1.62
Reported EPS (USD)	0.89	1.27	1.31	1.45	1.62
DPS (USD)	0.00	0.00	0.34	0.45	0.50
BVPS (USD)	5.3	6.0	6.8	7.7	8.7
Weighted average shares (m)	363	369	393	389	385
Average market cap (USDm)	na	9,854	10,584	10,584	10,584
Enterprise value (USDm)	na	8,918	9,328	9,002	8,642

Valuation Metrics

P/E (DB) (x)	na	21.0	20.4	18.5	16.6
P/E (Reported) (x)	na	21.0	20.4	18.5	16.6
P/BV (x)	0.00	4.34	3.92	3.48	3.08
FCF Yield (%)	na	4.8	4.9	5.7	6.3
Dividend Yield (%)	na	0.0	1.3	1.7	1.9
EV/Sales (x)	nm	1.3	1.4	1.2	1.1
EV/EBITDA (x)	nm	9.0	8.4	7.7	6.9
EV/EBIT (x)	nm	15.2	13.6	12.1	10.6

Income Statement (USDm)

Sales revenue	6,909	6,752	6,856	7,232	7,674
Gross profit	4,750	4,833	5,024	5,304	5,639
EBITDA	857	988	1,106	1,174	1,250
Depreciation	425	402	422	430	432
Amortisation	0	0	0	0	0
EBIT	432	586	684	744	818
Net interest income/(expense)	8	11	11	15	18
Associates/affiliates	41	54	60	69	80
Exceptionals/extraordinaries	15	21	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0
Profit before tax	496	672	755	828	916
Income tax expense	168	158	211	232	256
Minorities	5	12	13	15	16
Other post-tax income/(expense)	0	0	0	0	0
Net profit	323	502	530	582	643
DB adjustments (including dilution)	0	0	7	7	7
DB Net profit	323	502	537	588	650

Cash Flow (USDm)

Cash flow from operations	922	905	924	996	1,058
Net Capex	-512	-436	-405	-406	-410
Free cash flow	410	469	519	590	648
Equity raised/(bought back)	0	460	-100	-100	-100
Dividends paid	-214	-357	-99	-164	-188
Net inc/(dec) in borrowings	0	-6	0	0	0
Other investing/financing cash flows	-9	-27	0	0	0
Net cash flow	187	539	320	326	360
Change in working capital	127	18	10	35	41

Balance Sheet (USDm)

Cash and other liquid assets	425	964	1,284	1,610	1,969
Tangible fixed assets	2,033	1,814	1,797	1,774	1,751
Goodwill/intangible assets	0	0	0	0	0
Associates/investments	253	325	385	455	534
Other assets	490	624	629	648	671
Total assets	3,201	3,727	4,096	4,486	4,926
Interest bearing debt	34	28	28	28	28
Other liabilities	1,182	1,256	1,313	1,382	1,455
Total liabilities	1,216	1,284	1,341	1,410	1,483
Shareholders' equity	1,921	2,377	2,675	2,982	3,332
Minorities	64	66	79	94	111
Total shareholders' equity	1,985	2,443	2,754	3,076	3,442
Net debt	-391	-936	-1,256	-1,582	-1,941

Key Company Metrics

Sales growth (%)	nm	-2.3	1.5	5.5	6.1
DB EPS growth (%)	na	42.7	3.2	10.6	11.5
EBITDA Margin (%)	12.4	14.6	16.1	16.2	16.3
EBIT Margin (%)	6.3	8.7	10.0	10.3	10.7
Payout ratio (%)	0.0	0.0	25.1	30.2	30.2
ROE (%)	17.0	23.4	21.3	20.8	20.6
Capex/sales (%)	7.4	6.5	5.9	5.6	5.3
Capex/depreciation (x)	1.2	1.1	1.0	0.9	0.9
Net debt/equity (%)	-19.7	-38.3	-45.6	-51.4	-56.4
Net interest cover (x)	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates

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Investment thesis

Outlook

YUMC's continuous expansion into lower-tier cities (>50% of new stores DBe) and remodeling effort (75% of stores are less than five years old) should allow the largest fast food chain in China to deliver 4% store growth and 3% SSSg p.a. for KFC (70% of sales and 82% earnings in 2017).

With its ability to embrace technology and economy of scale, improvement in asset turn should help lower cost ratio to sales. Together with VAT reform benefit, we expect the restaurant margin to improve to 16.8% by 2019F from 15.3% in 2015. Operating profit should report a CAGR of 12% on a sales CAGR of 4.4%. This factors in RMB depreciation of 3% in 2017F based on the weighted average of the current rate.

Given the strong cashflow, we expect YUMC to return part of the cashflow to investors via a dividend payout of 25-30%, along with continuous share buyback (USD300m program was announced in Feb 17). We expect the company to continue to accumulate net cash, which could offer acquisition flexibility should the opportunity arise.

Valuation

Our primary valuation methodology is DCF. As YUMC's business is 100% from China, we use the China COE provided by Deutsche Bank's Economics Team. We use beta of 0.95x (same beta as YUM). The company COE is 9.2%. We use a long-term growth rate of 2%. This is at the high end of the 0-2% range that we apply for the consumer sector, as we believe there is still potential for increase in penetration.

We also look at trading multiples PE and EV/EBITDA in the China/HK consumer sector and regional/global QSR sectors, which we believe support our target price when taking into account its leading position in China, sustainability of the business and the steady EPS growth of 8% that we expect YUMC to deliver.

Our DCF-based target price is USD31.48. This translates into 24/22x CY17/18 PE. Our target price offers 17% total return potential.

Risks

Key downside risks are: 1) Intense competition, 2) Consumer preference changes, 3) Negative news or publicity (food safety issue and Sino US tension), 4) Failure to pass on cost increase, 5) Failure to optimize its store portfolio and 6) RMB depreciation and repatriation of cash outside of China.



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Valuation

Western brand with Chinese flavor that spin cashflow

We expect Yum China to deliver EPS growth of 3/11/12% for 2017/18/19F on

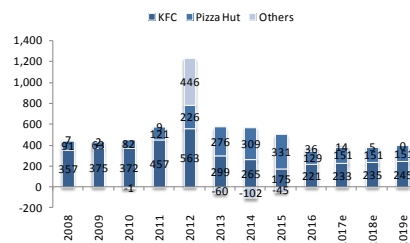
- NP growth of 6/10/11% for 2017/18/19F backed by
- Average unit growth of 4/4/4% for KFC and 8/7/6% for Pizza Hut
- SSSg of 3/3/3% for KFC and -4/-2/1% for Pizza Hut
- Operating profit growth of 16/9/10% on restaurant margin of ~17%.
- We expect the company to buyback 4m shares a year at USD25 per share (DBe) from its USD 300m share buyback program, given strong cashflow of 550-650m in 2017-19F.

KEY GROWTH DRIVERS

- Favorable macro environment** where penetration remains low with five stores per million people vs. 25 in HK, 37 in Australia and 57 for the US (for all YUMC brands, Figure 2). KFC will likely be able to find locations in the shopping malls and transportation hubs, due to government's urbanization target and five-year plan on an infrastructure project. YUMC's self own model also offers better flexibility in a changing environment (e.g. store size is ~40sm smaller for new units in 2016 for better efficiency and coffee machines were upgraded in selected stores for consumers' trading up and better experience).
- Its iconic products and new innovations (including localized offering) should help drive SSS.** YUMC launched ~150-200 new products in 2016 (DBe), which, together with a powerful marketing campaign, creates newness to consumers. An example of this is its recent success in Cremia (a USD4+ soft ice-cream).
- In addition, **the ability to embrace technology** allows the company to increase sales from delivery services (targeting 25% for the group in the long term from 10% of company sales in 2016), data analysis for CRM (60m KFC WOW members and 20 PH members), improve productivity apps that offer ordering (20m Super Apps downloaded) and mobile payment (17% of company sales in 2016 with 35% of sales in Dec 16). The sheer size of YUMC will allow economy of scale.

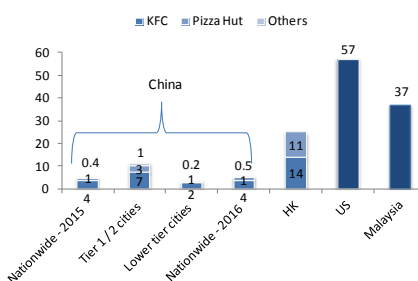
QSR is a scaled business. Although competitors (big and small) emerge at times, key long-term players tend to gain share over time and have a cost advantage. Recent VAT reform also benefits bigger chain players like YUMC, which source from large and reliable suppliers with VAT invoices.

Figure 1: Net increase of store number by KFC/PH/others (2008-2019e)



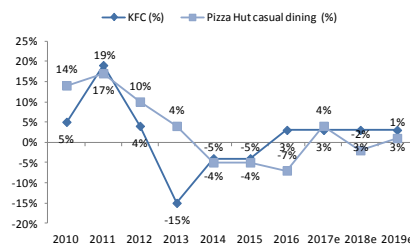
Source: Deutsche Bank estimates, company data

Figure 2: No. of stores per million people by market – room for growth in tier 1/2 cities



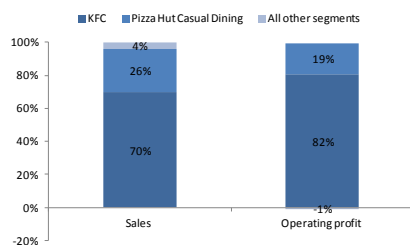
Source: Deutsche Bank estimates, company data
 Note: HK penetration breakdown by brand is based on store mix available from its company website

Figure 3: Annual SSSg trend for KFC and PH (2013-2019e)



Source: Deutsche Bank estimates, company data

Figure 4: Sales and earnings mix (2017F)



Source: Deutsche Bank estimates
 Note: operating profit is before unallocated cost



Strong FCF allows share buyback, potential for increasing dividend payout and acquisition flexibility

As QSR is a cashflow business, we expect YUMC, as an efficient player, to generate strong free cashflow of ~USD500-650m p.a. in 2017-2019F. We believe such capital offers flexibility for the company should there be any acquisitions opportunities (e.g., upstream investment, real estate network or investments in technology). In addition, the company announced a USD300m share buyback program in Feb 17. We expect management to buy back 4m shares a year at USD25/share, based on YUMC's share price of USD26.19 on its debut and the placement price of USD25.05/share to Primavera and Ant Financials. Based on YUMC's track record, we expect share buyback to be an on-going exercise.

Although there is an issue with repatriating to the US cashflow generated in China for dividend payment and share buyback, we believe the company will announce a dividend given its strong cashflow. In our model, we assume a payout of 25-30% for the next few years, and see potential for the payout to increase. For reference, YUM's dividend payout was 46% in 2016 (vs. 8% in 2004, Figure 6). For QSR, like CDC (341.HK Buy, HKD 26.30), the ordinary payout increased over time to 75%+ (from ~40% in 1993), with a special dividend every 2-3 years if there is strong cashflow.

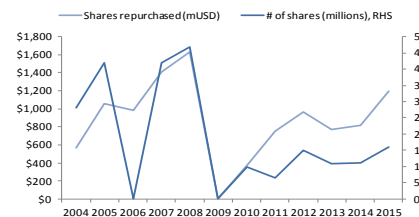
What drives SSS growth and what are the datapoints we can use as reference?

In our view, SSSg/sales growth is one of the key share price drivers for consumer companies, as it shows the health of the operation and the return.

- SSS for QSRs are related to CPI** (as seen in YUMC and CDC's case) (Figure 7/Figure 8/Figure 9/Figure 10) as brands tend to pass on the food price increase. DB expects CPI to pick up at 2.5/2.6% in FY17/18 and YUMC management expects a run rate of 3% commodity inflation, which should help drive SSS, especially ASP. Together with unit growth, we expect system sales growth of ~6% in LCY for YUMC.

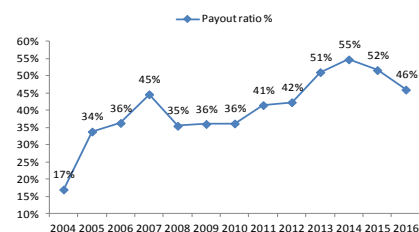
China's CPI is released on a monthly basis in the middle of each month. This might be one of the data points for the SSS trend.

Figure 5: YUM's share buyback history



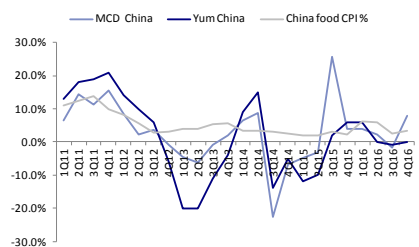
Source: Deutsche Bank, company data

Figure 6: YUM's dividend payout trend



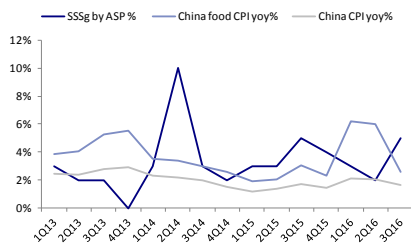
Source: Deutsche Bank, company data

Figure 7: MCD's China SSS vs. CPI and food CPI



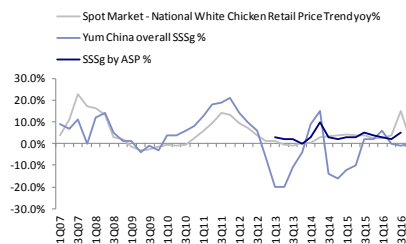
Source: Deutsche Bank, company data, NBS
 Note MCD covers 400+ cities vs. YUMC's 1,100 cities

Figure 8: YUMC's ASP vs. China overall CPI/food CPI



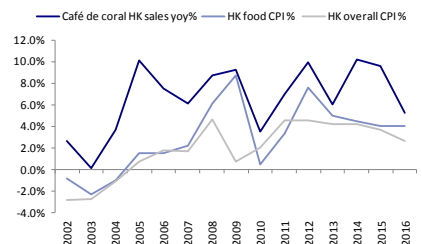
Source: Deutsche Bank, company data, NBS

Figure 9: YUMC's SSSg/ASP percentage vs. white chicken retail price yoy percentage



Source: Deutsche Bank, company data, MOFCOM

Figure 10: CDC's sales vs. HK overall/food CPI



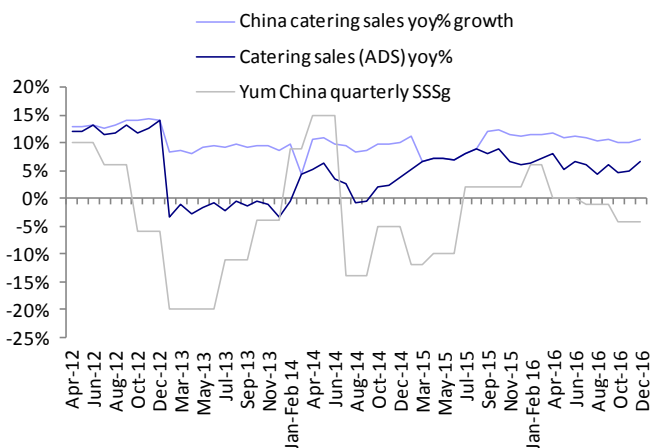
Source: Deutsche Bank, Company data, Census and Statistics Department

- YUMC's overall sales are correlated with the government's catering sales data** as YUMC accounts for 6%/2% of the market share in ADS restaurants and the whole catering market in China, respectively. The Chinese



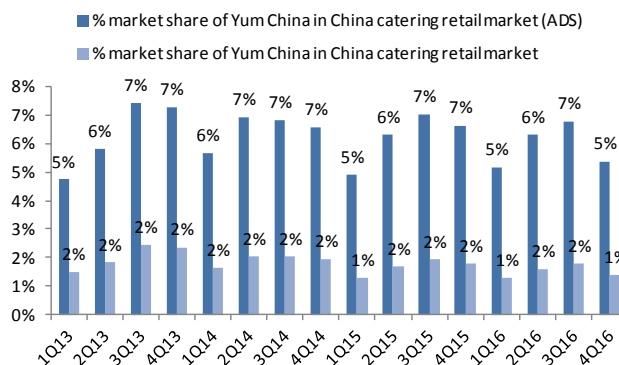
government releases monthly catering sales data (total catering business retail sales and above-designated-size [ADS] catering retail sales) in the middle of each month (Figure 11/Figure 12).

Figure 11: Catering sales vs. overall sales of YUMC



Source: Deutsche Bank, NBS, company data

Figure 12: Market share of YUMC over total china catering market/ADS catering market



Source: Deutsche Bank, Euromonitor
 Note: ADS means above-designated-size company

3) Peer's SSSg can serve as a reference too, although McDonald's (MCD) coverage is 50% less than Yum's (400+ cities for MCD vs. 1,100+ cities for YUMC). Share price of YUMC moved by 3% (S&P -4%) the day MCD announced its 4Q16 results with 7.9% SSSg in China on 23 Jan 17, ahead of YUMC announcing on 8 Feb. While SSS performance of the two might not be the same each quarter, in the longer term there is a correlation between them.

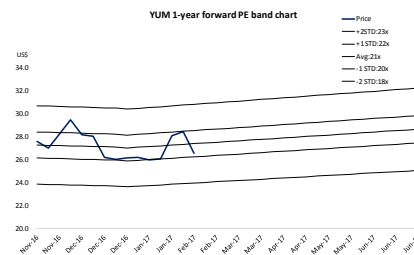
Relationship between Yums and Yum China

Deutsche Bank's US Restaurant Analyst Brett Levy recognized YUM! Brands' (YUM, Hold-rated) successful separation of the YUM China division into a separately traded company, resulting in the formation of YUM's largest franchisee. Post the October 2016 transaction, this move created two distinct companies: YUM! Brands, the highly franchised restaurant company and YUM China an operating/growth story.

YUM! Brands is now turning its focus to supporting a growing franchise base through sales driving initiatives and by aiding unit expansion, while also returning capital to shareholders. YUM! Brands' recent commentary during its conference calls and investor meetings has included a relatively straight-forward plan for what a company, post its control of the China operations looks like (by providing 2019 targets, including top-line, G&A and EPS on the operating side and its ownership mix, CAPEX and shareholder returns on the capital side).

DB does not expect this pathway to be linear and believes management's recent commentary echoes the same sentiment, pointing to near-term obstacles and headwinds that could serve as potential drags on 2017 operating profit growth (versus its LT model. including softer-than-hoped for Pizza Hut results, the timing of re-franchising efforts, a corresponding mismatch of G&A reductions as an offset, F/X pressure and the negative comparisons related to the extra week in 2016).

Figure 13: One-year forward PE band



Source: Deutsche Bank, Bloomberg Finance LP



Mr. Levy continues to rate YUM shares Hold with a valuation based on an ~15x NTM EV/EBITDA (which implies ~23x P/E). The target multiple reflects improving results across the domestic and international business segments following the company's recap and its move to an asset lighter/franchise heavy model and positions its shares within the mid-point valuation range for similarly franchised restaurant models.

We believe YUM's current valuation reflects ongoing challenges and risks across its growth markets (including China) and offers a fair value until the company is able to regain its consistent EPS growth algorithm. We believe it also reflects a balance of the improvements (capital and operational) and ongoing challenges (across its segments), thus resulting in a fair value for the shares.

DCF –based target price of USD31.48, initiating with a Buy

Implying a FY17/18E PE of 24/22x and EV/EBITDA of 10/9x; offering 17% total return potential

Our primary valuation methodology is DCF, employing a COE of 9.2%, beta of 0.95 and terminal growth rate of 2.0%. This produces a fair value estimate of USD31.48/share, implying a FY17/18E PE of 24/22x. Our target price offers 17% total return potential.

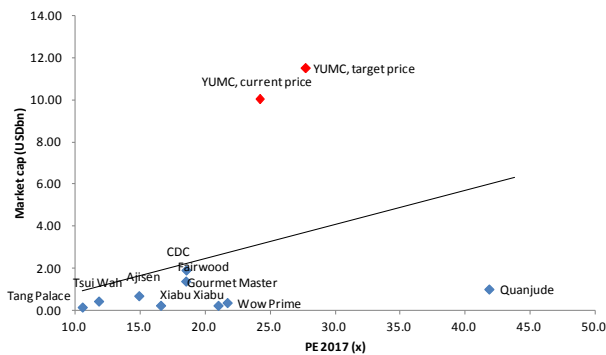
Figure 14: DCF sensitivity analysis

ENTITY VALUE AND CLAIMS (USDm)						ASSUMED WEIGHTED AVERAGE COST OF FUNDS							
Explicit Forecasts			4,541			Risk Free Rate					3.9%		
Terminal Valuation			5,654			Equity Beta					0.95		
ADD : Other Investments			1,039			Equity RP					5.6%		
ADD : Net Cash			1,256			Cost of Equity					9.2%		
LESS : Minorities			44			WACC					9.2%		
Total Value to Equity Claims			12,445		1.000	Nominal Long run growth					2.0%		
Current No. Shares			395										
Equity Value per share (USD)			31.48										
DCF Sensitivity Analysis on EV (USD)						DCF Sensitivity Analysis on CY17F PE (x)							
		Long run growth							Long run growth				
WACC		0.0%	1.0%	2.0%	3.0%	4.0%	WABC	0.0%	1.0%	2.0%	3.0%	4.0%	
7.2%		35.65	38.68	41.91	49.07	59.11	7.2%	26.58	28.84	31.24	36.59	44.07	
8.2%		31.62	33.74	35.79	40.42	46.13	8.2%	23.6	25.2	26.7	30.1	34.4	
9.2%		28.49	30.03	31.48	34.57	38.15	9.2%	21.24	22.39	23.47	25.77	28.44	
10.2%		26.00	27.14	28.08	30.37	32.76	10.2%	19.4	20.2	20.9	22.6	24.4	
11.2%		23.97	24.84	25.50	27.20	28.87	11.2%	17.9	18.5	19.0	20.3	21.5	

Source: Deutsche Bank

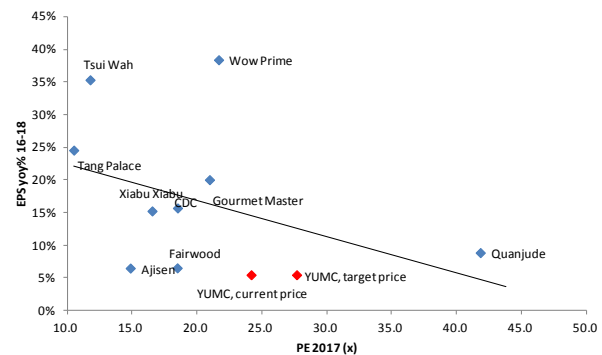


Figure 15: PEG vs. market cap comparison with peers



Source: Deutsche Bank, Bloomberg Finance LP consensus estimates

Figure 16: PEG vs. two-year EPS CAGR comparison with peers



Source: Deutsche Bank, Bloomberg Finance LP, closing price as of 15 Feb 17
 Note: CDC, Tsui Wah and YUMC are based on Deutsche Bank estimates, others are market consensus

We also look at trading multiples in the China/HK regional and international restaurant sectors and global restaurant, which we believe support our target price. When taking into account its leading position in China, sustainability of the business and the steady EPS growth of 6%, we expect YUMC to deliver.

The following are the observations:

- In Asia, leaders in the segment tend to have higher PE multiples (e.g. CDC in HK is trading at 23x FY18 PE vs. average of 20x, Jolibee in the Philippines and Jubilant in India are trading at 44x/33x FY18PE vs. market average of 28x).
- In the US, it seems that it is less obvious and mid-size players with a niche offer to consumers (like Domino's, Shake Shack, Panera Bread, etc.) tend to trade higher PE multiples.
- That said, for all markets, QSR tends to trade at a higher PE multiple than non-QSR/full-service restaurants, due to its stable and more predictable income stream.

2016 results review and key company guidance for 2017

Share price fell by 6% (S&P +0.6%) for two days after YUMC's 2016 results announcement on 7 Feb after market close, despite operating profit being 9% higher than USD600m guidance. We believe this could have been because market and investors had a higher expectation of SSSg.

For key guidance on 2017, management guided for a double-digit increase in operating profit from new store growth, SSSg and VAT reform, but offset by a high single-digit increase in G&A as a separately listed company.

Our 2017/18/19 EPS forecasts are -3/5/5% vs. consensus

However, our NP forecast is 2/2/4% vs. consensus forecasts for the same periods. We believe the key difference is our assumption on margin improvement. With ~3% SSSg and VAT reform benefits for KFC for the next three years, we believe the company could see better economy of scale. Our EPS is lower as we believe that, while we assume 4m shares of buyback each year, our forecast also includes the 16m warrants to Primavera and Ant Financials.



Figure 17: Deutsche Bank forecast vs. market forecast

YE Feb RMBm	DB forecast			Market consensus			Difference vs Market consensus		
	2017F	2018F	2019F	2017F	2018F	2019F	2017F	2018F	2019F
Sales	6,856	7,232	7,674	6,965	7,400	7,777	-1.6%	-2.3%	-1.3%
EBIT	684	744	818	711	782	840	-3.9%	-4.8%	-2.7%
Op profit	744	814	897	718	795	858	3.6%	2.3%	4.6%
Net profit	530	582	643	521	569	619	1.7%	2.3%	3.9%
EPS	1.31	1.45	1.62	1.35	1.52	1.70	-2.9%	-4.6%	-5.1%

Source: Deutsche Bank estimates
Note - fully diluted shares are 410m, 406m and 402m for 2017/18/19 respectively

Figure 18: Peer comparison (Greater China)

Company	Recom	Target (12 mth) Price	Local price	Mkt Cap (USD)	Rpt. Ccy	Fiscal YE	PE		PB		Dividend yield		ROE		EV/EBITDA		Payout ratio (%)		Net Debt/Share Equity		EPS yoy%		EPS 2-year CAGR %	
							2017	2018	2017	2018	2017	2018	2017	2018	2015	2016	2017	2018	2017	2018	2016	2015-2018	2017	2016-2019
QSR																								
Yum China	Buy	31.3	26.8	10,048.0	USD	Dec	20.4	18.5	3.9	3.5	1.3	1.7	21.3	20.8	8.4	7.7	-	-	(45.6)	(51.4)	42.7%	6.9%		
Cafe de Coral	Buy	28.9	26.3	1,914.7	HKD	Mar	22.0	18.5	4.7	4.4	3.6	4.2	22.7	24.6	10.0	8.8	77.0	77.0	(37.1)	(45.6)	-12.2%	15.6%		
Tsui Wah	Hold	1.4	1.3	229.9	HKD	Mar	13.9	11.8	1.4	1.3	5.3	6.4	11.2	12.5	4.4	3.4	70.0	70.0	(49.8)	(55.3)	-54.7%	35.3%		
Gourmet Master	NR	na	288.0	1,386.1	TWD	Dec	25.3	21.0	5.2	5.2	1.6	2.0	22.0	21.7	9.5	8.0	31.0	na	(2.7)	na	768.6%	20.0%		
Fairwood	NR	na	29.3	480.1	HKD	Mar	18.5	18.5	5.5	5.5	4.2	4.7	30.2	30.3	8.6	7.8	88.4	na	na	na	158.6%	6.5%		
Hop Hing	NR	na	0.2	232.3	HKD	Dec	na	na	4.1	4.1	na	na	na	na	na	na	38.3	na	na	na	0.7%	na		
Average							20.0	17.6	4.1	4.0	3.2	3.8	21.5	22.0	8.2	7.1	50.8	49.0	(33.8)	(50.8)	150.6%	16.8%		
Casual dining																								
Xiabu Xiaibu	NR	na	5.0	689.1	CNY	Dec	19.3	16.5	2.5	2.2	2.5	2.7	18.1	18.1	6.3	6.0	40.0	na	(2.5)	na	24.8%	15.2%		
Aijisen	NR	na	3.1	434.6	HKD	Dec	15.2	14.9	0.9	0.9	5.5	5.7	6.0	6.3	5.2	4.9	85.1	na	(4.0)	na	20.8%	6.4%		
Tang Palace	NR	na	2.7	149.6	CNY	Dec	13.7	10.5	2.7	2.7	7.4	8.3	24.2	27.3	3.8	3.2	79.9	na	(1.9)	na	11.5%	24.5%		
Future brights	NR	na	0.7	66.2	HKD	Dec	na	na	0.5	0.5	na	na	na	na	na	na	na	na	na	na	-6.6%	na		
Average							16.0	14.0	1.6	1.6	5.1	5.6	16.1	17.2	5.1	4.7	68.3	na	(2.8)	na	na	-6.6%	15.4%	
Full-service restaurants																								
Wow prime	NR	na	145.0	362.6	TWD	12/2015	29.95	21.66	3.20	3.20	6.50	4.79	16.23	12.40	4.81	4.86	221.34	na	8.85	na	45.0%	38.3%		
Xiao nan Guo	NR	na	2.8	181.0	HKD	12/2015	na	na	0.62	0.62	na	na	na	na	na	na	67.69	na	na	na	17.7%	na		
Quanjudu	NR	na	22.5	1,007.0	CNY	12/2015	47.5	41.8	4.8	4.8	na	na	na	na	na	na	51.7	na	na	na	0.4	na		
Average							38.7	31.7	2.9	2.9	6.5	4.8	16.2	12.4	4.8	4.9	113.6	na	8.85	na	na	35.1%	38.3%	

Source: Deutsche Bank, Bloomberg Finance LP, Closing price as of 22 Feb 2017
Note: forecast of non-rated companies are from Bloomberg Finance LP

Figure 19: Peer comparison (regional)

Company	Recom	Target (12 mth) Price	Local price	Mkt Cap (USD)	Rpt. Ccy	Fiscal YE	PE		PB		Dividend yield		ROE		EV/EBITDA		Payout ratio (%)		Debt/Share Equity		EPS yoy%		year CAGR %	
							2017	2018	2017	2018	2017	2018	2017	2018	2015	2016	2017	2018	2016	2015-2018	2017	2016-2019		
Regional - QSR																								
Jollibee Foods Corp	Buy	1400.0	1007.0	978.7	INR	Mar	44.7	31.3	6.8	5.8	0.4	0.6	16.3	20.1	16.6	12.4	20.0	18.7	(5.0)	(18.0)	27.1%	10.0%		
Jubilant Foodworks	Hold	205.0	201.8	4,317.4	PHP	Dec	32.9	29.7	5.2	4.7	1.1	1.7	18.8	18.7	19.2	16.2	35.0	50.0	(15.5)	3.5	-7.4%	13.8%		
Average							38.8	30.5	6.0	5.3	0.8	1.2	17.5	19.4	17.9	14.3	27.5	34.3	(10.2)	(7.3)	9.9%	11.9%		
Regional - non QSR																								
MK Restaurant Group	NR	na	59.5	na	THB	Dec	18.9	17.0	3.4	na	5.0	5.5	18.4	20.3	12.0	11.0	94.1	94.1	(6.0)	(8.5)	6.8%	10.1%		
Skylark	Buy	1800.0	1644.0	2,818.1	JPY	Dec	16.3	15.2	2.3	2.1	2.6	2.7	16.4	15.9	9.0	8.4	41.6	40.8	100.1	85.1	22.1%	6.6%		
Max's Group	Hold	24.6	27.0	419.2	PHP	Dec	32.6	27.7	3.5	3.1	0.5	0.6	12.5	13.2	16.0	13.9	17.3	17.0	49.7	35.7	10.3%	16.4%		
Shakey's Pizza	Buy	14.9	12.1	368.7	PHP	Dec	24.1	20.4	3.4	3.0	-	-	17.1	17.7	14.3	12.3	-	-	61.9	49.6	39.2%	-11.3%		
Average							23.0	20.1	3.2	2.7	2.0	2.2	16.1	16.8	12.8	11.4	38.3	38.0	51.4	40.5	19.6%	5.5%		

Source: Deutsche Bank, Bloomberg Finance LP, Closing price as of 22 Feb 2017
Note: forecast of non-rated companies are from Bloomberg Finance LP



Figure 20: Peer comparison (international)

Company	Recom Target (12 mth) Price	Local price	Mkt Cap (USD)	Rpt. Ccy	Fiscal YE	PE		PB		Dividend yield		ROE		EV/EBITDA		Payout ratio (%)		Net Debt/Share Equity		EPS yoY%		CAGR %	
						2017 2018	2017 2018	2017 2018	2017 2018	2017 2018	2015 2016	2016 2017	2017 2018	2018 2019	2016 2017	2016 2017	2016 2017	2016 2017					
International QSR																							
Domino's	Hold	49.0	55.7	3,819.4	AUD	Jun	33.4	28.6	10.0	8.9	2.2	2.5	32.7	33.9	17.8	15.4	70.0	70.0	58.1	45.6	40.7%	28.2%	
McDonald's	Buy	135.0	127.9	101,096.0	USD	Dec	20.6	19.1	nm	na	3.0	3.3	nm	nm	13.3	13.6	60.9	62.0	nm	nm	14.6%	8.5%	
Panera Bread	Hold	210.0	228.6	5,081.3	USD	Dec	30.7	27.4	13.5	na	-	-	64.0	61.1	12.6	10.9	-	-	125.1	188.1	8.6%	12.0%	
Sonic	Hold	25.0	26.6	1,208.0	USD	Aug	19.6	na	nm	na	-	na	nm	na	11.9	na	-	na	nm	nm	17.3%	2.9%	
YUM! Brands	Hold	65.0	66.1	26,481.9	USD	Dec	24.0	na	na	na	1.9	na	nm	na	16.2	na	47.6	na	nm	nm	10.2%	na	
Chipotle Mexican Grill	Sell	280.0	427.6	11,946.2	USD	Dec	54.5	39.6	8.5	8.0	-	-	16.3	22.4	21.8	16.8	-	-	(6.3)	(6.8)	-91.5%	190.2%	
Zoe's Kitchen	Hold	26.0	22.8	443.2	USD	Dec	168.1	na	na	na	-	na	2.0	na	18.2	na	-	na	20.3	26.0	-5.4%	na	
Starbucks	Hold	59.0	57.6	85,948.9	USD	Sep	23.7	na	18.6	na	2.1	na	68.7	na	13.0	na	51.9	na	(16.8)	(12.7)	20.0%	12.9%	
Autogrill	NR	na	8.2	2,201.9	EUR	Jan	22.4	20.8	3.4	3.4	2.0	2.2	15.3	15.7	6.1	5.7	47.5	na	0.2	na	47.4%	11.1%	
Jack in the Box	NR	na	103.6	3,276.9	USD	Jan	26.3	26.3	na	na	1.8	2.1	na	na	10.8	10.5	32.1	na	0.4	na	3.0%	12.0%	
Papa John's	NR	na	79.6	2,925.8	USD	Feb	31.5	28.2	na	na	1.1	1.1	na	na	15.3	14.1	32.8	na	na	na	29.9%	na	
Popeyes Louisiana Kitchen	NR	na	79.0	1,637.9	USD	Jan	37.5	32.0	195.0	195.0	na	na	na	1,309.3	18.1	16.7	-	-	na	na	20.0%	12.9%	
Shake Shack	NR	na	37.0	1,345.5	USD	Mar	81.2	66.9	9.4	9.4	na	na	12.3	12.4	23.8	19.6	na	na	(0.1)	na	na	na	
Wendy's /Arby's Group	NR	na	13.7	3,518.7	USD	Jan	34.5	34.5	5.0	5.0	2.2	2.7	19.2	na	13.3	12.2	13.1	na	0.7	na	-7.2%	14.8%	
Average							43.4	32.4	32.9	38.3	1.4	1.7	28.8	24.2	15.2	13.6	27.4	26.4	20.2	48.0	8.3%	30.5%	
International non-QSR																							
Bloomin' Brands	Hold	20.0	17.9	1,895.7	USD	Dec	13.5	12.6	4.7	na	1.6	1.9	48.7	40.6	7.1	7.0	21.4	23.0	446.0	304.3	0.4%	8.4%	
Buffalo Wild Wings	Hold	155.0	156.1	2,513.6	USD	Dec	28.2	24.6	21.8	na	-	-	28.8	89.0	9.8	9.2	-	-	30.9	417.1	3.0%	12.0%	
Texas Roadhouse	Hold	45.0	41.9	3,300.2	USD	Dec	25.3	21.8	3.9	na	1.7	1.9	17.5	18.9	11.1	9.8	42.6	40.4	(6.6)	(10.0)	24.1%	13.6%	
Darden Restaurants	Hold	78.0	75.4	9,260.1	USD	May	19.0	17.5	4.2	na	2.8	2.9	25.3	25.8	9.7	8.9	51.9	49.9	8.5	12.7	34.2%	10.3%	
Del Frisco's	Hold	16.0	17.2	400.2	USD	Dec	19.7	na	na	na	-	na	8.1	na	7.4	na	-	na	(6.9)	(8.3)	-0.4%	na	
Fogo de Chao	Hold	14.5	14.4	404.7	USD	Dec	15.3	na	na	na	-	na	8.7	na	8.5	na	-	na	45.3	34.7	22.4%	na	
Ruth's Hospitality Group	Buy	19.0	17.3	547.9	USD	Dec	16.6	15.4	5.1	na	-	-	36.6	34.4	8.6	8.1	-	-	28.1	11.5	11.2%	9.6%	
CBRL Group	NR	na	160.0	3,846.8	USD	Jul	20.7	20.7	7.3	7.3	3.2	3.4	35.5	39.2	9.8	9.3	98.5	na	0.0	na	773.7%	5.6%	
Cheesecake Factory	NR	na	60.1	2,850.5	USD	Jan	21.2	19.7	4.9	4.9	1.7	1.7	24.3	25.4	9.6	9.1	30.8	30.3	na	na	237.1%	9.3%	
DineEquity	NR	na	59.7	1,080.8	USD	Dec	9.9	9.7	4.2	4.2	6.5	6.9	36.6	37.1	9.0	8.9	63.0	na	na	na	576.8%	5.8%	
Ruth's Chris	NR	na	17.3	550.1	USD	Dec	18.2	16.2	7.1	7.1	1.6	1.6	36.6	34.4	9.0	8.6	27.1	28.8	0.0	na	86.0%	7.6%	
Red Robin	NR	na	49.9	641.6	USD	Dec	18.4	17.9	1.8	1.8	na	na	9.7	13.1	6.7	6.3	-	-	na	na	331.9%	15.9%	
Ruby Tuesday	NR	na	1.9	114.5	USD	May	36.1	36.1	0.3	0.3	na	na	na	na	na	na	na	na	na	na	5.2%	na	
Brinker International	NR	na	42.1	2,057.8	USD	Jun	12.0	12.0	(10.9)	(10.9)	3.4	3.7	(39.3)	(48.0)	8.0	7.7	36.9	na	0.7	na	351.4%	7.6%	
Average							19.6	18.7	4.5	2.1	1.9	2.4	21.3	28.2	8.8	8.4	28.6	21.5	54.6	108.9	175.5%	9.6%	

Source: Deutsche Bank, Bloomberg Finance LP, closing price as of 22 Feb 2017
Note: forecast of non-rated companies are from Bloomberg Finance LP

Comparison with peers on operations

There is no sizable QSR listed separately other than YUMC.

McDonald China is part of the global company listed in the US and Dicos is owned by Ting Hsin, Taiwan. We pick CDC (HK's largest QSR with 39% share), Tsui Wah (fast casual dining chain in HK/China) and Xiabu Xiabu (fast casual dining chain in China) and compare its operational performance with YUMC.

Trend in the industry – multi-brand, smaller size format and online delivery

- Smaller stores to weather the storm.** This is because smaller stalls see difficulties in getting a bigger store location in HK/ China. In addition, smaller store size will need a lower breakeven level and thus, can better manage weather market volatility. YUMC commented that the size for new units opened in 2016 was ~40sm less for KFC and PH stores. In HK CDC now seeks 1000-2,000 sf size store vs. 3,000 in the past.
- Catering consumer preference.** Another trend is the multi-format trend, especially for casual dining. This is to cater to consumers' demand for variety. YUMC currently has six brands and in Dec 16, it opened its first Taco Bell in Shanghai. Xiabu Xiabu opened several mid-end hot pot restaurants called Coucou in tier 1 cities and targets different product offerings at different parts of the day.
- Convenience.** Online delivery platforms are consolidating their number of restaurant partners and focusing on the better quality ones. Delivery sales are ~10% for YUMC (of which KFC's mix increased from 7% in 4Q15 to 10% in 4Q16). Online delivery accounts for 10% of Tsui Wah's China sales. Xiabu Xiabu is working with online platform companies to improve the delivery process (as their products need to be kept at low temperatures). All players view delivery as a one of the key drivers for SSS.



When comparing these four companies based on common size, **YUMC's per store sales in China is similar to that of CDC and Xiabu Xiabu** (sales per store is half of YUMC and CDC but size of the store is also 50% smaller). **However, as YUMC is in 1,100 cities** (while CDC's store is mainly in more affluent South China and Xiabu Xiabu's sales is 70% in tier 1 cities), **we view YUMC's sales per store** (50% in tier 1/2 cities and 50% in tier 3/4 cities) **as better than others in terms of productivity.**

GPM and opex ratios for the companies' China operation are similar, except for Xiabu Xiabu. However, Xiabu Xiabu has a restaurant margin of 20% in 2015, which is similar to YUMC (ex 3% license fee).

- We believe that **YUMC's sourcing advantage** is not just having **cheaper sourcing** (which ensures competitive price with good margin) but also the **consistency and quality of the supply**. In addition, YUMC experienced GPM improvement by 2.8ppt, partly due to **VAT reform**. This reform **benefits most key players as they use big suppliers, which produce invoices**. According to Xiabu Xiabu, CDC and Tsui Wah, such a benefit is likely to be **in the range of 2-2.5ppt when fully implemented**. However, as the reform only started in May 16 and needs to be rolled out by provinces, such benefits will gradually kick in, as explained by YUMC and other industry players.
- When comparing the staff cost ratio (one of the two key operating cost items other than rental), it is important to note that YUMC only discloses the staff cost at the store level and shows the restaurant margin. However, for the others, staff costs include headquarters and backend staff. Based on our analysis of company data, we believe **Yum's staff cost ratio is lower than Tsui Wah China by 1-2ppt and its rental ratio is lower than Xiabu Xiabu and Tsui Wah by 1-2 ppt**. Although the ratio is lower, YUMC pays 10-20% better than the market rate at manager level, according to the company.
- **G&A for YUMC and CDC is about 6% but 10% for Xiabu Xiabu**. We believe this reflects the scale effect.

When comparing the four companies' **ROE**, YUMC and CDC have a similar ROE at roughly 20%, YUMC and CDC's ROE is driven by faster sales growth, showing its efficiency in driving sales per store. Xiabu Xiabu as a fast casual dining chain, relies on lower opex ratio to drive EBITM.



Figure 21: SSSg trend for restaurants in China/HK

		2010	2011	2012	2013	2014	1Q15	2Q15	1H15	3Q15	2015	1Q16	2Q16	3Q16	4Q16
Ajsen (HK)	0538.HK	2.8%	5.0%	0.7%	4.3%	-2.7%	2.0%	6.8%	4.3%	4.6%	6.0%	-2.0%	-0.7%	-0.7%	na
Ajsen (China)	0538.HK	8.7%	-6.0%	-12.6%	7.6%	2.3%	-6.0%	-10.1%	-7.8%	-9.2%	-7.5%	-6.1%	-9.6%	-10.8%	na
Café de Coral*	0341.HK	Flat in HK; 5.6% in S.C.; 14% in E.C	6% in HK; 8% in S.C.; 13% in E.C	5% in HK; 1% in S.C	9% in HK; 4% in S.C	mig-to-high single digit in HK; 3% in S.C	na	na	HK: mid-single digit	na	HK: +4% South China: -7%		HK: 5%; Mainland: 1.2%		HK:4%; China 1-2%
Hop Hing	0047.HK	na	na	7.0%	-8.1%	1.1% Yoshinoya: 1.5% DQ -3.2%	-3.8%	na	-3.8% Yoshinoya: -4.0% DQ -1.6%	na	-5.1% Yoshinoya: -5% DQ: -6.2%	-6.7% in HKD -2.2% in RMB	na	4.7%	na
Tsui Wah*	1314.HK	12.5% (HK:12.5%)	12.9% (HK: 12.5%; PRC: 16.2%)	10% (HK:8-10%; 13% in PRC)	5.0%	HK: 1-3%; PRC: 0-2%	na	na	Flat in HK; down 5-7% in China	na	single digit decline		China:2-3% down; HK: 5%		China: flat; HK: 1-2% down
Xiao Nan Guo	3666.HK	13.2%	1.7%	-7.1%	-10.1%	1.0%	5.2%	1.3%	3.7%	-0.2%	positive	-1.4%	-2.8%	na	na
Xiabu Xiabu	0520.HK	na	na				-3.3%		-4.7%		-4.0%	0.6%		3%-4%	na
MCD China	MCD.N	6.3%	12.0%	3.2%	3.0%	negative	-4.8%	-3.0%	na	25.8%	1.8%	4.0%	+2.1%	-1.8%	7.9%
Yum China	YUMC.N	6.0%	19.0%	4.0%	-12.5%	-5.0%	-12.0%	-10.0%	-11.0%	2.0%	-4.0%	6.0%	Even	-1.0%	0.0%

Source: Deutsche Bank, company data

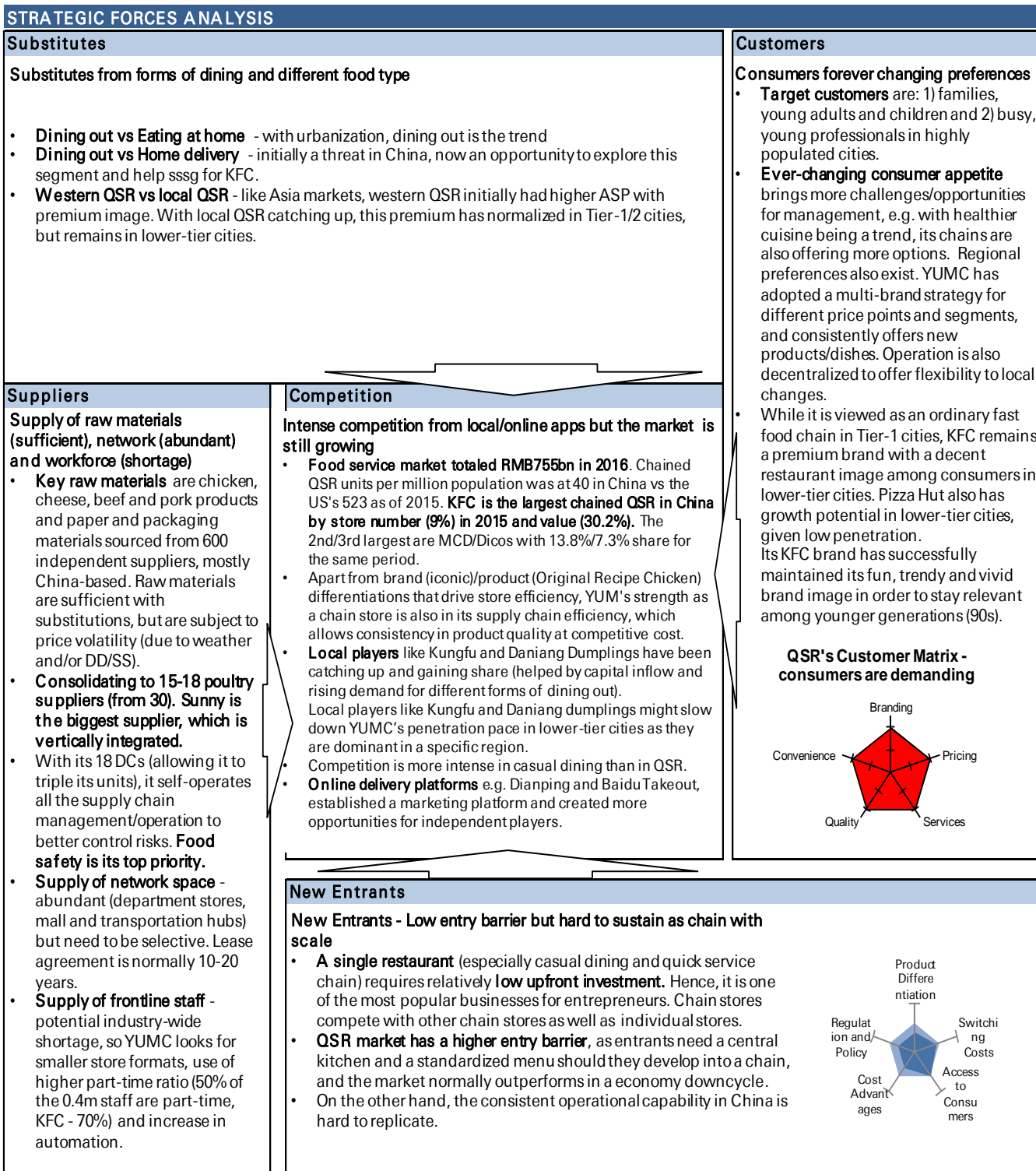
Figure 22: Peer comparison

Company name	Café de Coral		Tsui Wah		Xiabu Xiabu		YUM China	
Period / currency	YE Mar/ HK\$		YE Mar/ HK\$		YE Dec/ RMBm		YE Dec / USDM	
Sales per store	China: HKD9.95m(USD1.28m), HK: HKD23.3m(USD3.0m)		China: HKD25.3m(USD3.3m), HK: HKD40.7m(USD5.2m)		RMB4.39m(USD0.65m)		KFC: USD1.18m, PH: USD1.08m	
ASP	HK - HK\$35; China - RMB30+		HK- HK\$70-80; China RMB70		Xiabu Xiabu - RMB 47; Cou Cou - RMB120-140		KFC - ~RMB 30; Pizza Hut - ~RMB xx.	
Average store size (new units)	HK~ 300sm ; China - bigger than HK		Both HK/China- 300-400sm		Xiabu Xiabu - 100-150sm; Cou Cou - 350-500sm		300sm or less	
Capex per store	HK: 4~5mn HKD; China:2~3mn RMB		both HKD4~5m (in the past 8-10m for bigger store)		Xiabu Xiabu - RMB1.1 ; Cou Cou - RMB4m		USD0.42m	
Revenue	FY16	FY17e	FY16	FY17e	2,015	1H16	2,015	2,016
Common size %	7,567	7,903	1,868	1,966	2,425	1,263	6,909	6,752
Gross profit	68.8%	68.8%	71.3%	70.9%	61.0%	62.9%	68.8%	71.6%
Other income and gains	0.0%	0.0%	0.7%	0.5%	0.3%	1.8%	0.0%	0.0%
Opex	-60.7%	-59.8%	-61.2%	-66.6%	-50.8%	-50.9%	-62.5%	-62.9%
Staff cost	-29.0%	-29.0%	-27.5%	-28.5%	-22.4%	-23.6%	-20.1%	-21.2%
Rental cost	-11.5%	-10.9%	-16.7%	-17.5%	-13.5%	-13.9%	-11.2%	-11.2%
Depreciation	-4.0%	-4.2%	-6.3%	-14.3%	-5.0%	-4.6%	-6.2%	-6.0%
Others	-16.2%	-15.6%	-10.8%	11.1%	-9.9%	-8.8%	-25.1%	-24.5%
EBITDA	12.1%	13.3%	10.1%	11.1%	15.5%	18.3%	12.4%	14.6%
EBIT	8.1%	9.0%	3.8%	4.8%	10.5%	13.7%	6.3%	8.7%
Net Profit	6.8%	7.6%	3.8%	5.2%	10.9%	11.0%	4.7%	7.4%
ROE (Dupont breakdown)	16%	20%	4%	7%	15%		16%	20%
EBIT margin %	8.1%	9%	3.8%	5%	10.5%		6.3%	9%
Asset turnover	1.7	1.8	1.2	1.3	1.2		2.2	1.8
Financial cost ratio %	1.0	1.0	1.1	1.1	1.1		1.1	1.1
Tax burden	0.8	0.8	0.7	0.8	0.8		0.7	0.8
Financial leverage	1.4	1.5	1.3	1.3	1.3		1.6	1.5

Source: Deutsche Bank, company data



Figure 23: Porter's five forces



Source: Deutsche Bank, company data



Figure 24: SWOT analysis

S trength	W eakness
<p>1. Multi-brand strategy to cater to consumers' diverse demands in taste, store experience and price point.</p> <p>2. Market leader in China QSR/casual dining restaurants with 30.2%/24% of market share. It benefits from scale at the back end.</p> <p>3. Vast network with 7500+ stores in 1100+ cities. It is the most penetrated QSR in its coverage.</p> <p>4. Highly educated workforce and long-tenured management team (on average, 15 years of experience) with 420,000 employees in total by end-2016.</p> <p>5. It is also known for success in localizing its menu and new product launch capability (150 new products launched in 2016).</p> <p>6. Strong brand equity (78 years of history for KFC; entered China in 1987) with iconic culture (original 11 herbs and spice recipe chicken).</p> <p>7. Efficient and high-quality supply chain with diverse suppliers (600 suppliers) and distribution (17 DCs).</p>	<p>1. Western QSR has a "junk food" image particularly in Tier-1/2 cities, and consuming healthy food is considered to be more trendy.</p> <p>2. Productivity of old stores, especially in Tier-1 cities, needs improvement.</p> <p>3. Higher labor cost/turnover are industry-wide issues. Chains like KFC work on automation and smaller store formats.</p> <p>4. Negative publicity (food safety issue and Sino US tension) in the past.</p> <p>5. Pizza Hut's sss momentum is yet to pick up amid increasingly intense competition in the China casual dining market.</p>
O pportunities	T hreats
<p>1. Rapidly growing middle class (40% of total population by 2022 from 10% in 2009) and accelerating urbanization (60%/70% by 2020/30 from 56.1% in 2015) indicates significant demand for catering business opportunities. The fast food chain is not yet saturated. Management targets to increase its store number from 7,562 to 20,000 in the long term.</p> <p>2. Development of nationwide transportation hub.</p> <p>3. Younger generation's changing lifestyles, e.g. increasing 'living alone singles', especially in Tier-1 cities, rely heavily on QSR rather than self-cook. Investment by Ant Finance should help YUMC in exploring how digital techniques can cater to consumer demand and preference.</p> <p>4. Online delivery apps have made QSR restaurants more accessible to consumers.</p>	<p>1. Keen competition from local restaurants and new emerging brands. KFC's market share has shrunk from 40% to 30% over the past ten years.</p> <p>2. Operational risks (the need for localization) related to aggressive expansion in lower-tier cities. Higher overheads as a separately listed company.</p> <p>3. Disruption in traffic if there is political tension between China and the US.</p>

Source: Deutsche Bank, company data



Risks and Challenges

Summary

- Intense competition
- Change in consumer preference
- Negative news or publicity (Food safety issue and Sino US tension)
- Failure in optimizing its store portfolio
- Failure in revamping Pizza Hut
- Failure to pass on cost increase
- RMB depreciation and repatriation of cash outside of China

Intense competition

Competition comes from: 1) western QSR/casual dining chain, 2) local QSR/casual dining players (both chains and one store operators) and 3) home delivery apps. When economy slows, investments in the catering business continue, based on our experience in markets like HK. It will likely face risk of higher rental for the new store locations in transportation hubs. Some snack food companies or QSR with central kitchen might turn more aggressive in bidding the site. In addition, dining out/delivery apps are regarded as the next growth segment/business model and attract a lot of investments. Thus, over the past years, the market became more fragmented and market shares of KFC's shrank from 40% in 2006 to 30% in 2015.

We do not believe the decline in market shares is a concern at this stage, because:

- Western QSR (like KFC) is the pioneer of the QSR industry in China but has been viewed as premium food in the past (still the case in lower tier cities). With income growth and more investment in the industry, we expect casual dining and full-service restaurants to take off.
- Overall the catering segment is expected to grow by ~11% in 2017, according to the government. We only expect YUMC to grow by 5-6% in sales (LCY) over the next three years. We therefore expect continuous market share loss. However, we believe that it is appropriate for YUMC not to accelerate its store opening plan for increased market share until the overall economy recovers.

Figure 25: Major competitors

	Yum's brand	Western brands	Local brands	Others	Remarks
QSR	KFC, Taco Bell, East Dawning	MCD, Dicos, Burger King	Kung Fu, Yong he	Delivery Apps Aggregators like Meituan, ele.me, etc. Convenience stores	Less competition on home delivery from 2016
Casual Dining	Pizza Hut, Little Sheep	Domino's Pizza, Papa John's	Quanjudu, Hai di lao	Delivery Apps Aggregators like Meituan, ele.me, etc	na

Source: Deutsche Bank



Change in consumer preference

Chinese consumers, especially in tier 1/2 cities, are becoming more health conscious and might view KFC's fried chicken and Pizza Hut's pizzas as unhealthy. In addition, there are more choices for casual dining than there were ten years ago. Younger consumers prefer home delivery to takeaways resulting in foot traffic at stores.

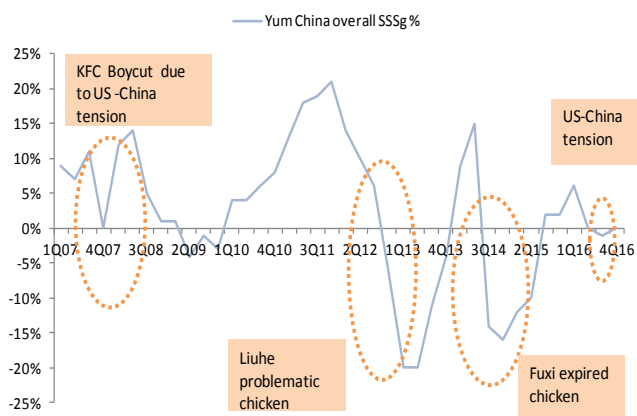
Yum is therefore offering more healthy choices on the menu (e.g. soya milk and green salad) in tier 1 cities. It offers new dishes and an upgraded dining environment at Pizza Hut. Meanwhile, KFC has teamed up with food delivery aggregators and has its own delivery websites/apps to boost delivery sales. In 4Q16, KFC's delivery sales grew 37% yoy to account for 9.9% of total sales vs. 7.2% of total sales in 4Q15. For reference, the whole online food delivery market grew by 62% in 2016.

Negative news or publicity (food safety issue and Sino US tension)

Food safety is always a key risk to all restaurant chains. Quality control along the supply chain is also important, which management has been upgrading all the time. Over the past years, Yum China sales performance has been impacted by food safety issues related to Yum's restaurants/franchises, suppliers/distributors and even competitors. As a US QSR chain, KFC has been affected by Sino US tension as some consumers (especially in lower tier cities) demonstrated outside its stores. While SSS was affected in 3Q16, there is less volatility than in the past (Figure 26). We believe the presence of two strategic investors from the mainland will help the company to better communication with the market.

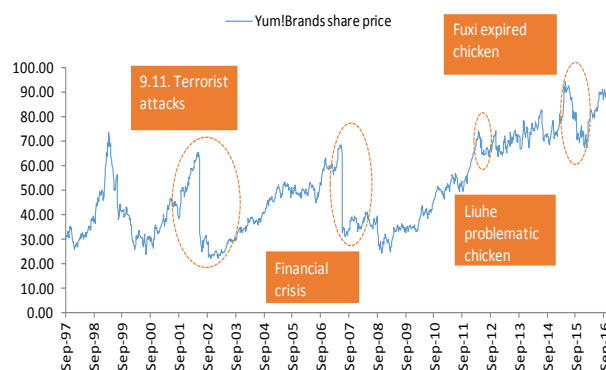
Bird flu also affects the traffic of fried chicken fast food chains. Over the past two months, several H7N9 bird flu infected persons were detected in South of China, particularly in Guangdong (Hunan and Jiangxi). Thus, we believe consumers will reduce their intake of chicken.

Figure 26: SSSg is sensitive to negative news or publicity...



Source: Deutsche Bank, company data

Figure 27: ...same with share price performance



Source: Deutsche Bank, Bloomberg Finance LP Note: share price is unadjusted.



Figure 28: Major incidents that affected Yum China

Time	Incident
2005	KFC is reported to find "Sudan I" from its chicken wings and the company apologized to the public.
2008	A boycott of KFC with protests outside its stores in 11 cities was called after the Chinese blamed Washington for an international tribunal's dismissal of Beijing's maritime claims. (KFC was regarded as a potent symbol of American capitalism.)
2010-2011	Tests conducted by a third-party agency found eight batches from a total of 18 batches of chicken supplied to Yum by Liuhe had antibiotics levels that didn't meet prescribed standards.
Dec 12	Yum admitted that the products from Liuhe's factory were not qualified and announced that it has stopped buying from Liuhe in Aug 12.
Jul 14	Yum apologized to customers on 21 Jul 14 after Chinese regulators closed a local meat supplier following a TV report (about the workers picking up meat from a factory floor and mixing meat beyond expiration date with fresh meat). Yum stated that it immediately stopped using the supplier, Shanghai Husi Food Co Ltd., and require KFC and Pizza Hut to stop using products from Husi. Shanghai Municipal Food and Drug Administration shut Husi down.
Jul 16	KFC stores in China were hit by anti-US protests and boycott after an international court rejected China's claim to historic rights in the South China Sea.

Source: Deutsche Bank, Bloomberg Finance LP, Reuters, Channel News Asia

Failure to optimize its store portfolio for sales growth

Yum targets to open 600+ gross stores a year with ~350-400 in KFC, ~150 in PH and the rest other formats. Meanwhile, it continues to remodel existing stores and develop new formats as foot traffic changes given new CBD areas, residential sites, transportation hubs, etc. In lower tier cities, it seeks a lower capex model to accelerate growth. Failure to optimize its store portfolio (i.e. asset management) will result in sales decline and margin pressure. Every 1% decline in sss at KFC will result in a 4.4% decline in NP (1% = 24m) on our estimates. We estimate that every ten stores less at KFC will result in -0.3% decline in NP (10 stores = 2m), ceteris paribus.

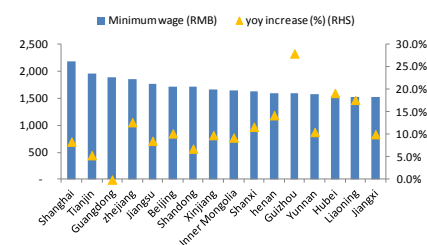
Failure to revamp Pizza Hut

Pizza Hut's performance has been weak with a decline in SSS (especially on volume) for the past three years. Operating profit dropped from USD235m in 2013 to USD155 in 2016. In our view, competition is intense in the casual dining segment, with lots of venture capital investing in this segment. YUMC views the revamp of PH as a major task in 2017 and it is one of the key tasks for Joey Wat, the newly appointed President and COO of YUMC. Ms. Wat will also overlook PH from now on, as well as steering KFC. The market awaits more details on the revamp strategy.

Failure to pass on cost increases; higher overheads post spin-off

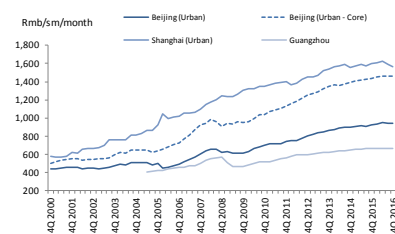
Labor costs as a percentage of sales increased from 16% in 2011 to 21% in 2016 for Yum China. Minimal wages in China have been increasing over the past years and will possibly continue the upward trend within an inflationary economy cycle. As a service-oriented company, labor costs inevitably create more pressure. Rental cost hike has also continuously put pressure on Yum over the past years (Figure 29 and Figure 30). Thus, if YUMC fails to increase ASP and pass the cost hike to consumers, profitability might deteriorate. In addition, we expect higher overhead cost in 2017 (post spin off in Nov 16).

Figure 29: Minimal wages in China (latest update for 2015/2016)



Source: Deutsche Bank, xinhuanet

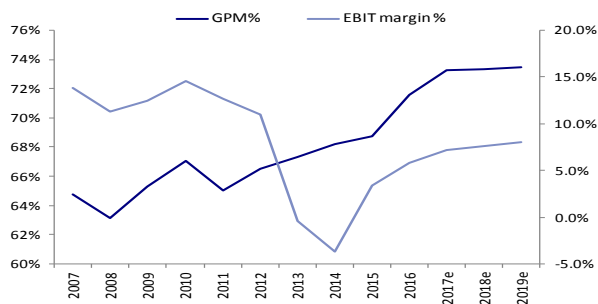
Figure 30: Rental for commercial properties



Source: Deutsche Bank, JLL

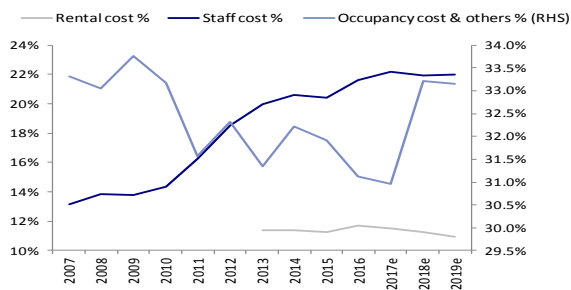


Figure 31: GPM percentage vs. EBIT margin percentage



Source: Deutsche Bank estimates, company data
 Note: EBIT margin in 2007-2012 has been factored in licensing fee to YUM

Figure 32: Cost ratio trend



Source: Deutsche Bank estimates, company data
 Note: Occupancy cost & others % in 2007-2012 has been factored in licensing fee to YUM

RMB depreciation and repatriation of cash outside of China

As the company is reported and quoted in USD, while its functional currency is RMB, RMB depreciation negatively affects reported sales (non cash translation impact). Based on the current rate, we expect a -3/0/0% RMB depreciation impact for 2017/18/19. For reference, the Deutsche Bank economic team expects RMB depreciation of -10/-8.6% for 2017/18. Should we use Deutsche Bank's RMB forecast, our NP would be lowered by 7/15/15% and our target price would be down by 14.6% to USD26.9.

Figure 33: Changes in forecast by using Deutsche Bank RMB forecast

	DB forecast (using DB RMB forecast)			DB forecast (current)			Market consensus			Difference					
	2017F	2018F	2019F	2017F	2018F	2019F	2017F	2018F	2019F	vs DB forecast (current)			vs Market consensus		
YE Feb RMBm										2017F	2018F	2019F	2017F	2018F	2019F
Sales	6,359	6,126	6,500	6,856	7,232	7,674	6,965	7,400	7,777	-7.3%	-15.3%	-15.3%	-8.7%	-17.2%	-16.4%
EBIT	634	631	693	684	744	818	711	782	840	-7.3%	-15.3%	-15.3%	-10.8%	-19.3%	-17.6%
Op profit	690	689	760	744	814	897	718	795	858	-7.3%	-15.3%	-15.3%	-3.9%	-13.4%	-11.4%
Net profit	492	494	545	530	582	643	521	569	619	-7.2%	-15.1%	-15.2%	-5.5%	-13.2%	-11.9%
EPS	1.22	1.23	1.37	1.31	1.45	1.62	1.35	1.52	1.70	-7.1%	-15.0%	-15.1%	-9.8%	-18.9%	-19.4%

Source: Deutsche Bank estimates, Bloomberg Finance LP

As a listed company in the US with all its profit and cash generated from China, any share buyback or dividend payment will require payment of withholding tax if the cash is repatriated back to the US. This should result in a higher effective tax rate (between 25-35%) and impact NP. However, in the short to mid-term, as the company has USD460m cash proceeds from its strategic investors (in USD and outside China), we believe there is no imminent issue.



Committed to growth

Summary – building a sustainable growth model

YUMC 's long-term vision is to remain the leader in the restaurant space by:

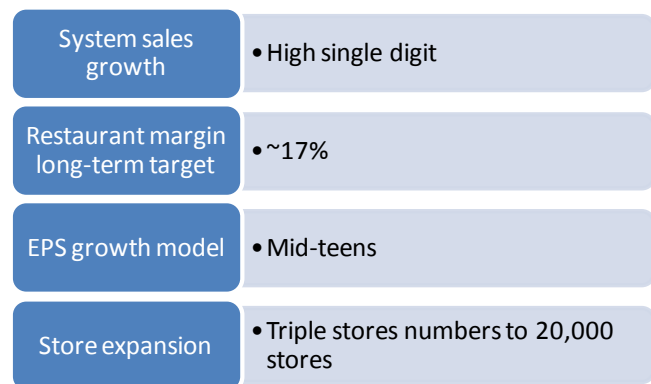
- creating a mid-teens EPS growth business model
- promoting its iconic products and innovations
- maintaining favorable macro development (i.e. CPI and infrastructure build-up)
- being supported by strategic investors who share the same vision

Creating a mid-teens EPS growth business model

Long-term target: ongoing mid-teens EPS growth on HSD system sales growth

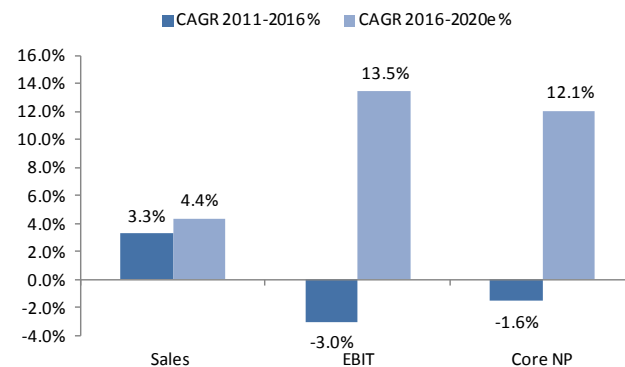
The aim is to achieve this through: network growth (in cities, transportation hubs and malls), SSSg (including delivery) and margin enhancement at the restaurant level and scale level. Based on the penetration ratio in the US, YUMC has the potential to operate 20,000 restaurants in China from the current 7,562. This would likely be achieved by opening new restaurants in fast-growing big cities, transportation hubs, and new shopping centers.

Figure 34: Long-term target



Source: Deutsche Bank, company data
 Note: EBIT margin in 2007-2012 has been factored in licensing fee to YUM

Figure 35: Sales/EBIT/core NP/EPS CAGR, 2011-2016 vs. 2016 – 2020e (change)



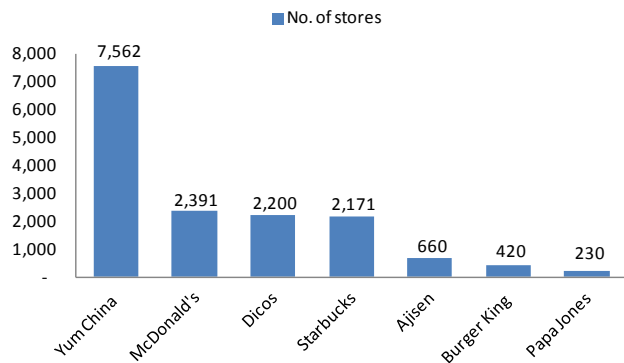
Source: Deutsche Bank estimates, company data
 Note: Occupancy cost & others % in 2007-2012 has been factored in licensing fee to YUM

We believe it is achievable despite its already dominant share

Compared with other international restaurant operators (Figure 36), Yum China has the strongest presence in 1,100+ cities and has opened an average of two new locations per day over the past five years. Each year, there are over 2bn customers in YUMC stores. It is already the largest chain with 30% share as of 2016. We believe, that despite its dominant share, it has the key drivers for a sustainable growth in EPS in the mid-teens, given the relatively low penetration (Figure 34), iconic products, favorable macro backdrop and committed management/strategic shareholders.

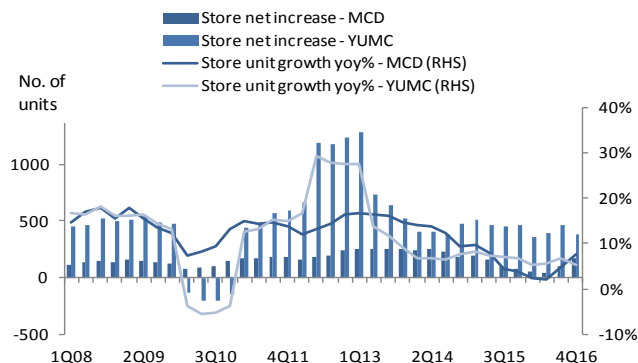


Figure 36: No. of stores as of 2016 YUMC vs. other international peers in China



Source: Deutsche Bank, company data

Figure 37: Store growth – MCD China vs. YUMC



Source: Deutsche Bank, company data
 Note: Store closure for YUMC in 2010 is mainly on Xiao fei yang.

Iconic products and new innovations; Drivers of sales momentum – Differentiated recipe and innovative products

There are lots of fried chicken chains in China but KFC has its unique recipe

KFC's unique fried chicken recipe, with a blend of 11 herbs and spices, remains the key item on the menu in China (and globally). Although there are several fried/non fried chicken chains in China, pure replicas died down and some chain operators opted for menu differentiation, given KFC's strong brand equity. KFC offered 50 items in China vs. 29 in the US to cater to a more diverse appetite. In addition, China has in the past had bigger stores than the US.

Something old, something new...a sixpence in shareholder's shoe

KFC China also localizes its menu and offers different products. The company has a global tracking system to help track consumers' change of preference. It has a food innovation committee that screens all the creative ideas brainstormed from its food lab, and then decides which one should be launched to which market. The lead time for new product launches can be as short as 1-2 months for KFC, after shortlisting by the food committee. YUMC launched 75 new items in 2015 and we estimate it launched 150/200 new items to the market in 2016.

For example, this CNY, the company offered Roast Whole Chicken, particularly for CNY bucket delivery, which became a "key option leader" (网红) product online. Equipment is more advanced than in other countries and the company also installed very high quality coffee machines



Figure 38: KFC's localized products in China (example)



Source: Deutsche Bank * note Zinger Stacker is different from the US as 2 pieces of meat is too much for Chinese consumers and thus they replaced it with one piece of meat and one harsh brown

Backed by favorable macro development

Government commits to boosting domestic consumption

According to NBS, consumption growth has contributed 64.6% to GDP growth during in 2016. In the latest 13th Five-year Plan in Domestic Trade released in Nov, the government set a series of targets (Figure 39).

Providing framework for YUMC's growth

We believe the key drivers for QSR and casual dining are: 1) Urbanization (Figure 41) and 2) consumer upgrade, which drives consumers to dine out either for convenience's sake or for a lifestyle experience. Together with investment in infrastructure and commercial facilities, they should provide the framework for YUMC's growth.

Figure 39: 13th Five-year Plan

Target	Target by 2020
Total retail sales	CAGR +10% to RMB48tr
Total catering	CAGR +7.5% to RMB11.2tr
Ecommerce	CAGR +15% to RMB43.8tr
o/w real goods transaction	CAGR +20% CAGR to RMB10tr
Driven by	
Urbanization	Hukou-based urbanization rate to rise to 45% by 2020 from 39.9% by 2015
Consumption upgrade	In rural areas, healthcare, entertainment, education & culture, and other new areas like information, green, quality consumption

Source: Deutsche Bank, MOFCOM 16 Nov 2016

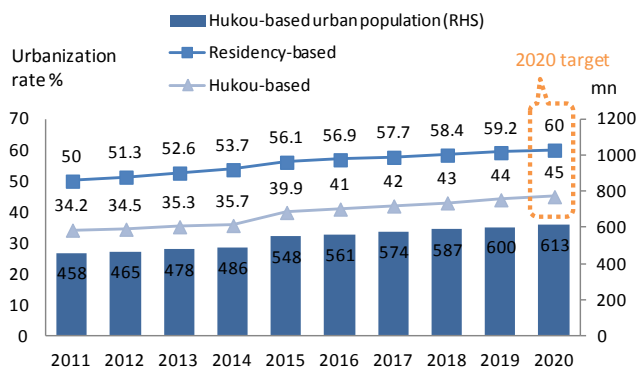
Figure 40: Unique growth opportunities for Yum China

	China's Five-Year Outlook/consumer trend	YUMC strategy
Size of the market	Urban population growth of 75MM, 19 city clusters; urbanization to reach 60% in 2020 and 30% in 2030	Expanding footprint across urban centers
Infrastructure	Doubling of transportation hubs, airports, high speed rail	Targeting units in all major transportation hubs. Can have a few unites in each hubs. Double no. of hubs (currently its stores cover 250 hubs)
Commercial facilities	1,250 new shopping malls	1-2 stores in top ranking malls
Consumer preference	Fragmentation of demand	Multi-brand Taco Bell, Little sheep and others Taco Bell Shanghai opened in Dec 2016

Source: Deutsche Bank, company presentation

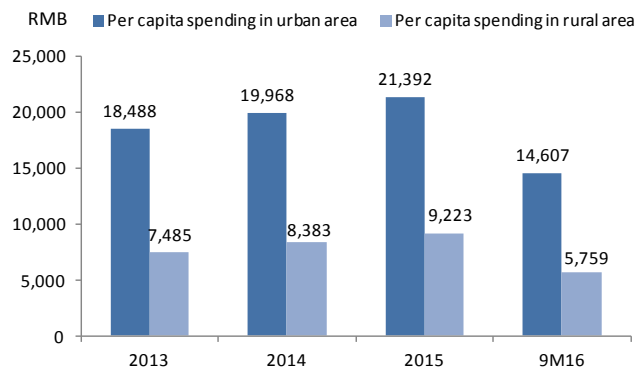


Figure 41: Urbanization to reach 60% by 2020



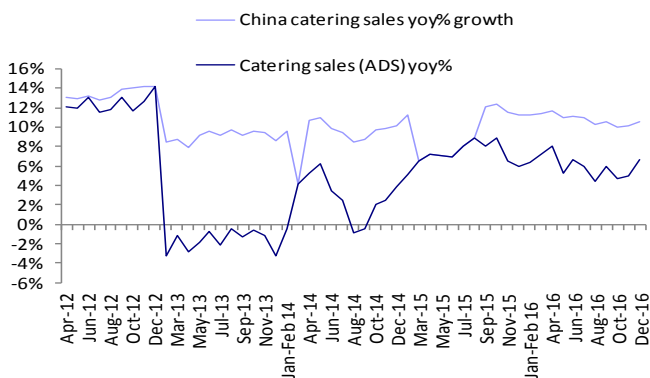
Source: Deutsche Bank, Gov.cn, NDRC, Wind

Figure 42: Per capita spending in urban vs. rural area



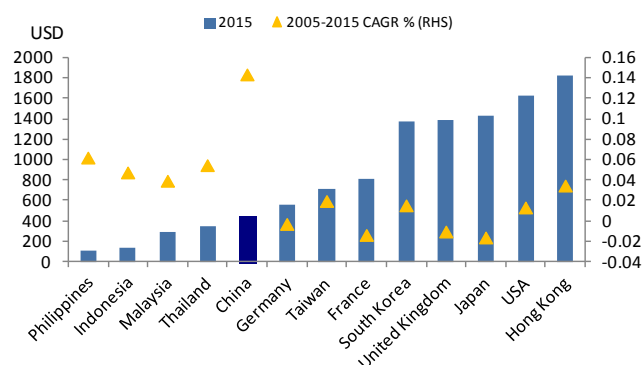
Source: Deutsche Bank, Wind

Figure 43: China catering retail started to recover since end-2014



Source: Deutsche Bank, Wind, NBS

Figure 44: Per capita spending in restaurants remains low but with fastest CAGR from 2005 to 2015



Source: Deutsche Bank, Wind

Supported by strategic investors that share the same vision

Credible strategic partners

Primavera and Ant Financial invested USD460m in YUMC and became shareholders on its list on 1 Nov 16. As of 31 Dec 16, it owns 4.8% shares (18.4m shares) and 16.4m warrants.

- **Dr. Fred Hu, founder of Primavera**, has advised the Chinese government on financial and pension reform, SOE restructuring and macroeconomic policies. We believe this will **help YUMC in exploring its potentials in China with better insight into China's policy and functioning of the market**. He is the chairman of the board.
- The other partner, **Ant Financial**, is a subsidiary of Alibaba engaged in third-party payment. We believe YUMC can benefit from Ant Financial's **expertise of big data and digital ecosystem in understanding consumers' spending pattern**.



A distinct coverage model

Summary – Convenience matters

Store footprint – A race to the top (especially at initial stage)

- For the benefits: of 1) Branding, 2) Early mover advantage into lower tier cities and 3) Scale (on sourcing and product innovation)
- New coverage potentials extend to transportation hubs and online

YUM’s KFC – Major western QSR operators’ distinct “coverage models”

Extensive store network is a key factor to success

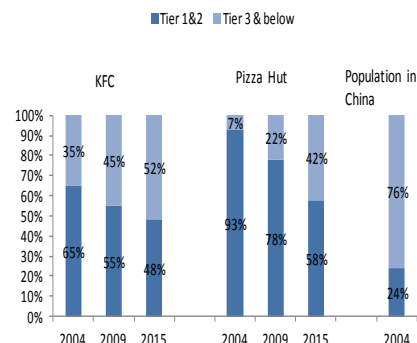
Unlike full-service restaurants that compete heavily on branding, we believe QSR competes more on convenience, especially in the early stage of development. This is best reflected on the allocation of the store network. We believe QSR operators take into account various factors when deciding the coverage model, such include: the ability to reach target consumers (including home delivery), cost (logistics and rental) and even China’s infrastructure investments. To better understand Yum’s KFC coverage and its strategy, we compare the network coverage of the three key QSR chain in China.

1) KFC China allocates more stores to affluent provinces

KFC China and MCD China’s store allocation is positively correlated to the income level of located province (Figure 46). Thus, we believe that with higher GDP growth in lower tier cities, this will help increase the number of stores in those markets.

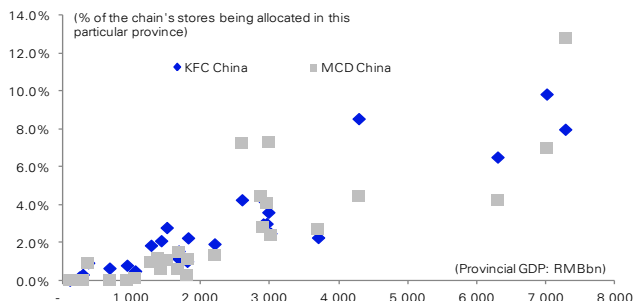
Separately, Dicos, YUMC’s key competitor in lower tier cities, strategically concentrates its stores at China’s mid-income provinces (Figure 47). We believe Dicos’ move is dictated by its strategy to achieve regional dominance, as it is a late comer in the segment (set up in 1994) with a lower-average ticket price.

Figure 45: Increasing penetration in lower tier cities (No. of store breakdown by city tier)



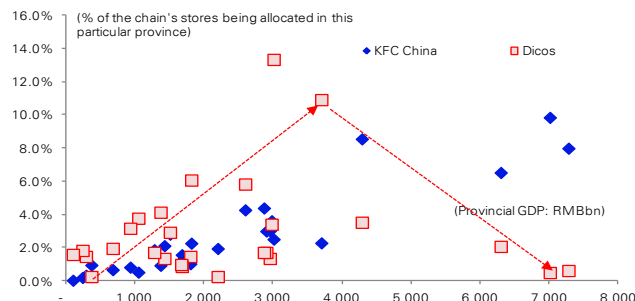
Source: Deutsche Bank, company data

Figure 46: Higher GDP, more stores – this is not a surprise to us (each mark is a province)



Source: Deutsche Bank estimates, CEIC, Baidu Map, Dianpignig Note: we pinpoint store locations using Dianping and double check using Baidu Map

Figure 47: Dicos’ coverage model focuses on regional dominance (each mark is a province)



Source: Deutsche Bank estimates, CEIC, Baidu Map, Dianpignig Note: we pinpoint store locations using Dianping and double check using Baidu Map

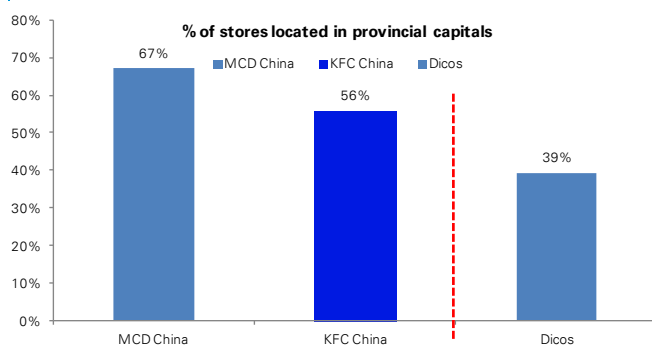


2) Within each province, MCD allocates most stores to provincial capitals, while Dicos focuses on regions outside the capital; KFC more balanced

Analyzing the store allocation within a specific province, we see MCD China and KFC China allocate more stores to province capitals (Figure 48). Dicos, on the other hand, allocates more stores to non-capital regions, with its franchise strategy.

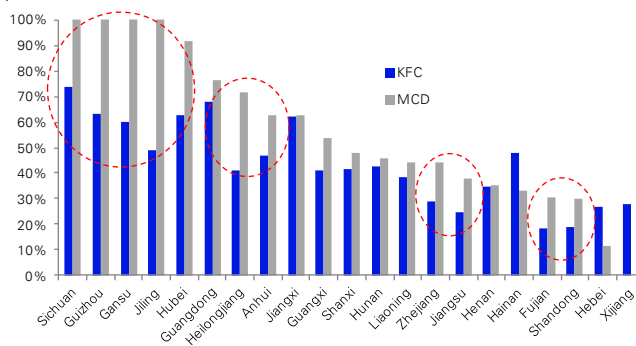
When we compare KFC China and MCD China, the former operates a more balanced network with 56% stores in capitals, while the rest are in outside regions. Also, we noticed that KFC China has been strategically expanding outside of the province capitals in selected regions (Figure 49; red highlights). KFC's more widespread network is attributable to its strong supply chain (we will discuss later), which allows management to carry out its penetration strategy to lower tier cities.

Figure 48: KFC China and MCD allocate more network to provincial capital cities



Source: Deutsche Bank estimates, CEIC, Baidu Map, Dianping Note: we pinpoint store locations using Dianping and double check using Baidu Map

Figure 49: KFC China strategically expands beyond provincial capitals in selected regions

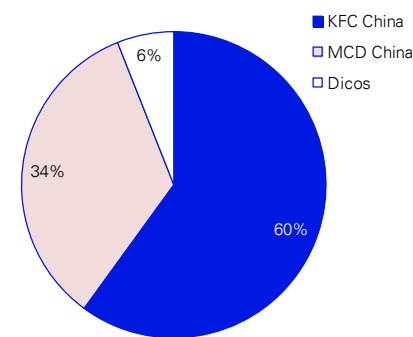


Source: Deutsche Bank estimates, CEIC, Baidu Map, Dianping Note: we pinpoint store locations using Dianping and double check using Baidu Map

Benefits of the KFC store network model: 1) Branding, 2) Early mover advantage into lower tier cities and 3) Scale

- Branding:** Operating a scaled network in China's affluent regions increases KFC's brand equity, in our view (Figure 50). This is especially positive during the early stage of the China catering industry development (when KFC is viewed as casual dining more than QSR).
- Early mover advantage into lower tier cities:** KFC's strategic expansion beyond province capital cities allows it to enter lower tier cities where rent is still low. Analyzing Figure 49, we sensed KFC's tendency to branch into lower tier cities faster than MCD China, due to its supply chain. KFC's expansion beyond provincial capital is especially rapid in provinces where we witnessed significant increase in rent. We estimate that KFC can often achieve over a ten-year tenure at the new malls in lower tier city (to largely lock-in the rental).
- Scale:** We believe it is easier for KFC to increase scale. This is driven by KFC's national network (vs. Dicos), more balanced exposure in provincial capitals and lower tier cities (vs. MCD China), together with 18 distribution centers.(Figure 58)
 - Scale benefit on protein sourcing:** In China's protein procurement market, "1,000 stores" and "2,000 stores" represent two major thresholds, based on our channel checks. QSR chains' bargaining power on protein suppliers increased drastically upon passing

Figure 50: Most preferred QSR brand in China



Source: Deutsche Bank, company data, Brand Image Tracking in 50+ cities, AC Nielsen. Note 1: western casual dining restaurants, note 2: KFC data as of Aug. 2016, Pizza Hut Dine In data as of September 30, 2016



those thresholds. We believe such led to KFC China's dominance in the past.

- **Scale benefit on innovation:** YUMC's innovation kitchen allows the company to introduce more localized cuisine. This is likely a benefit of greater scale in China.

As the largest directly run store network (with possibly the highest penetration in China), YUMC has increased management complexity and exposure to macro environment volatility. This is because KFC is viewed as more casual dining in lower tier cities and more exposed to changes in discretionary income vs in tier 1 cities, it is a QSR chain.

One model cannot fit all

All major store models adopted by KFC

We estimate over 70% of KFC stores are standard stores: composed of kitchen area and dining area (50:50), with an area size of 300-350 sqm, generating RMB8-10m revenue per year (Figure 48).

We believe KFC China's most profitable stores are located at specialty locations including transportation hubs, hospitals and tourists sites. Such stores face consistent traffic. We estimate such flagship stores generate over RMB 20m revenue. Most importantly, such stores likely generate a higher operating margin, despite generally higher rent.

Meanwhile, we estimate KFC strategically operates smaller stores (especially in Shanghai). The mission of smaller stores is to maintain the coverage of KFC delivery, even though such stores are likely less profitable in general.

Figure 51: Major store models adopted by KFC China

Store type	Flagship store	Cluster stores	Standard stores	Small stores	New models
Example	BJ Capital Airport, Suzhou Subway	SH Hongqiao Airport	CBD area, lower tier cities...etc.	Mainly Shanghai, to increase the coverage of home delivery	Multiple new models under trial, including new store layout (separate the ordering counter from food collection counter), as well as the use to order APP (leverage high in-store wifi coverage).
Area-size* (sqm)	500-1,000	500-1,000 (with multiple smaller stores and one "kitchen store")	300-350	180-200	
Annual revenue (RMB)	Over 20m	Over 20m	8-10m	Lower	
Operating margin	Higher	Higher	company average%	Lower	

Source: Deutsche Bank estimates, company data

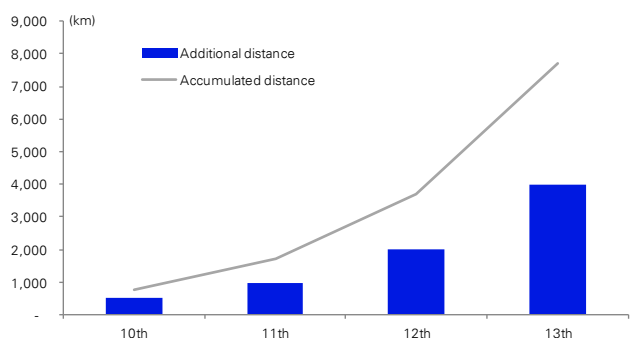
Opportunity 1: transportation hub build-ups – new location for new stores

In our view, one of the most important opportunities for KFC China is the upcoming infrastructure build-up. YUMC management also specifically mentioned it is targeting to have units in all major transportation hubs. Around 20% new stores are located in transportation hubs and these stores tend to have better margin, according to management. Regarding the new stores that opened in 2016 (half of them are located in new cities), around 1/3 are in shopping malls and 20% in transportation hub.

China's 13th Five-Year Project aims to accelerate investments in transportation drastically. The nation aims to increase the distance of city rail transportation system by 4,000km between 2015 and 2020 (or up 100% when compared to the previous Five-Year Plan; Figure 52). The number of China's metro stations and metro transit hubs will increase by 110/181% after the build-up.

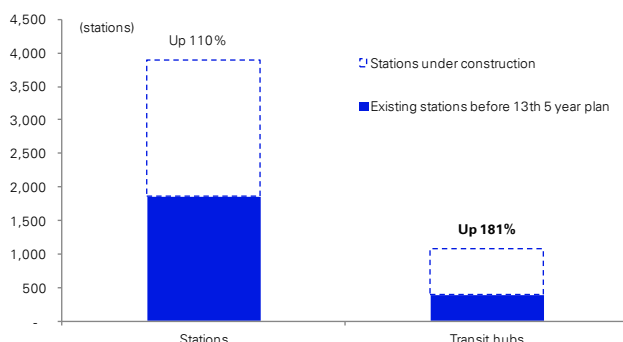


Figure 52: City rail transit: national distance



Source: Deutsche Bank, China Association of Metro

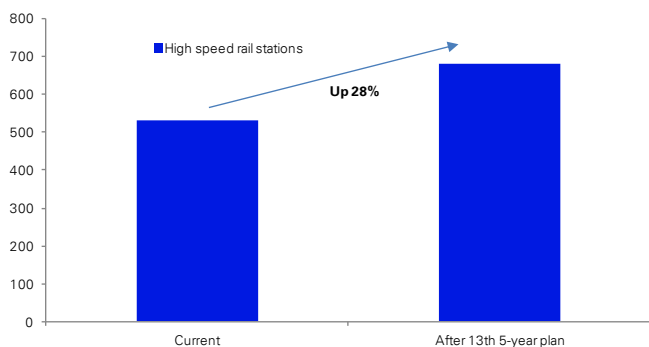
Figure 53: City rail transit: number of stations



Source: Deutsche Bank, China Association of Metro

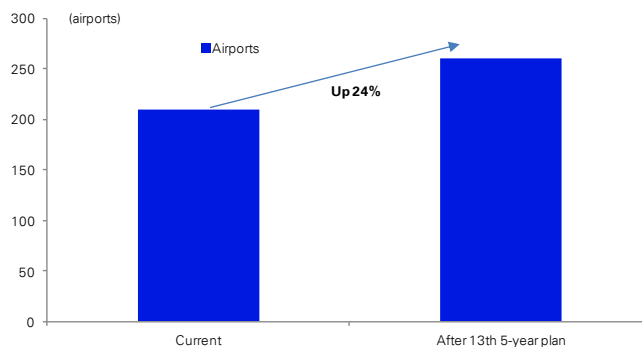
The same also applies to high speed rail stations as well as airports. Both are scheduled to increase by over 20% during the 13th Five-Year Plan.

Figure 54: Also building more high speed rail stations...



Source: Deutsche Bank, CEIC

Figure 55: ...as well as airports



Source: Deutsche Bank, CEIC

Opportunity 2: a profound change to the home delivery landscape

Currently, home delivery represents 10% of YUMC's system sales and 8% of KFC China revenue. Management wishes to increase delivery's contribution to system sales to 25% in the long term, while doubling KFC's revenue contribution from home delivery.

Figure 56: YUMC's guidance on home delivery business – to double sales in five years

	Total	KFC delivery	Pizza Hut Home Delivery
		Single largest delivery brand	leading delivery brand concept
Sales USDm	700		
% to total sales	~10%	8%	
Avg ASP			
Online ordering	85%		
Units engaged in home delivery	4,000		
Delivery drivers	20,000		
Target - % to total sales	25%		

Source: Deutsche Bank, company data

We believe the target is achievable:

- Home delivery remains at tier 1 and tier 2 cities now. We estimate that home delivery as a percentage of sales to be as high as 20-25% in tier 1 cities like Shanghai (vs. national of 8%).

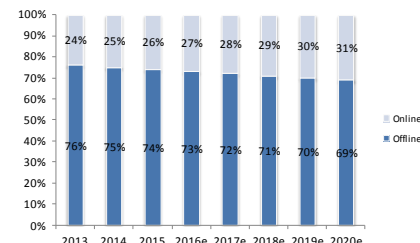


- We believe as the delivery fleet becomes more available in lower tier cities, home delivery service will also trickle down.
- **A profound change in KFC's relationship with third party home delivery companies.** Third party home delivery platforms (most notably Ele.me, Meituan and Baidu Takeout) triggered heavy competition to leading brands like KFC. For example, one of Ele's important source of revenues is ranking fee, restaurants pay Ele for better ranking in the search page. Ele effectively allowed a lot of "mom & pop" restaurants to take a higher ranking when consumers searched for home delivery. We witnessed the worst competition triggered by Ele in 2014 and 2015, which currently has improved.

In 2016, we saw a change in strategy by the third party delivery platforms. After CCTV unveiled a series of food safety issues related to third party delivery platforms, the Chinese government strengthened its control over unlicensed restaurants and consumers were more cautious too. Subsequently, third party delivery platforms teamed up with key restaurant chains.

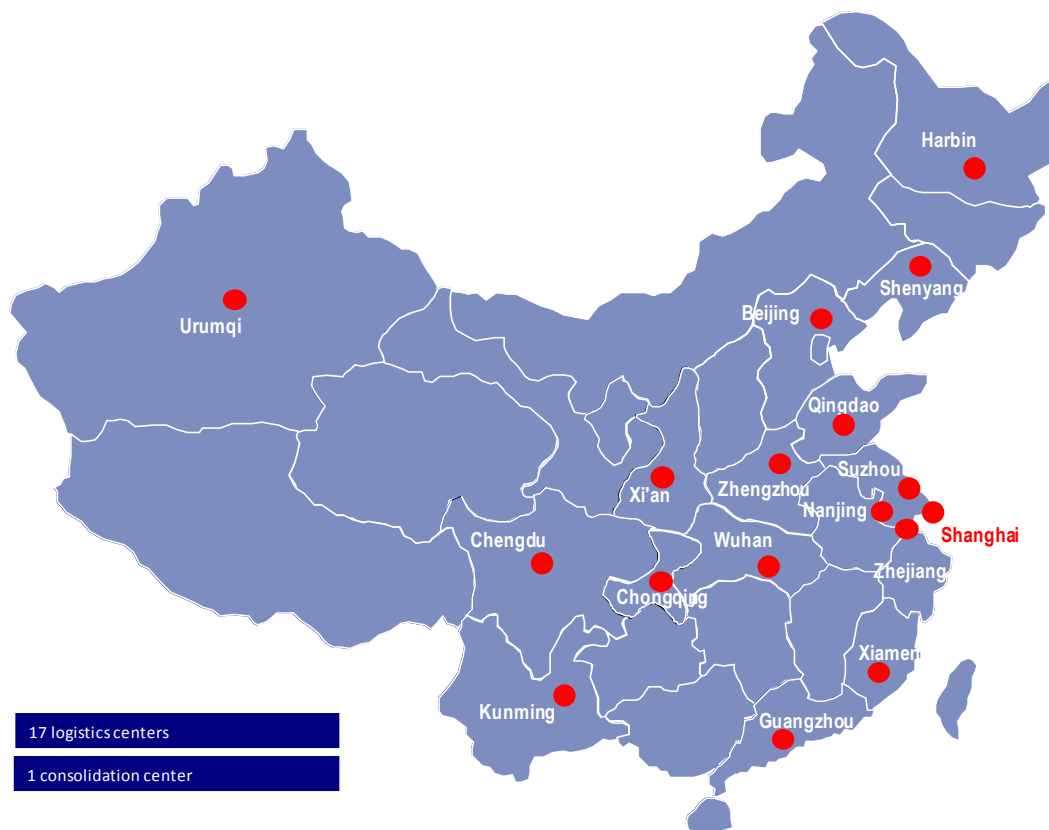
We also believe Ele has turned less aggressive on cash burn, after receiving USD1.25bn funding from a group of financiers including Ant Financial, which is also YUMC's major shareholder.

Figure 57: China catering business breakdown online/offline



Source: Deutsche Bank estimates, Euromonitor

Figure 58: YUMC's nationwide logistics hub



Source: Deutsche Bank, company data



Staying Competitive

Summary – The right menu for future challenges

...and the taste

In our view, as the largest restaurant chain in China has shown (and should continue to show) its ability to:

- Stay competitive through economic cycle
- Stay invested to improve asset turn and productivity

Staying competitive through the economic cycle

A restaurant chain needs to stay competitive; lots of smaller players come and go

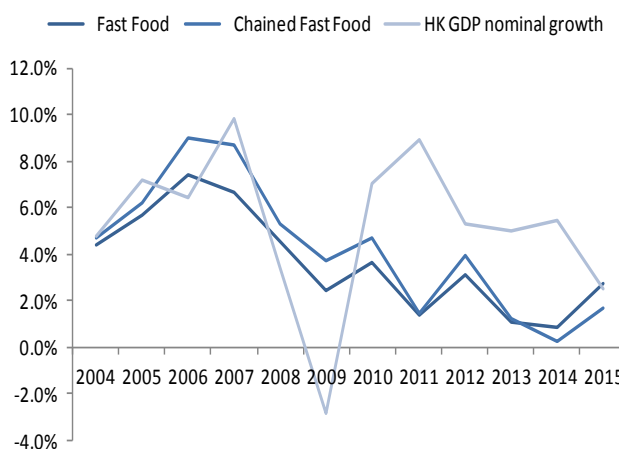
The restaurant market is fragmented with low entry barriers. Competition exists at a nationwide chain store level as well as a single store level (a one-store operator can be a competitor of a chain store nearby). A retiree or unemployed person can set up a restaurant with relatively low capex. Thus, in a market like HK, the number of restaurant units increased during the economic downturn (Figure 59 and Figure 60). However, the number of restaurant units declined when the market recovered. Small players come and go, while key chain stores remain.

Figure 59: China nominal GDP growth percentage vs. no. of fast food outlets yoy percent growth in China



Source: Deutsche Bank, Euromonitor

Figure 60: HK nominal GDP growth vs. no. of fast food store/chain fast food outlets



Source: Deutsche Bank Euromonitor

Self own model gives flexibility on upgrade and changes

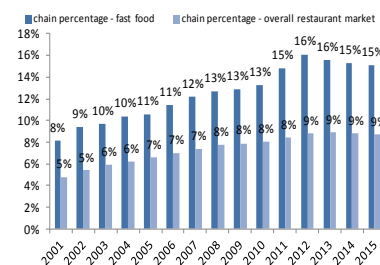
YUMC has significantly invested in assets to improve store image and refresh brand equity. For KFC, each store will be practically/entirely remodeled every few years (e.g. shorter for stores at transportation hubs). This ongoing upgrade and change also helped KFC to realize a turnaround in last two years. It streamlined the investment of new builds by 25% (capex) in three years and developed different models, i.e. small box/economic model for high/low tier cities, respectively.



YUMC – securing its leading position in QSR, while exploring new brands

We see YUMC as a chain that will remain a relevant player over time with its continuous product launches, multi-brand initiatives and network expansion on/offline. We believe that branding is important for QSR because whenever consumers travel, they typically have certain expectations for its product (taste, food quality and speed).

Figure 61: Fast food has higher chain percentage than restaurant in general – China



Source: Deutsche Bank, Euromonitor

Figure 62: Multi-format strategy to tap consumers' preference

Brands	Date of establishment	Scale	Products	Remarks
KFC	1987, Beijing	>5,000 KFC restaurants across 1,100 cities across China + 24 hour delivery	In addition to its Original Recipe Chicken, it offers an extensive localized menu to cater to local preferences.	The largest restaurant brand in China in terms of system sales. QSR brand.
Pizza Hut	1990, Beijing	~1,600 Pizza Hut restaurants across 400 cities	Tasty and affordable priced pizza and other western dishes, as well as local dishes	The world's largest pizza company and the first restaurant chain to introduce pizza and Western-style casual dining to China.
Pizza Hut Delivery	2001	~350 Pizza Hut Home Service units in 50 cities+ across China.	Pizza, as well as its many Chinese/Western dishes, delivered to consumers' homes or offices.	na
East Dawning	2005, Shanghai	~15 stores primarily located in large coastal cities in China.	convenient and quality Chinese food in a comfortable setting	QSR brand specializing in Chinese cuisine.
Little Sheep	1999, Inner Mongolia	~ 250 units in China and international markets. Of these, over 200 units are franchised.	Hot pot chain famous for its soup base and six-month-old mutton sourced from Inner Mongolia.	Casual dining brand acquired in 2011.
Taco Bell	Dec, 2016	One store	Tacos and other Mexican food	na

Source: Deutsche Bank

Staying invested to improve asset turn and productivity

Store remodeling initiatives will likely never stop

Given the different stage of economic development within China (i.e. tier 1/2 cities vs. 3/4 cities vs. even lower tier cities), remodeling will continue, in our view. Store remodeling is needed especially in tier 1/2 cities where it has older stores and competition is more intense. It adopted a more cost effective and flexible store remodeling two years ago (Figure 65), which focuses on refreshing consumer-facing elements which help contemporize the brand, appeal to the youth and strengthen its overall customer experience and brand image. In 2016, they remodeled 791 stores (including 720 KFC and 69 PH) and around 500 stores in 2017 (DBE). Management commented that >75% of the stores were units remodeled or opened under the current format in the last five years by the end of 2016.



Figure 63: New remodeling – focuses on refreshing consumers facing elements

	Old modeling	New remodeling accelerate since 2015
Target	Tier 1/2 cities (~ 52% of the total number of stores) and these stores have been in operation for many years	
Store age that required remodeling	seven years	More proactive and varied – with consumers looking for newness, YUM has increased the number of partial remodel.
Capex	equivalent to capex of a new store. ~3.7m per store and smaller like 2-2.5m RMB in lower tier cities.	In the past two years, management introduced three types of remodeling namely, minor (RMB2.2m capex), partial (1.1m) and mini (RMB0.1m).
Length required for refurbishment (store closures)	40-50 days	As short as one month

Source: Deutsche Bank

New store is designed to weather cycles

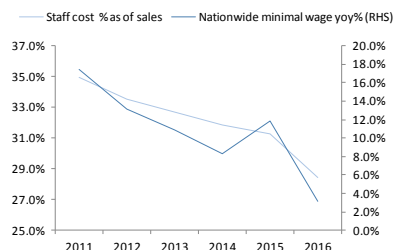
New stores are smaller in size (~300sm or less vs. 350-400sm+ in the past) as it is easier to operate through cycles and with less seating space, which is also in line with consumers’ change in dining behavior (e.g. stores that are located within transportation hubs stores might share a kitchen). This will lower the size requirement as well as the number of workers in those stores.

Investing in automation is also important. Labor cost, the second largest cost item at opex after rental, should continue to increase. Salary of the front line staff is normally linked to minimum wage, which has grow at a double-digit rate in the past (the government’s Five-Year Plan was to have 10% annual growth for each of 13th Five-Year Plan).

While overall labor wage inflation has come down modestly of late, YUMC is working to mitigate its impact through the rollout of cash counting machines, general process changes and the increased usage of cashless payment by consumers (like the use of mobile apps for ordering). On a separate note, its mobile initiatives enable its ability to rollout a loyalty program – KFC’s K-Gold loyalty program called “WOW” (60m+ members as of 2016), which helps management in data analysis and roll out effective digital marketing.

Regarding new store opening, plus remodeling and infrastructure investment (especially in digital and delivery), we expect ~USD500m capex a year.

Figure 64: Nationwide minimal wage yoy percentage vs. staff cost as percentage of sales for YUMC (2011-2016)



Source: Deutsche Bank. Wind, Company data

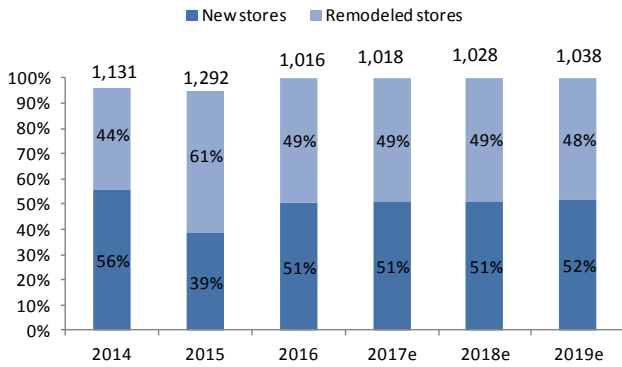
Figure 65: New store image examples



Source: Deutsche Bank, Company presentation

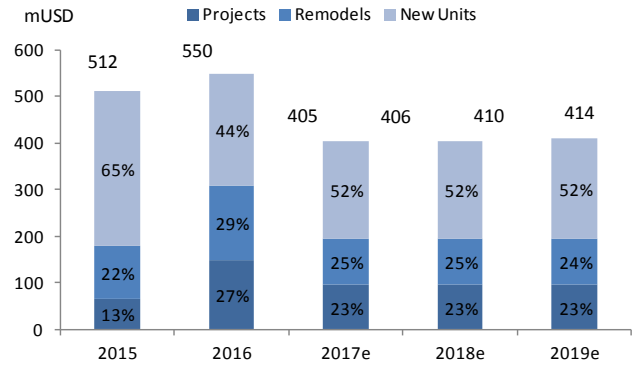


Figure 66: Rejuvenate its brand asset with new image



Source: Deutsche Bank estimates, company data

Figure 67: Capex breakdown (2015-2020e)



Source: Deutsche Bank estimates, company data



Figure 68: YUMC - Key assumptions

YE Dec USD m	2014 A	2015 A	Annual		2018 F	2019 F
			2016 A	2017 F		
Key assumptions						
Macro data						
CPI *	2.0	1.4	2.0	2.5	2.6	na
CPI (food)	3.1	2.3	na	na	na	na
Minimum wage increase	9.7%	11.7%	na	na	na	na
Currency - USD/RMB	0.162	0.159	0.150	0.146	0.146	0.146
% change	-0.5%	-1.9%	-5.5%	-3.0%	0.0%	0.0%
Overall						
No of restaurants	6,715	7,176	7,562	7,960	8,351	8,747
KFC	4,828	5,003	5,224	5,457	5,692	5,937
Pizza Hut Casual Dining	1,313	1,572	1,714	1,835	1,956	2,077
Others	574	601	624	668	703	733
% growth	7.6%	6.9%	5.4%	5.3%	4.9%	4.7%
System sales growth (%) ex FX	1%	2%	5%	5.5%	5.9%	6.4%
SSS (%)	-5%	-4%	flat	0.7%	1.2%	1.9%
KFC						
Company owned stores	3,651	3,777	3,890	4,034	4,185	4,342
Average store growth	na	3.5%	3.0%	3.7%	3.7%	3.8%
Average sales per store (RMBm)	8.08	7.75	7.82	7.98	8.14	8.30
Average growth	na	-4.2%	1.0%	2.0%	2.0%	2.0%
SSS (%)	-4.0%	-4.0%	3.0%	3.0%	3.0%	3.0%
System sales (USDm)	6,119	5,998	5,986	6,185	6,586	7,007
Sales	4,893	4,768	4,696	4,811	5,095	5,395
Restaurant profit	559	620	746	850	886	929
Restaurant margin	11.7%	13.3%	16.3%	18.1%	17.8%	17.7%
Operating profit	435	499	645	742	796	855
% growth						
System sales (RMB)	-1.0%	0.0%	6.0%	6.5%	6.5%	6.4%
Sales	-2.0%	-2.6%	-1.5%	2.4%	5.9%	5.9%
Restaurant profit	0.4%	10.9%	20.3%	13.9%	4.3%	4.8%
Operating profit	-4.6%	14.7%	29.3%	15.1%	7.3%	7.3%
Pizza Hut Casual Dining						
Company owned stores	1187	1443	1643	1775	1896	2017
Average store growth	na	21.6%	13.9%	8.0%	6.8%	6.4%
Average sales per store (RMBm)	8.82	7.95	7.18	6.82	6.62	6.62
Average growth	na	-9.8%	-9.7%	-5.0%	-3.0%	0.0%
SSS (%)	-5%	-4%	-7%	-4%	-2%	1%
System sales (USDm)	1,696	1,835	1,780	1,770	1,834	1,951
Sales	1,696	1,825	1,774	1,764	1,828	1,945
Restaurant profit	243	225	248	255	274	306
Restaurant margin	14.3%	12.3%	14.0%	14.5%	15.0%	15.7%
Operating profit	176	145	150	155	172	200
% growth						
System sales (RMB)	11.4%	10.4%	2.1%	2.5%	3.6%	6.4%
Sales	11.4%	7.6%	-2.8%	-0.6%	3.6%	6.4%
Restaurant profit	-16.5%	-7.4%	10.2%	3.0%	7.3%	11.8%
Operating profit	-25.1%	-17.6%	3.4%	3.5%	10.6%	16.6%

Source: Deutsche Bank estimates, company data



Figure 69: Profit and loss breakdown (2017 onwards DBE)

P&L as reported	2014	2015	2016	2017	2018	2019
Sales	6,934	6,909	6,752	6,856	7,232	7,674
Company sales	6,821	6,789	6,622	6,732	7,097	7,529
Franchise fees and income	113	120	130	124	135	145
Company restaurant expenses	(6,029)	(5,931)	(5,610)	(5,610)	(5,914)	(6,267)
Food and paper	(2,207)	(2,159)	(1,919)	(1,833)	(1,927)	(2,035)
Staff cost	(1,407)	(1,386)	(1,432)	(1,492)	(1,585)	(1,688)
Occupancy cost & others	(2,415)	(2,386)	(2,259)	(2,286)	(2,402)	(2,544)
License fee to YUM	(217)	(219)	(198)	(201)	(212)	(225)
O/C cost	(788)	(776)	(792)	(791)	(815)	(839)
Others	(1,410)	(1,391)	(1,270)	(1,294)	(1,375)	(1,480)
Restaurant profit	792	858	1,012	1,122	1,183	1,262
Restaurant margin	11.6%	12.6%	15.3%	16.7%	16.7%	16.8%
G&A	(389)	(395)	(424)	(443)	(450)	(462)
Franchise expense	(64)	(70)	(71)	(74)	(78)	(83)
License fee to YUM	(48)	(50)	(43)	(45)	(49)	(53)
Other franchise cost	(16)	(20)	(28)	(29)	(29)	(30)
Closure and impairment expense	(517)	(64)	(78)	(60)	(61)	(62)
Refranchising gain	17	13	15	15	16	17
Other income	51	26	56	60	69	80
Equity income from investments in unconsolidated affiliates	30	41	54	60	69	80
Others	21	(15)	2	-	-	-
Operating profit	3	488	640	744	814	897
Interest income	14	8	11	11	15	18
Interest expense	-	-	-	-	-	-
Change in fair value of financial instruments	-	-	21	-	-	-
Profit before tax	17	496	672	755	828	916
Tax	(54)	(168)	(158)	(211)	(232)	(256)
PAT	(37)	328	514	544	596	659
Minorities	30	(5)	(12)	(13)	(15)	(16)
Net Profit	(7)	323	502	530	582	643
Adjusted EBITDA	931	998	1,107	1,232	1,310	1,397
Core operating profit	466	503	638	744	814	897
Number of shares (FD) m shares		363	369	410	406	402
EPS (USD)		0.87	1.27	1.31	1.45	1.62
% growth in USD						
Sales	0.4%	-0.4%	-2.3%	1.5%	5.5%	6.1%
Company restaurant expenses	1.1%	-1.6%	-5.4%	0.0%	5.4%	6.0%
Restaurant profit	-5.1%	8.3%	17.9%	10.8%	5.4%	6.7%
Operating profit	-98.7%	16166.7%	31.1%	16.3%	9.3%	10.3%
ETR	-317.6%	-33.9%	-23.5%	-28.0%	-28.0%	-28.0%
Net Profit	-105.6%	-4714.3%	55.4%	5.6%	9.7%	10.5%
Adjusted EBITDA	-1.9%	7.2%	10.9%	11.3%	6.4%	6.7%
Core operating profit	-11.1%	7.9%	26.8%	16.7%	9.3%	10.3%
EPS (USD)			45.2%	3.2%	10.6%	11.5%
% growth in RMB						
Sales	0.9%	1.5%	3.1%	4.4%	5.5%	6.1%
Company restaurant expenses	1.5%	0.3%	0.1%	2.9%	5.4%	6.0%
Restaurant profit	-4.7%	10.0%	22.2%	13.4%	5.4%	6.7%
Operating profit	-97.7%	15869.3%	34.8%	18.7%	9.3%	10.3%
Net Profit	-104.6%	-4625.2%	57.8%	8.4%	9.7%	10.5%

Source: Company data, Deutsche Bank



Figure 70: Sales and earnings breakdown (2017 onwards DBE)

Sales and Operating profit breakdown	2014	2015	2016	2017	2018	2019
Sales	6,934	6,909	6,752	6,856	7,232	7,674
KFC	4,893	4,768	4,696	4,811	5,095	5,395
Pizza Hut Casual Dining	1,696	1,825	1,774	1,764	1,828	1,945
All other segments	345	316	282	282	308	334
Operating profit	3	488	640	745	814	897
KFC	435	499	645	742	796	855
Pizza Hut Casual Dining	176	145	150	155	172	200
All other segments	(44)	(14)	(6)	(9)	(3)	1
Unallocated G&A	(143)	(144)	(153)	(159)	(164)	(169)
Unallocated closure and impairment	(463)	-	(17)	-	-	-
Unallocated other income	25	(11)	6	-	(4)	(7)
Unallocated refranchising gain	17	13	15	15	16	17
% growth in USD						
Sales	0.4%	-0.4%	-2.3%	1.5%	5.5%	6.1%
KFC	-2.0%	-2.6%	-1.5%	2.4%	5.9%	5.9%
Pizza Hut Casual Dining	11.4%	7.6%	-2.8%	-0.6%	3.6%	6.4%
All other segments	-11.1%	-8.4%	-10.8%	-0.2%	9.5%	8.3%
Operating profit						
KFC	-98.7%	16166.7%	31.1%	16.3%	9.3%	10.3%
Pizza Hut Casual Dining	-4.6%	14.7%	29.3%	15.1%	7.3%	7.3%
All other segments	-25.1%	-17.6%	3.4%	3.5%	10.6%	16.6%
All other segments	-18.5%	-68.2%	-57.1%	54.6%	-68.2%	-128.8%
% growth in RMB						
Sales	0.9%	1.6%	3.4%	4.7%	5.4%	6.1%
KFC	-1.6%	-0.7%	4.2%	5.6%	5.9%	5.9%
Pizza Hut Casual Dining	12.0%	9.7%	2.9%	2.5%	3.6%	6.4%
All other segments	-10.7%	-6.6%	-5.5%	2.9%	9.5%	8.3%
Operating profit						
KFC	-98.7%	16479.3%	38.8%	19.9%	9.2%	10.3%
Pizza Hut Casual Dining	-4.1%	16.9%	36.8%	18.6%	7.3%	7.3%
All other segments	-24.7%	-16.0%	9.5%	6.7%	10.6%	16.6%
All other segments	-18.1%	-67.6%	-54.6%	59.3%	-68.2%	-128.8%

Source: Deutsche Bank, company data



Figure 71: Balance sheet

Y/E Dec, RMBm	14A	15A	16A	17F	18F	19F
Fixed Assets	2,217	2,033	1,814	1,797	1,774	1,751
Deferred Expenditure	141	116	162	162	162	162
Investment	251	253	325	385	455	534
Stock & Work in Progress	260	189	268	272	287	305
Debtors		60	76	74	75	79
Cash and Deposits	238	425	964	1,284	1,610	1,969
Other Current Assets	90	109	120	120	120	120
Total Assets	3,257	3,201	3,727	4,096	4,486	4,926
Creditors	(1,004)	(926)	(971)	(986)	(1,040)	(1,104)
Short-Term Debt	0	0	0	0	0	0
Other Current Liabilities	(36)	(22)	(33)	(75)	(90)	(99)
Total Assets Less Current Liabilities	2,217	2,253	2,723	3,034	3,356	3,722
Share Capital	1,671	1,791	2,337	2,237	2,137	2,037
Reserves	217	130	40	438	845	1,295
Shareholders' Funds	1,888	1,921	2,377	2,675	2,982	3,332
Minority Interests	66	64	66	79	94	111
Long Term Debt	34	34	28	28	28	28
Other Long Term Liabilities	229	234	252	252	252	252
Total Assets Less Current Liabilities	2,217	2,253	2,723	2,723	3,034	3,356
Net (Debt)/Cash	204	391	936	1,256	1,582	1,941
Total Capital Employed	1,988	2,019	2,471	2,782	3,104	3,470
Working Capital	(684)	(661)	(629)	(639)	(674)	(715)

Source: Deutsche Bank, company data



Figure 72: Cash flow statement

Y/E Dec, RMBm	15A	16A	17F	18F	19F
Profit Before Tax	543.0	651.0	755.2	828.3	915.7
Taxes Paid	(153.0)	(147.0)	(202.2)	(227.8)	(251.5)
Depreciation	425.0	402.0	421.6	429.6	432.4
Contrib. Less Div. from Assoc.	(20.0)	(19.0)	(60.2)	(69.3)	(79.7)
Gross Cashflow	795.0	887.0	914.4	960.8	1,016.9
Net Capex	(512.0)	(436.0)	(405.0)	(405.9)	(410.1)
Net Change in Working Capital	127.0	18.0	9.7	35.0	41.2
Free Cashflow	410.0	469.0	519.2	589.9	648.0
Dividend Paid	(214.0)	(357.0)	(99.4)	(164.0)	(188.3)
Investments	-	-	-	-	-
Disposals	-	19.0	-	-	-
Issued Share Capital	0.0	460.0	(100.0)	(100.0)	(100.0)
Forex. Adj. & Others	(9.0)	(46.0)	0.0	0.0	0.0
Net Cashflow	187.0	545.0	319.7	325.9	359.7
Net (Debt) / Cash at Start	204.0	391.0	936.0	1,255.7	1,581.6
Net Cashflow	187.0	545.0	319.7	325.9	359.7
Net (Debt) / Cash at Y/E	391.0	936.0	1,255.7	1,581.6	1,941.3

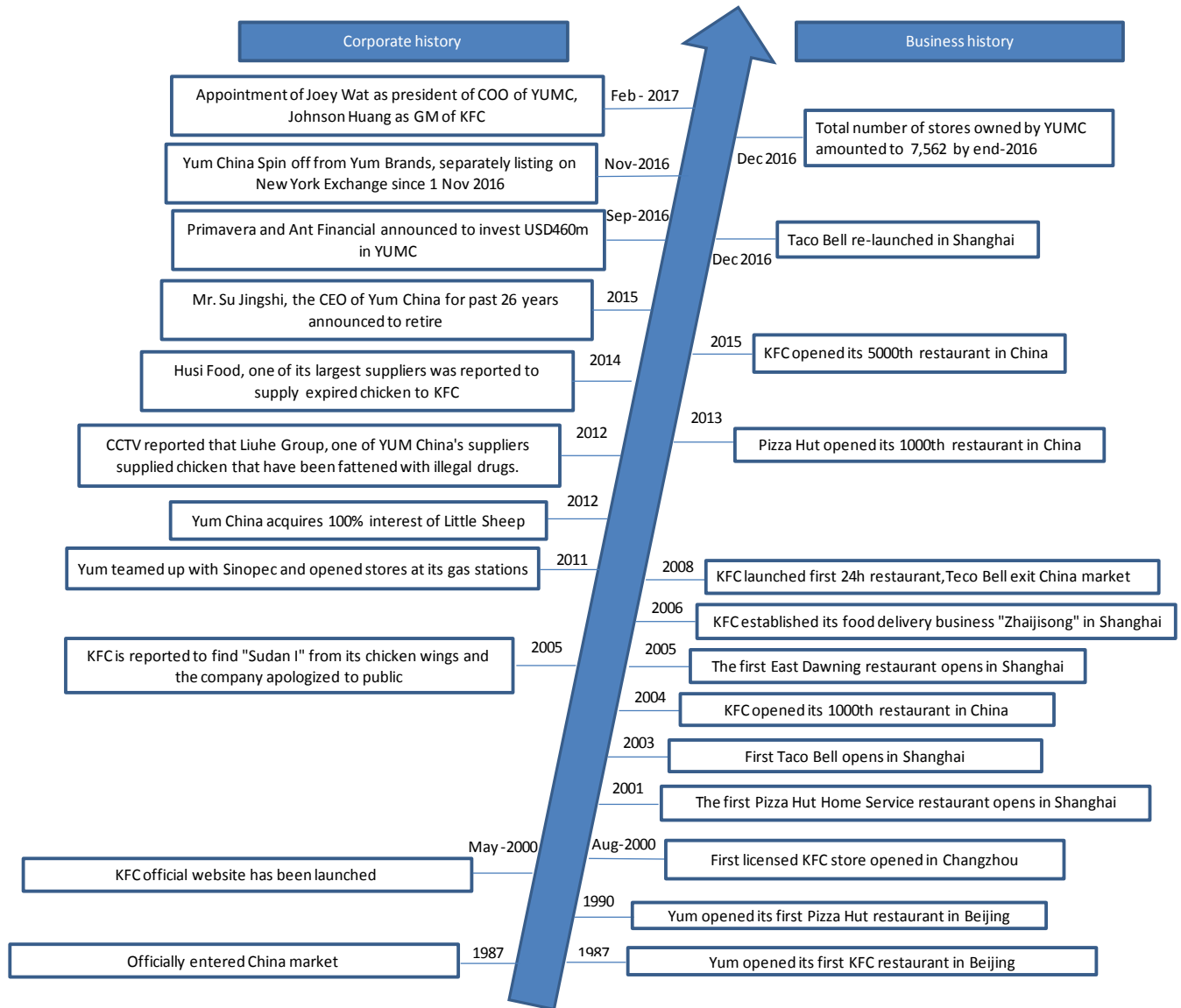
Source: Deutsche Bank, company data



Appendix A

Company history, shareholding structure

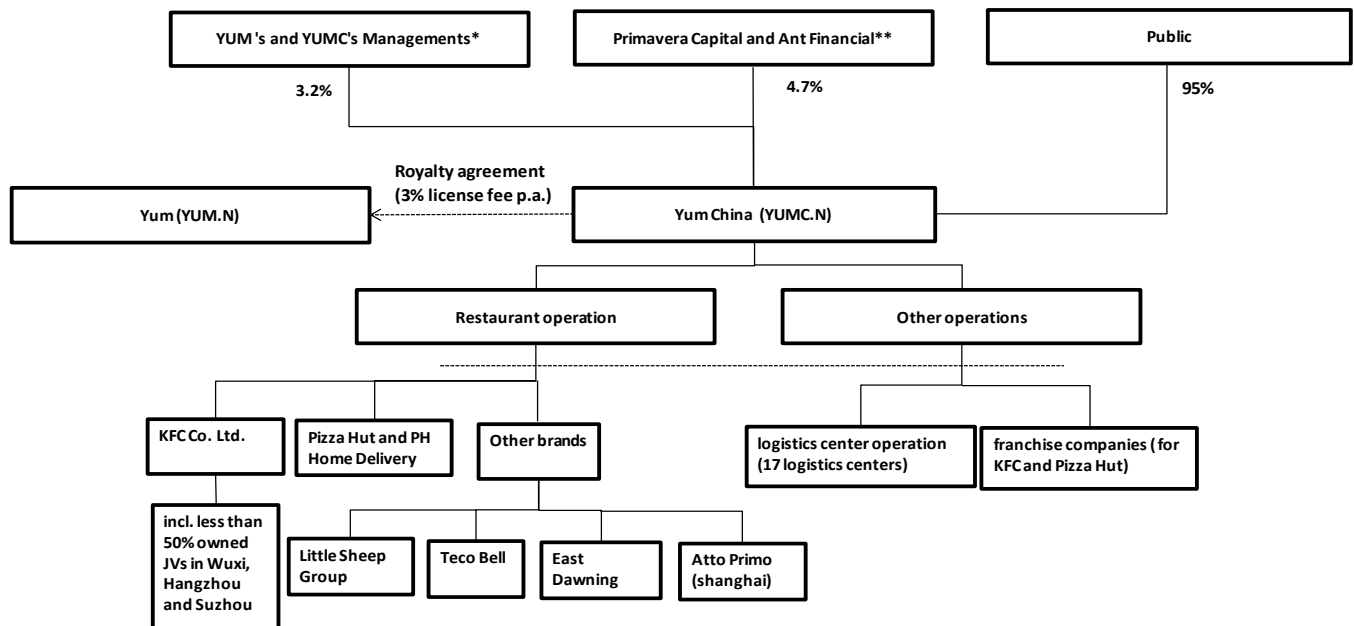
Figure 73: Company history



Source: Deutsche Bank, Company data



Figure 74: Shareholding structure



Source: Deutsche Bank, Company data
 Note: * DBs; **16m warrants excluded; shareholding based on 395m no. of diluted shares as of end-2016

Management profile – continuity; key members with average of 20 years of experience and...

Figure 75: Board of directors

Name	Age	Title	Contribution to the board
Peter A. Bassi	68	Director	...knowledge of the QSR industry and global franchising; extensive public company board and corporate governance experience.
Christian L. Campbell	66	Director	...knowledge of the QSR industry, global franchising and corporate leadership.
Ed Yiu- Cheong Chan	54	Director	...knowledge of the F&B industry in Asia, extensive public company board and corporate governance experience.
Edouard Etedgui	65	Director	...senior management experience in various international consumer product industries, extensive financial expertise and public company board experience.
Louis T. Hsieh	53	Director	...corporate leadership and public company board experience as well as his extensive financial and international business experience.
Fred Hu	54	Director	...knowledge of China market on macro and policy front.
Jonathan S. Linen	73	Director	...operating and management experience, expertise in finance, marketing and international business development and public company board and committee experience.
Muktesh "Micky" Pant	62	Director and CEO	...corporate leadership and public company board experience.
Zili Shao	58	Director	...extensive professional experience in Asia, public company board and corporate governance experience.

Source: Deutsche Bank, company data



Figure 76: Management team – of the 15 top leaders of YUMC, over half have been with the company since founding

Name	Age	Title
Muktesh "Micky" Pant	63	Chief Executive Officer
Edwin "Ted" Stedem	44	Chief Financial Officer
Joey Wat	46	President and Chief Operation Offer
Johnson Huang	55	General manager of KFC
Peter Kao	60	Chief Executive Officer, Pizza Hut
Mark Chu	59	Senior Advisor to the Chief Executive Officer
Shella Ng	52	Chief Legal Officer and Corporate Secretary
Danny Tan	48	Chief Support Officer
Christabel Lo	54	Chief People Officer
Sunny Sun	45	Chief Growth Officer
Ted Lee	50	Vice President and Brand General Manager, Little Sheep
Jeff Kuai	36	Brand General Manager, Pizza Hut Home Service
Angela Ai	63	Chief Development Officer
Alice Wang	46	Vice President, Public Affairs
Paul Hill	56	Vice President and Controller

Source: Deutsche Bank, company data



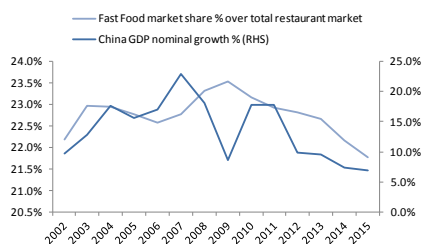
Comparing China Fast Food market vs. US and Hong Kong

The catering market shows a divergent trend when compared to mature markets, due to different dining culture and different development stages.

In HK and the US, the share of fast food as a percentage to the total catering market continues to increase over time. Fast food is regarded as the most economical choice, even compared to self-cooking.

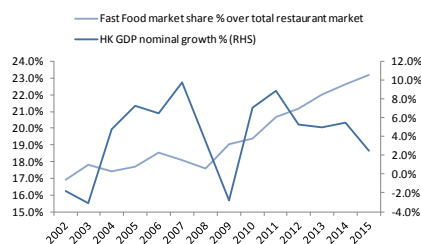
However, in China, fast food is somewhat correlated with an economy cycle as consumers, as cooking at home is still cheaper especially in lower tier cities. As fast food was introduced by western chains in the 80/90s, it was regarded as consumption upgrade when consumers went to a fast food restaurant.

Figure 77: Fast food percentage market share vs. GDP yoy percentage – China



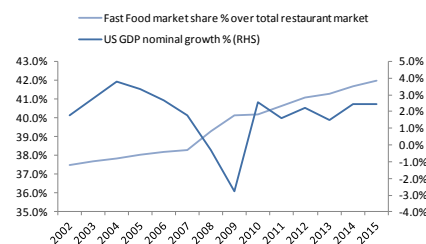
Source: Deutsche Bank, Euromonitor

Figure 78: Fast food percentage market share vs. GDP yoy percentage – HK



Source: Deutsche Bank, Euromonitor

Figure 79: Fast food percentage market share vs. GDP yoy percentage - US

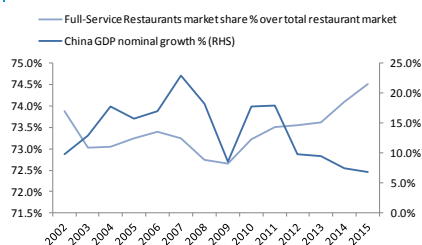


Source: Deutsche Bank, Euromonitor

Consumer trading up in China

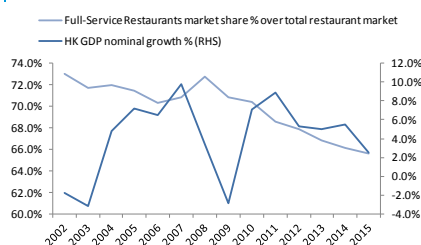
The full-service restaurant segment (Figure 80) is taking off despite the economic slowdown in China. This is driven by consumers' trading up with income growth. In HK/US, casual dining in full-service restaurants is trending down, along with a softer economy environment.

Figure 80: Full-service restaurants percentage market share vs. GDP yoy percentage – China



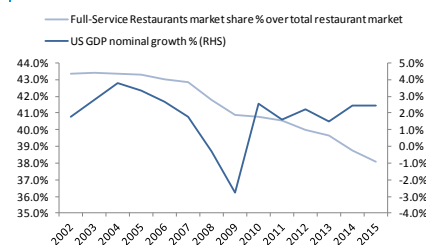
Source: Deutsche Bank, Euromonitor

Figure 81: Full-service restaurants percentage market share vs. GDP yoy percentage – HK



Source: Deutsche Bank, Euromonitor

Figure 82: Full-service restaurants percentage market share vs. GDP yoy percentage – US



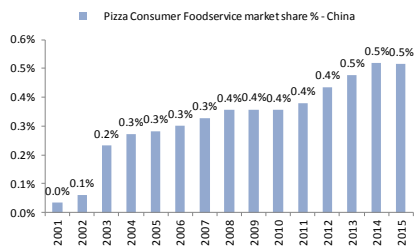
Source: Deutsche Bank, Euromonitor

Pizza – a western taste

Pizza, a typical western food, accounts for ~8% of the total catering market in US, while in China/HK, the market share of pizza consumer foodservice remains low at below 2%. Euromonitor categorizes pizza chains as a separate category in the US market vs. in HK and China where it is within the full-services segment. Some pizza chains in the US are in fact fast food chains, while in HK and China, most of them remain in full-scale restaurant format and compete with other cuisines.

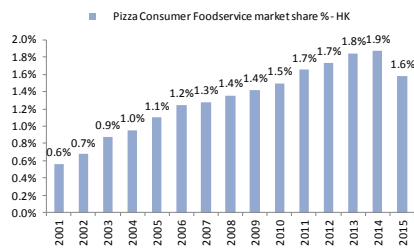


Figure 83: Pizza Consumer Foodservice market share percentage – China



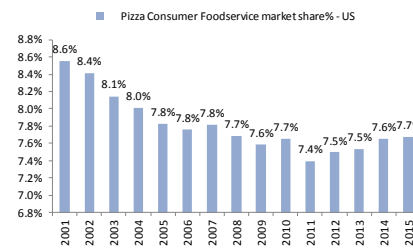
Source: Deutsche Bank, Euromonitor

Figure 84: Pizza Consumer Foodservice market share percentage – HK



Source: Deutsche Bank, Euromonitor

Figure 85: Pizza Consumer Foodservice market share percentage – US

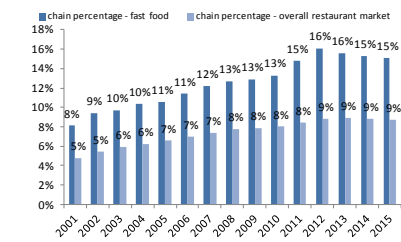


Source: Deutsche Bank, Euromonitor

Higher share for chain operation in fast food segment

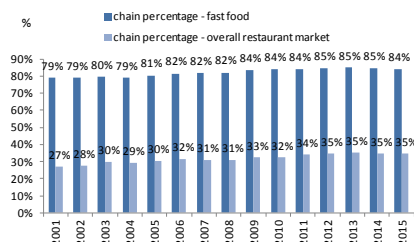
Higher share is seen for chain stores in fast food segments vs. overall segments for the three markets because this is a segment that requires scale and back-end support like logistic centers, central kitchen, etc. However, the share in China is still relatively low at ~15% vs. 70-80% for HK and the US.

Figure 86: Fast food has higher chain percentage than restaurant in general – China



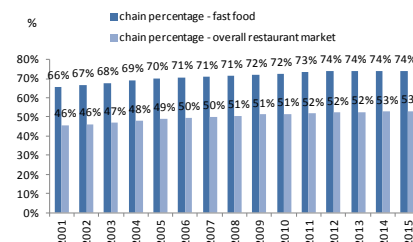
Source: Deutsche Bank, Euromonitor

Figure 87: Fast food has higher chain percentage than restaurant in general – HK



Source: Deutsche Bank, Euromonitor

Figure 88: Fast food has higher chain percentage than restaurant in general – US



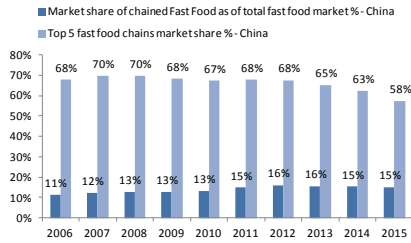
Source: Deutsche Bank, Euromonitor

Overall chained fast food picked up in share in China/HK but top five's shares tapping off

Market share of fast food chains vs. non-chains has steadily picked up from 11% in 2006 to 15% in 2015 in China. However, the top five chains' concentration declined in HK and China, while the US has been more stable over the past ten years. We believe competition in Asia is more intense, as consumers' preferences change faster.

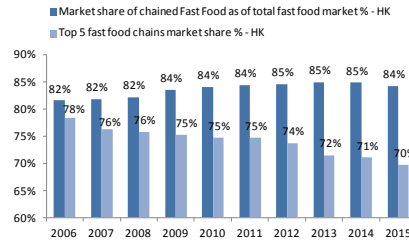


Figure 89: Market share of chained Fast Food as percentage to total fast food market percent vs. top five fast food chains' share (2006-2015) – China



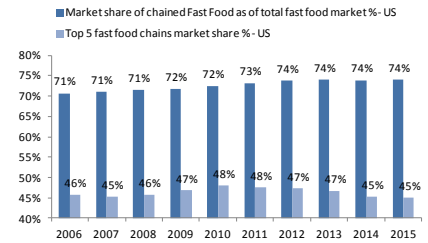
Source: Deutsche Bank, Euromonitor

Figure 90: Market share of chained Fast Food as percentage to total fast food market percent vs. top five fast food chains' share (2006-2015) – HK



Source: Deutsche Bank, Euromonitor

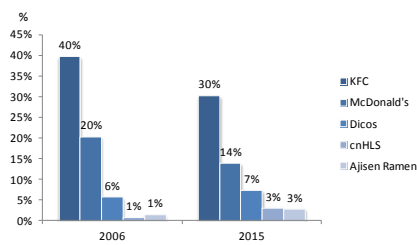
Figure 91: Market share of chained Fast Food as percentage to total fast food market percent vs. top five fast food chains' share (2006-2015) – US



Source: Deutsche Bank, Euromonitor

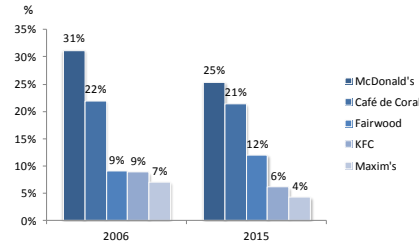
Western fast food chains are early player in the market; locals are catching up
 The decline in shares in China is mainly from KFC and MCD. We believe this is because competition is more intense. The western chains introduced the fast food segment in China in 80s/90s, and local players are catching up. In addition, brand fragmentation is also a trend.

Figure 92: Market share of top five fast food chains 2006 vs. 2015 – China



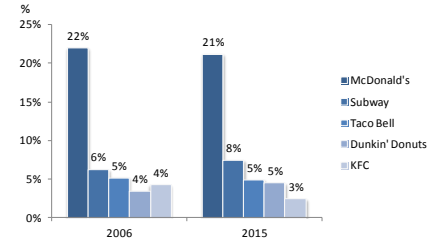
Source: Deutsche Bank, Euromonitor

Figure 93: Market share of top five fast food chains 2006 vs. 2015 – HK



Source: Deutsche Bank, Euromonitor

Figure 94: Market share of Top five fast food chains 2006 vs. 2015 – US



Source: Deutsche Bank, Euromonitor

The authors of this report wishes to acknowledge the contribution made by Louise Li, employee of Evalueserve, a third-party provider to Deutsche Bank of offshore research support services.



Yum! Brands – Valuation and risks

Our price target is based on an ~15x NTM EV/EBITDA (which implies ~23x P/E). The target multiple reflects improving results across the domestic and international business segments following the company's recap and move to an asset lighter model and positions the shares within the mid-point of other highly franchised models. This multiple is in-line with other highly franchised restaurants. Upside risks include YUM China returning to above-average growth, driving valuation multiples higher, lower commodity costs, stable and available labor. Downside risks include the growing strength of domestic and international players; operational risks related food inflation, availability and safety as well as labor costs due to minimum wage rates and overall inflation as well as ACA and other benefits and international risks related to global economies, foreign exchange rates and third party supply chain controls as well as capital risks ranging from interest rates to leverage to franchisees healthy.



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Yum China	YUMC.N	26.77 (USD) 22 Feb 17	NA
YUM! Brands	YUM.N	66.10 (USD) 22 Feb 17	14

Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr>. Aside from within this report, important conflict disclosures can also be found at <https://gm.db.com/equities> under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

Important Disclosures Required by U.S. Regulators

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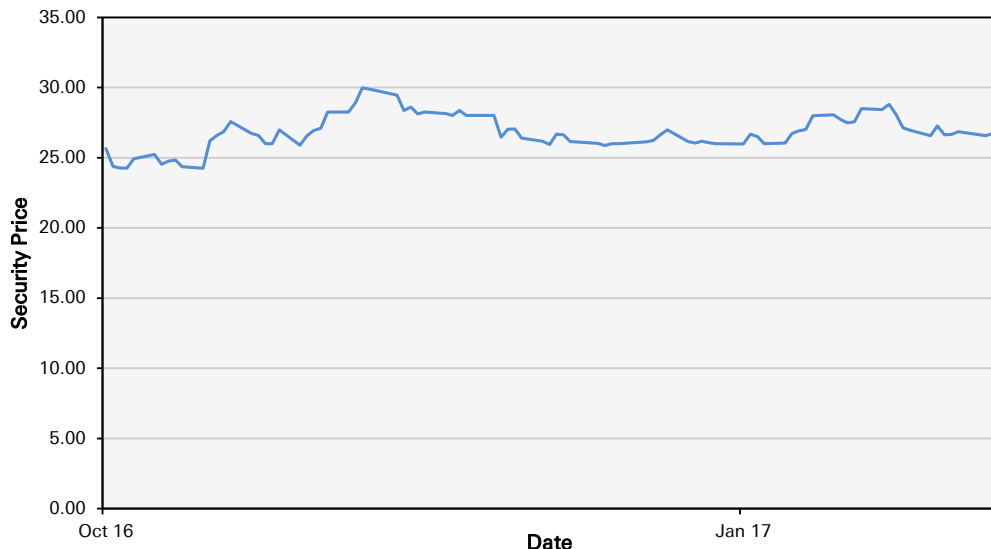
Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Anne Ling



Historical recommendations and target price: Yum China (YUMC.N)

(as of 2/22/2017)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9,2002

**Analyst is no longer at Deutsche Bank

Historical recommendations and target price: YUM! Brands (YUM.N)

(as of 2/22/2017)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
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- Suspended Rating

*New Recommendation Structure as of September 9,2002

**Analyst is no longer at Deutsche Bank

1. 31/07/2014:	Buy, Target Price Change USD78.00 Jason West, CFA**	6. 11/07/2016:	Hold, Target Price Change USD83.00 Brett Levy
2. 22/08/2014:	No Recommendation, Target Price Change USD0.00	7. 30/09/2016:	Hold, Target Price Change USD86.00 Brett Levy
3. 28/05/2015:	Upgrade to Hold, Target Price Change USD90.00 Karen Short**	8. 06/10/2016:	Hold, Target Price Change USD88.00 Brett Levy
4. 07/10/2015:	Hold, Target Price Change USD76.00 Karen Short**	9. 01/11/2016:	Hold, Target Price Change USD65.00 Brett Levy
5. 21/04/2016:	Hold, Target Price Change USD81.00 Brett Levy		



Equity rating key

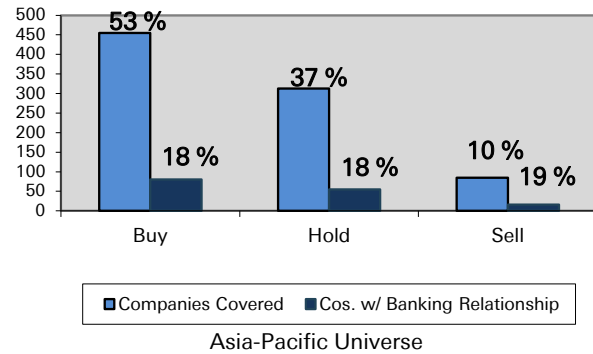
Buy: Based on a current 12-month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships





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Macroeconomic fluctuations often account for most of the risks associated with exposures to instruments that promise to pay fixed or variable interest rates. For an investor who is long fixed rate instruments (thus receiving these cash



flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus cause a loss. The longer the maturity of a certain cash flow and the higher the move in the discount factor, the higher will be the loss. Upside surprises in inflation, fiscal funding needs, and FX depreciation rates are among the most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client segmentation, regulation (including changes in assets holding limits for different types of investors), changes in tax policies, currency convertibility (which may constrain currency conversion, repatriation of profits and/or the liquidation of positions), and settlement issues related to local clearing houses are also important risk factors to be considered. The sensitivity of fixed income instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to FX depreciation, or to specified interest rates – these are common in emerging markets. It is important to note that the index fixings may – by construction – lag or mis-measure the actual move in the underlying variables they are intended to track. The choice of the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed to a typically short-dated interest rate reference index) are exchanged for fixed coupons. It is also important to acknowledge that funding in a currency that differs from the currency in which coupons are denominated carries FX risk. Naturally, options on swaps (swaptions) also bear the risks typical to options in addition to the risks related to rates movements.

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