

Company Report

China Merchants Securities (HK) Co., Ltd.
Hong Kong Equity Research

Yum China (YUMC US/9987 HK)

1Q23 SSSG recovering, but management still cautious

- COVID affected 4Q22 results more than expected
- SSSG recovering in 1Q23 but mgmt. still cautious
- Maintain HOLD. New TP of USD66/HKD514.7

COVID restrictions negatively affected 4Q22 revenue

YUMC announced 4Q22 revenue of USD2,088mn (+9% yoy, -18% vs. CMS est.). Currency neutral revenue increased 2% yoy. Self-owned restaurant revenue was USD21.9751mn (-5% yoy, -15% vs CMS est.). Operating profit was USD41mn (-94% yoy, -72% vs. CMS est.). Net income was USD53mn (-89% yoy, -50% vs. CMS est.).

Sales growth recovering in 1Q23

COVID affected 4Q22 sales more than we expected. At its peak, some 4,300 restaurants (nearly 1/3 of its total network) were either closed or could not provide dine-in services. After the relaxation of COVID restriction in mid Dec, operations of 1,300 restaurants were affected by a shortage of workers. Overall system sales and SSSG both decreased by 4% yoy respectively. KFC's SSSG fell 3% yoy while Pizza Hut's SSSG fell 8% yoy. In 1Q23, sales growth have been encouraging. Management said that SSSG grew by mid-single-digit pts vs FY22 Chinese New Year period, but have not recovered to pre-COVID levels. However, YUMC remains cautious regarding consumer spending post Chinese New Year.

Exceptional cost management

The lower revenue led to lower than expected margins. 4Q22 restaurant margins were 10.4%, +2.9ppts yoy, -2.3ppts vs CMS est. YUMC continued to implement efficiency measures such as sharing of management teams between different outlets and using digital resources to schedule staff. YUMC expects the efficiency measures to continue to help offset increases in chicken prices and wages in FY23.

New restaurant guidance of 1,100 – 1,300

YUMC opened 538 net new restaurants in 4Q22 bringing the number of net new restaurants opened in FY22 to 1,159 and the total number of restaurants to 12,947. Mgmt set its guidance for net new openings of 1,100-1,300 in FY23.

Maintain HOLD; increase TP to USD66/HKD514.7

We tweak our FY23E/24E EPS forecasts by -2%, and -3% respectively. We increase our TP to USD66/HKD514.7 which implies a TP multiple of 39.4x PE (previous 32.8x) on the next 12 months' EPS USD1.67. We maintain our HOLD rating. **Key catalysts:** Faster than expected recovery in sales, slowing cost inflation leading to higher-than-expected margins. **Key risk:** Weaker than expected consumer spending.

Financials

Year ended 31 Dec (USD mn)	2021	2022	2023E	2024E	2025E
Revenue	9,853	9,569	11,824	13,293	14,870
yoy growth	19.2%	-2.9%	23.6%	12.4%	11.9%
Net profit attributable	990	443	703	744	856
Adj. basic EPS (USD)	1.26	1.04	1.68	1.78	2.04
yoy growth	-21.1%	-17.1%	60.7%	5.8%	15.0%
P/E (9987 HK)	49.2x	59.3x	36.9x	34.9x	30.3x
ROE	14%	6%	10%	9%	10%
Net debt (cash)/ equity	-14%	-16%	-21%	-27%	-30%

Sources: Company data, CMS (HK) estimates; Closing prices as of Feb. 8, 2023 (HK market) & Feb. 7, 2023 (US market)

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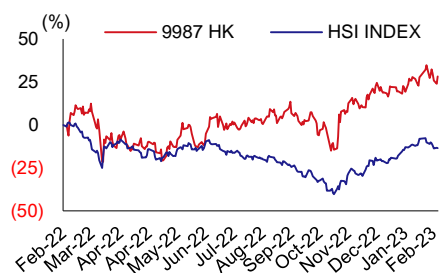
WHAT'S NEW

4Q22 revenue were lower than expected due to COVID. Maintain HOLD but increase TP to USD66/HKD514.7

HOLD

Previous	HOLD
Price	USD60.39/HKD480.0
12-month Target Price (Potential up/downside)	USD66.0/HKD514.7 (+9.3%/+7.2%)
Previous	USD54.0/HKD421.1

Price Performance



Source: Bloomberg; share price as of Feb 8, 2023

%	1m	6m	12m
9987 HK	9.8	28.8	35.4
HSI	1.4	6.2	(12.5)

Sector: Consumer

Hang Seng Index (Feb 8, 2023)	21,284
HSCEI (Feb 8, 2023)	7,189

Key Data

52-week range (HKD)	12.6 - 38.751
Market cap (USD mn)	27,167
Avg. daily volume (mn)	4.45
BVPS (USD)	4.29

Shareholding Structure

Senior mgmt. & others	4.4%
No. of shares outstanding (mn)	421
Free float	95.6%

Source: Bloomberg

Related Research

1. China Catering Sector - FY23 Outlook: Re opening rebound not fully priced in yet (OVERWEIGHT) (Jan 19, 2023)
2. Yum China (9987 HK/YUMC US) - Results beat; Cost controls should be sustainable (HOLD) (Nov 2, 2022)

Figure 1: 4Q22 results vs our estimates

Unit: USD mn	4Q22 est 招证预测	4Q22 act 实际业绩	% diff 相差%	yoy % 同比%	Excl. FX, yoy % 剔除外汇同比
Revenue	2,489	2,088	-16.1%	-8.9%	2%
KFC	1,834	1,591	-13.2%	-2.8%	
Pizzahut	501	404	-19.3%	-15.7%	
Others (mainly franchise)	154	93	-39.6%	-44.3%	
Restaurant profit	296	205	-30.8%	31.4%	
KFC	272	199	-26.8%	46.3%	
Pizzahut	33	7	-79.0%	-75.0%	
Others (mainly franchise)	(9)	(1)	-88.6%	-87.5%	
Restaurant margin	12.7%	10.4%	-2.3 ppt	2.9 ppt	
KFC	15.0%	12.7%	-2.3 ppt	4.1 ppt	
Pizzahut	6.7%	1.9%	-4.8 ppt	3.3 ppt	
Others (mainly franchise)	-44.6%	-9.1%	35.6 ppt	40.9 ppt	
Operating profit	146	41	-71.9%	-93.5%	189%
KFC	187	117	-37.5%	82.8%	
Pizzahut	5	(20)	-465.2%	233.3%	
Others (mainly franchise)	(47)	(56)	19.7%	-109.7%	
OPM	5.9%	2.1%	-3.8 ppt	-25.5 ppt	
KFC	10.2%	7.4%	-2.8 ppt	3.3 ppt	
Pizzahut	1.1%	-5.0%	-6.0 ppt	-3.6 ppt	
Others (mainly franchise)	-30.4%	-60.2%	-29.8 ppt	-404.5 ppt	
Net income	107	53	-50.4%	-88.8%	
NPM	4.3%	2.5%	-1.8 ppt	-18.2 ppt	
Adj. EPS (USD)	0.25	0.13	-48.9%	-88.3%	140%
Operational data					
Number of stores (total)	12,714	12,947	1.8%	9.8%	
KFC	8,925	9,094	1.9%	11.3%	
Pizzahut	2,855	2,903	1.7%	12.1%	
Others (mainly franchise)	934	950	1.7%	-7.8%	
Revenue per store (self-owned, US\$000)	213	153	-28.3%	-26.5%	
KFC	224	172	-23.3%	-19.8%	
Pizzahut	184	137	-25.4%	-29.2%	
Others	114	12	-89.8%	-88.3%	

Sources: Company data, CMS (HK) estimates

Note: "Others" includes other brands, corporate and unallocated, and intersegment elimination

Figure 2: Key assumptions adjustment

Change table	FY23E			FY24E			FY25E
	Original	New	diff %	Original	New	diff %	New
Unit: USD mn							
Total Revenue	11,868	11,824	-0.4%	13,316	13,293	-0.2%	14,870
KFC	8,799	9,118	3.6%	9,879	10,236	3.6%	11,438
Pizzahut	2,384	2,306	-3.3%	2,706	2,614	-3.4%	2,942
Others (mainly franchise)	685	401	-41.5%	731	444	-39.3%	490
Restaurant profit	1,519	1,672	10.1%	1,644	1,807	9.9%	1,987
KFC	1,338	1,413	5.6%	1,455	1,524	4.8%	1,647
Pizzahut	232	250	7.7%	264	284	7.5%	319
Others (mainly franchise)	(51)	9	-118.3%	(75)	(0)	-99.4%	21
Restaurant margin	13.6%	14.7%	1.1 ppt	13.0%	14.1%	1.0 ppt	13.8%
KFC	15.4%	15.7%	0.3 ppt	14.9%	15.1%	0.2 ppt	14.6%
Pizzahut	9.8%	10.9%	1.1 ppt	9.8%	10.9%	1.1 ppt	10.9%
Others (mainly franchise)	-59.2%	11.3%	70.5 ppt	-57.6%	-0.4%	57.2 ppt	12.1%
Operating profit	1,000	958	-4.2%	1,044	996	-4.7%	1,125
KFC	1,056	1,170	10.8%	1,163	1,247	7.2%	1,335
Pizzahut	118	146	23.8%	137	166	20.7%	187
Others (mainly franchise)	(174)	(358)	105.3%	(256)	(418)	62.9%	(397)
OPM	8.4%	8.1%	-0.3 ppt	7.8%	7.5%	-0.4 ppt	7.6%
KFC	12.0%	12.8%	0.8 ppt	11.8%	12.2%	0.4 ppt	11.7%
Pizzahut	4.9%	6.3%	1.4 ppt	5.1%	6.3%	1.3 ppt	6.4%
Others (mainly franchise)	-25.4%	-89.3%	-63.9 ppt	-35.1%	-94.1%	-59.1 ppt	-81.0%
Net income	720	702	-2.4%	769	743	-3.4%	855
NPM	6.1%	5.9%	-0.1 ppt	5.8%	5.6%	-0.2 ppt	5.7%
EPS (USD)	1.70	1.66	-2.2%	1.81	1.76	-3.1%	2.02
Operational data							
Number of stores (total)	14,048	14,192	1.0%	14,425	14,488	0.4%	14,783
KFC	9,888	9,984	1.0%	10,891	10,914	0.2%	11,884
Pizzahut	3,131	3,179	1.5%	3,407	3,455	1.4%	3,731
Others (mainly franchise)	1,029	1,029	0.0%	1,134	1,134	0.0%	1,239
Revenue per store (self-owned, US\$'000)	918	922	0.4%	1,008	1,017	0.9%	1,116
KFC	976	994	1.8%	998	1,017	1.9%	1,039
Pizzahut	798	759	-4.9%	833	793	-4.9%	827
Others	327	313	-4.3%	355	341	-3.9%	363

Sources: Company data, CMS (HK) estimates

Note: "Others" includes other brands, corporate and unallocated, and intersegment elimination

Figure 3: Target price valuation

Target price calculation	
1-yr fwd target P/E	39.4x
Fwd 12 month adj. EPS (USD)	1.68
Target price (HKD)	514.7
Stock price (HKD)	480.0
Upside	7.2%

Sources: Company data, Bloomberg, CMS (HK) estimate;

Note: H share (9987 HK) is the closing price as of Feb 8, 2023.

Financial statement

Balance Sheet

USD mn	2021	2022	2023E	2024E	2025E
Cash and cash equivalents	1,136	1,130	1,671	2,219	2,583
Short-term investments	2,860	2,022	2,022	2,022	2,022
Accounts receivable, net	67	64	112	126	139
Inventories, net	432	417	467	533	536
Prepaid expenses and others	221	307	283	317	247
Total current assets	4,716	3,940	4,555	5,218	5,527
PP&E	2,251	2,118	2,274	2,341	2,343
Operating lease right-of-use	2,612	2,219	1,953	1,532	1,437
Goodwill	2,142	1,988	2,142	2,142	2,142
Intangible assets, net	272	159	195	183	180
Deferred income taxes	106	113	113	113	113
Investments in affiliates	292	266	266	266	266
Other assets	832	1,023	1,436	1,612	1,776
Non-current assets	8,507	7,886	8,380	8,188	8,257
Total assets	13,223	11,826	12,935	13,406	13,783
Accounts payable and others	2,332	2,098	2,639	2,844	3,033
Income taxes payable	51	68	75	85	111
Total Current Liabilities	2,383	2,166	2,714	2,929	3,144
NC operating lease liabilities	2,286	1,906	1,621	1,200	1,105
NC finance lease obligations	40	42	42	42	42
Other liabilities	592	552	756	859	937
Total non-current liabilities	2,918	2,500	2,419	2,101	2,084
Total liabilities	5,301	4,666	5,133	5,030	5,228
Redeemable NCI	14	12	12	12	12
Common stock	4	4	4	4	4
Treasury stock	-803	0	0	0	0
Additional paid-in capital	4,695	4,390	4,390	4,390	4,390
Retained earnings	2,892	2,191	2,820	3,383	3,559
Accumulated others	268	-103	-103	-103	-103
Total Equity – Yum China	7,056	6,482	7,111	7,674	7,850
Non-controlling interests	852	666	678	690	693
Total Equity	7,908	7,148	7,789	8,364	8,543
Total Liabilities and Equity	13,223	11,826	12,935	13,406	13,783

Cashflow

USD mn	2021	2022	2023E	2024E	2025E
Net income	1,023	478	715	756	787
D&A	516	602	922	1,166	1,166
Share-based compensation	41	42	0	0	0
Changes in OWC	-418	-168	189	-320	-200
Others	-31	459	-209	-73	-86
CF from operating activities	1,131	1,413	1,616	1,530	1,667
Capital expenditure	-689	-679	-800	-800	-800
Others	-166	157	-154	0	0
CF from investing activities	-855	-522	-954	-800	-800
Repayment of bank borrowings	0	0	0	0	0
New borrowings raised	0	0	0	0	0
Proceeds from equity issuance	0	0	0	0	0
Share repurchases	-75	-466	0	0	0
Cash dividends paid	-203	-202	-153	-181	-186
Others	-35	-176	0	0	0
CF from financing activities	-313	-844	-153	-181	-186
FX effects	15	-53	31	0	0
Net cash flow	-22	-6	541	549	681

P&L

USD mn	2021	2022	2023E	2024E	2025E
Revenues	9,853	9,569	11,824	13,293	14,870
Restaurant expenses	-7,734	-7,829	-9,712	-11,036	-12,423
G&A expenses	-564	-594	-753	-849	-899
Franchise expenses	-64	-34	-36	-41	-45
Expenses for transactions with franchisees and unconsolidated affiliates	-649	-279	-278	-285	-292
Other expenses/income	-74	-204	-86	-86	-86
Adj. operating profit	768	629	958	996	1,125
One-off gain/expense	618	-1	0	0	0
Operating profit	1,386	628	958	996	1,125
Interest income, net	60	84	63	85	115
Investment (loss) gain	-54	-26	0	0	0
Profit before tax	1,392	686	1,022	1,080	1,240
Income tax (provision) benefit	-369	-207	-307	-324	-372
Net income	1,023	479	715	756	868
Non-controlling interest	-33	-36	-12	-12	-12
Attributable net profit	990	443	703	744	856
Adj. net profit	526	442	703	744	856
Basic EPS (USD)	2.34	1.04	1.68	1.78	2.04
Adj. Basic EPS (USD)	1.26	1.04	1.68	1.78	2.04
Div. per share (USD)	0.47	0.42	0.36	0.42	0.41

Financial Ratio

	2021	2022	2023E	2024E	2025E
yoy growth rate					
Revenue	19.2%	-2.9%	23.6%	12.4%	11.9%
Adj. operating profit	6.4%	-18.1%	52.4%	3.9%	13.0%
Adj. net profit	-14.5%	-16.0%	59.1%	5.8%	15.0%
Adj. EPS	-21.1%	-17.1%	60.7%	5.8%	15.0%
Profitability					
Restaurant margin	12.5%	13.4%	14.1%	13.6%	13.4%
adj. OPM	7.8%	6.6%	8.1%	7.5%	7.6%
adj. NPM	5.3%	4.6%	5.9%	5.6%	5.8%
Liquidity					
AR days	3.1	2.5	2.7	3.3	3.3
Inventory days	53.9	54.6	45.6	45.2	43.1
AP days	228.9	233.6	202.9	211.7	204.6
Cash conversion cycle	-172.0	-176.5	-154.6	-163.2	-158.2
Cash flow & leverage					
Free cash low	469	236	981	743	953
Net debt to equity	-14.4%	-15.8%	-21.4%	-26.5%	-30.2%
Dividend payout ratio	20.5%	40.6%	21.7%	23.6%	20.5%
Dividend yield	0.8%	0.7%	0.6%	0.7%	0.7%
Return analysis					
ROE	14.2%	6.4%	9.6%	9.4%	10.3%
Asset turnover	0.8	0.8	1.0	1.0	1.1
Net margin	10.4%	5.0%	6.0%	5.7%	5.8%
Financial leverage	1.7	1.7	1.7	1.6	1.6
ROIC	12.5%	5.1%	8.5%	9.2%	10.9%
Valuation ratios (9987 HK)					
P/E	49.2x	59.3x	36.9x	34.9x	30.3x
P/B	3.4x	3.7x	3.4x	3.1x	3.1x

Sources: Company data, CMS (HK) estimates

Investment Ratings

Industry Rating	Definition
OVERWEIGHT	Expect sector to outperform the market over the next 12 months
NEUTRAL	Expect sector to perform in-line with the market over the next 12 months
UNDERWEIGHT	Expect sector to underperform the market over the next 12 months

Company Rating	Definition
BUY	Expect stock to generate 10%+ return over the next 12 months
HOLD	Expect stock to generate +10% to -10% over the next 12 months
SELL	Expect stock to generate loss of 10%+ over the next 12 months

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Hong Kong

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