

# Yum China (9987 HK)

## 2Q24E is tough but turnaround is still possible

The 1Q24 results of Yum China were satisfactory, however the catering industry remain subdued and hence we have become more cautious about YUMC's 2Q24E outlook. But since the turnaround in 2H24E should still be intact, plus the massive buyback and dividend payment, we continue to maintain BUY.

■ **1Q24 results roughly inline.** For 1Q24, Yum China's sales increased by 1% YoY to US\$ 2.96bn, missing CMBI est. by 6%, due to: 1) slight miss in Pizza Hut's SSSG (fell by 5% vs CMBI est. of -3%), 2) CNY depreciation, 3) lower-than-expected sales per store (as a result of smaller-sized new stores). But net profit only fell by 1% YoY to US\$ 287mn, inline with CMBI est., consisted of: 1) lower-than-expected GP margin (due to heavy promotions) but 2) better-than-expected rent and other opex and G&A expenses. In terms of segment, delivery sales grew strongly by 8% while dine-in sales fell by 2%. KFC's SSS was resilient and dropped by just 2% while Pizza Hut's SSS fell by 5%, and KFC/ Pizza Hut's restaurant level OP margin were at 19.3%/ 12.5%, 2.9ppt/ 1.7ppt lower than last year.

■ **We are conservative about 2Q24E but still expect a turnaround in 2H24E.** Even though Yum China's 1Q24 results were muted but we tend to believe this was mostly due to its highly fragmented industry nature (where price war could intensify easily when the economic growth slowed down). In fact, under these macro circumstances, the fast food segment has already outperformed and we are pleased by Yum China's successful execution of planned strategy of "driving transaction and sales while protecting the margin". Going forward in 2Q24E, we believe Yum China's strategy will continue: 1) a series of new product launches (e.g. Pizza Hut's Pizza Burger), 2) more value for money products (e.g. more Pizza Hut priced below RMB 50), 3) more small orders (e.g. one person meal or for delivery) and 4) K-coffee continues to be popular (30% YoY volume growth in 1Q24, boosted by new product like sparking coffee), more side by side K-coffee stands could be opened in the near future (kitchen will be shared with KFC stores and hence margin is protected). However we would still be conservative about 2Q24E, because of: 1) the high base effect (strong sales growth) and 2) margin drag, due to absence of other income and tax reliefs of US\$ 12mn last year and heavy promotions (even though the management will step up its costs saving in the G&A expenses (could drive down to just 5% of sales), by its Project Fresh Eye and its AI technology). While the 3-year growth target during FY23-26E (HSD to double digit sales and double digit EPS) could still be intact, we have become slightly more conservative and now forecast only 4%/3% sales/ net profit growth in FY24E. But we are still expecting a pickup in 2H24E.

■ **Maintain BUY but trim TP to HK\$ 348.13.** Our new TP is based on 23x FY24E P/E (revised down from 24x) still around 1 s.d. below 5-year average P/E of 27x. We revised down FY24E/ 25E/ 26E net profit by 5.4%/ 5.0%/ 4.4% to reflect: 1) slower-than-expected sales growth, 2) lower sales per store, 3) lower GP margin and 4) weaker operating leverage, etc. The counter is now trading at 19x FY24E P/E.

### Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (US\$ mn)	9,569	10,978	11,422	12,459	13,540
YoY growth (%)	(2.9)	14.7	4.0	9.1	8.7
Operating profit (US\$ mn)	629.0	1,106.0	1,072.7	1,252.5	1,419.4
Net profit (US\$ mn)	442.0	827.0	848.0	953.5	1,082.8
EPS (Reported) (US\$)	1.04	1.97	1.95	2.20	2.49
YoY growth (%)	(54.4)	89.3	(0.8)	12.4	13.6
P/E (x)	36.2	19.1	19.3	17.1	15.1
P/B (x)	2.1	2.1	1.9	1.7	1.6
Yield (%)	1.3	1.5	1.4	1.6	1.8
ROE (%)	5.9	11.0	10.3	10.7	11.1

Source: Company data, Bloomberg, CMBIGM estimates

### BUY (Maintain)

**Target Price** **HK\$348.13**

(Previous TP) HK\$384.17)

**Up/Downside** **18.3%**

**Current Price** **HK\$294.40**

### China Consumer Discretionary

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### Stock Data

Mkt Cap (HK\$ mn)	123,353.6
Avg 3 mths t/o (HK\$ mn)	185.2
52w High/Low (HK\$)	504.00/264.00
Total Issued Shares (mn)	419.0

Source: FactSet

### Shareholding Structure

JPMorgan Chase & Co.	10.5%
Invesco Advisers, Inc.	8.0%

Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	-4.5%	-11.0%
3-mth	9.8%	-4.3%
6-mth	-28.1%	-30.7%

Source: FactSet

### 12-mth Price Performance



Source: FactSet

- **Store opening and capex plan remained intact.** Yum China has opened 378 net new stores in 1Q24, representing 14% YoY growth, much faster than the 10% to 12% growth implied by the FY24E target of 1,500 to 1,700 net new store openings. Noted that the number of restaurants for other brands has actually decreased but that was only due to the downsizing of Taco bell while the Little Sheep and Huang Ji Huang are still growing.
- **No change on the buyback and dividend plan in FY24E.** The Company will continue its plan to buy back shares worth of US\$ 1.25bn and roughly dividend worth of US\$ 275mn in FY24E.

## Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (US\$ mn)						
<b>Revenue</b>	<b>9,853</b>	<b>9,569</b>	<b>10,978</b>	<b>11,422</b>	<b>12,459</b>	<b>13,540</b>
Cost of goods sold	(2,812)	(2,836)	(3,224)	(3,409)	(3,695)	(4,020)
<b>Gross profit</b>	<b>7,041</b>	<b>6,733</b>	<b>7,754</b>	<b>8,013</b>	<b>8,764</b>	<b>9,520</b>
<b>Operating expenses</b>	<b>(6,298)</b>	<b>(6,010)</b>	<b>(6,648)</b>	<b>(6,940)</b>	<b>(7,512)</b>	<b>(8,101)</b>
Selling expense	0	0	0	0	0	0
Admin expense	(663)	(704)	(779)	(731)	(785)	(853)
Staff costs	(2,258)	(2,389)	(2,725)	(2,951)	(3,188)	(3,439)
Other rental related expenses	(959)	(884)	(935)	(952)	(1,012)	(1,075)
Others	(1,902)	(1,431)	(1,756)	(1,686)	(1,861)	(2,013)
<b>Operating profit</b>	<b>1,386</b>	<b>629</b>	<b>1,106</b>	<b>1,073</b>	<b>1,253</b>	<b>1,419</b>
Other income	643	(94)	0	0	0	0
Share of (losses)/profits of associates/JV	0	0	0	0	0	0
<b>EBITDA</b>	<b>1,902</b>	<b>1,231</b>	<b>1,559</b>	<b>1,692</b>	<b>1,919</b>	<b>2,140</b>
Depreciation	(505)	(582)	(423)	(562)	(626)	(708)
Other amortisation	(11)	(20)	(30)	(57)	(40)	(13)
Interest income	60	84	169	139	159	182
Interest expense	0	0	0	0	0	0
<b>Net Interest income/(expense)</b>	<b>60</b>	<b>84</b>	<b>169</b>	<b>139</b>	<b>159</b>	<b>182</b>
Other income/expense	(54)	(26)	(49)	0	(50)	(54)
<b>Pre-tax profit</b>	<b>1,392</b>	<b>687</b>	<b>1,226</b>	<b>1,211</b>	<b>1,362</b>	<b>1,547</b>
Income tax	(369)	(209)	(325)	(303)	(341)	(387)
<b>After tax profit</b>	<b>1,023</b>	<b>478</b>	<b>901</b>	<b>909</b>	<b>1,022</b>	<b>1,160</b>
Minority interest	(33)	(36)	(74)	(61)	(68)	(77)
<b>Net profit</b>	<b>990</b>	<b>442</b>	<b>827</b>	<b>848</b>	<b>953</b>	<b>1,083</b>

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (US\$ mn)						
<b>Current assets</b>	<b>4,716</b>	<b>3,940</b>	<b>5,177</b>	<b>5,931</b>	<b>6,689</b>	<b>7,580</b>
Cash & equivalents	1,136	1,130	2,245	2,954	3,629	4,429
Restricted cash	2,860	2,022	2,022	2,022	2,022	2,022
Account receivables	67	64	75	78	85	93
Inventories	432	417	483	510	553	602
Prepayment	221	307	352	366	400	434
Other current assets	0	0	0	0	0	0
<b>Non-current assets</b>	<b>8,507</b>	<b>7,886</b>	<b>7,545</b>	<b>7,501</b>	<b>7,671</b>	<b>7,830</b>
PP&E	2,251	2,118	2,319	2,499	2,682	2,855
Right-of-use assets	2,612	2,219	2,219	2,219	2,219	2,219
Investment in JVs & assos	292	266	266	266	266	266
Intangibles	272	159	99	42	2	(11)
Goodwill	2,142	1,988	1,506	1,339	1,365	1,365
Other non-current assets	938	1,136	1,136	1,136	1,136	1,136
<b>Total assets</b>	<b>13,223</b>	<b>11,826</b>	<b>12,722</b>	<b>13,432</b>	<b>14,360</b>	<b>15,410</b>
<b>Current liabilities</b>	<b>2,383</b>	<b>2,166</b>	<b>2,363</b>	<b>2,444</b>	<b>2,589</b>	<b>2,748</b>
Short-term borrowings	0	0	0	0	0	0
Account payables	830	830	944	998	1,081	1,177
Tax payable	51	68	68	68	68	68
Other current liabilities	1,502	1,268	1,352	1,378	1,440	1,504
<b>Non-current liabilities</b>	<b>2,918</b>	<b>2,500</b>	<b>2,500</b>	<b>2,500</b>	<b>2,500</b>	<b>2,500</b>
Long-term borrowings	0	0	0	0	0	0
Other non-current liabilities	2,918	2,500	2,500	2,500	2,500	2,500
<b>Total liabilities</b>	<b>5,301</b>	<b>4,666</b>	<b>4,863</b>	<b>4,944</b>	<b>5,089</b>	<b>5,248</b>
Share capital	4,967	4,291	4,291	4,291	4,291	4,291
Retained earnings	2,892	2,191	2,588	3,202	3,893	4,678
Other reserves	63	678	980	1,046	1,143	1,256
<b>Total shareholders equity</b>	<b>7,922</b>	<b>7,160</b>	<b>7,859</b>	<b>8,540</b>	<b>9,328</b>	<b>10,225</b>
Minority interest	0	0	0	0	0	0
<b>Total equity and liabilities</b>	<b>13,223</b>	<b>11,826</b>	<b>12,722</b>	<b>13,483</b>	<b>14,417</b>	<b>15,473</b>

<b>CASH FLOW</b>	<b>2021A</b>	<b>2022A</b>	<b>2023A</b>	<b>2024E</b>	<b>2025E</b>	<b>2026E</b>
<b>YE 31 Dec (US\$ mn)</b>						
<b>Operating</b>						
<b>Profit before taxation</b>	<b>1,392</b>	<b>687</b>	<b>1,226</b>	<b>1,211</b>	<b>1,362</b>	<b>1,547</b>
Depreciation & amortization	516	602	453	619	666	721
Tax paid	160	(20)	(325)	(303)	(341)	(387)
Change in working capital	53	0	75	36	62	69
Others	(990)	144	602	116	(31)	(6)
<b>Net cash from operations</b>	<b>1,131</b>	<b>1,413</b>	<b>2,031</b>	<b>1,679</b>	<b>1,718</b>	<b>1,943</b>
<b>Investing</b>						
Capital expenditure	(689)	(679)	(714)	(742)	(810)	(880)
Acquisition of subsidiaries/ investments	(115)	(23)	0	0	0	0
Others	(51)	180	0	0	0	0
<b>Net cash from investing</b>	<b>(855)</b>	<b>(522)</b>	<b>(714)</b>	<b>(742)</b>	<b>(810)</b>	<b>(880)</b>
<b>Financing</b>						
Dividend paid	(203)	(202)	(202)	(228)	(234)	(263)
Net borrowings	0	0	0	0	0	0
Proceeds from share issues	0	0	0	0	0	0
Share repurchases	(75)	(466)	0	0	0	0
Others	(35)	(176)	0	0	0	0
<b>Net cash from financing</b>	<b>(313)</b>	<b>(844)</b>	<b>(202)</b>	<b>(228)</b>	<b>(234)</b>	<b>(263)</b>
<b>Net change in cash</b>						
Cash at the beginning of the year	1,158	1,136	1,130	2,245	2,954	3,629
Exchange difference	15	(53)	0	0	0	0
Others	(37)	47	1,115	709	675	800
<b>Cash at the end of the year</b>	<b>1,136</b>	<b>1,130</b>	<b>2,245</b>	<b>2,954</b>	<b>3,629</b>	<b>4,429</b>

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

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