Yum China Holdings, Inc. (YUMC)

Updated July 20th, 2022, by Yiannis Zourmpanos

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	17.1%	**Market Cap:**	$19.5B
Fair Value Price:	$27	**5 Year Growth Estimate:**	30.0%	**Ex-Dividend Date:**	05/27/2022
% Fair Value:	174%	**5 Year Valuation Multiple Estimate:**	-10.5%	**Dividend Payment Date:**	06/21/2022
Dividend Yield:	1.0%	**5 Year Price Target**	$100	**Years Of Dividend Growth:**	1
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Rating:**	Buy

Overview & Current Events

Yum China Holdings, Inc. is the largest restaurant company in China, with more than 12,117 locations in 1,600 cities. The company's restaurant holding includes KFC (8,441 stores), Pizza Hut (2,679), and other brands, including Taco Bell (997). As of the end of the first quarter of 2022, the company owned and operated 90% of its restaurants (10% franchised). Yum, China separated from Yum! Brands in October 2016. The company reported $9.9 billion in revenues in 2021.

On May 3rd, 2022, Yum China announced Q1 2022 results reporting revenue of $2.7 billion for the quarter, up 4.3% as compared to $2.6 billion during the same period last year. The company recorded an operating profit of $191 million, a decline of 44.1% compared to $342 million during Q1 2021. Yum China's Non-GAAP EPS of $0.24 missed analysts' estimate by $0.09.

The company suffered from COVID-19 headwinds during the quarter, particularly in China, which accounts for around 35% of the company's store and sales mix. The COVID-19 situation deteriorated in the latter half of the first quarter in March, and over 1,700 stores on average offered only takeaway and delivery services, of which approximately 40% of stores remained temporarily closed. Moreover, same-store sales were also affected by the re-emergence of COVID-19 during the quarter as it declined by more than 20% YoY during March. Restaurant margin during Q1 2022 was reported at 13.8%, down by 490 basis points compared to 18.7% in Q1 2021. The company noted that the restaurant margin remained constricted in the quarter due to increased commodity prices, wages, and utility prices.

The company maintained a conservative stance for Q2 2022 as the full effect of COVID lockdowns would be reflected in the results. Eastern China, one of the most prosperous regions in the country, is impacted, with major cities such as Shanghai, Shenzhen, Guangzhou, Tianjin, and Suzhou undergoing strict lockdown measures as the Chinese government implemented the Zero-Covid policy.

However, the management remained optimistic about achieving its 2022 targets for the year, as they expect a disciplined approach of opening high-quality new stores and approximately 1,000 to 1,200 new stores in the year. In addition, they expect capital expenditures in the range of approximately $800 million to $1 billion for investments in digital, supply chain infrastructure, and store network expansion.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	-	-	-	-	$1.36	$1.01	$1.53	$1.84	$1.51	$1.22	***$0.90***	***$3.34***
DPS	-	-	-	-	-	$0.10	$0.42	$0.48	$0.24	$0.48	***$0.48***	***$0.71***
Shares	-	-	-	-	383.3	384.7	379.0	376.0	420.0	428.0	***415.0***	***402.5***

Yum China has grappled with COVID-19-related challenges with intermittent lockdowns from 2020 to the current year, which has affected its earnings in recent years. However, we believe the company is well-positioned for growth in the coming years with a favorable industry outlook. The fast food restaurant industry still has a lot of room for growth, with it constituting only about 17% of restaurant spending compared with 61% in the U.S. We believe the trend will change in the coming years, driven by secular trends and Yum China, with its substantial brand value and market size stands to be the biggest beneficiary as macro headwinds subside. We forecast a 30.0% growth in EPS from 2022, in line with the company's aggressive expansion plan in China (1,806 gross new stores opened in 2021, 1000-1200 planned for 2022). In

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addition, once the COVID headwinds subside, we expect significant improvement in same-store sales and restaurant margins to reach the pre-covid level of nearly 16% contributing to the company's earnings. As a result, we believe the company will be able to grow its dividends at a healthy pace going forward.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Avg. P/E	-	-	-	-	20.0	35.1	25.4	23.9	33.2	48.6	***52.2***	***30.0***
Avg. Yld.	-	-	-	-	-	0.3%	1.1%	1.1%	0.5%	0.8%	***1.0%***	***0.7%***

Yum China is trading at a forward P/E of 52.2, higher than the five-year average of 33.2. Since the earnings have declined significantly and are expected to grow at a high pace as COVID-related restrictions are set aside, the stock seems to be trading at a premium. We expect the P/E to normalize as earnings continue to grow and have assumed a conservative P/E of 30.0 for 2027. According to the valuation, we have a 5-year price target of $100 on the stock, suggesting a 113% upside potential from current levels.

Safety, Quality, Competitive Advantage, & Recession Resiliency

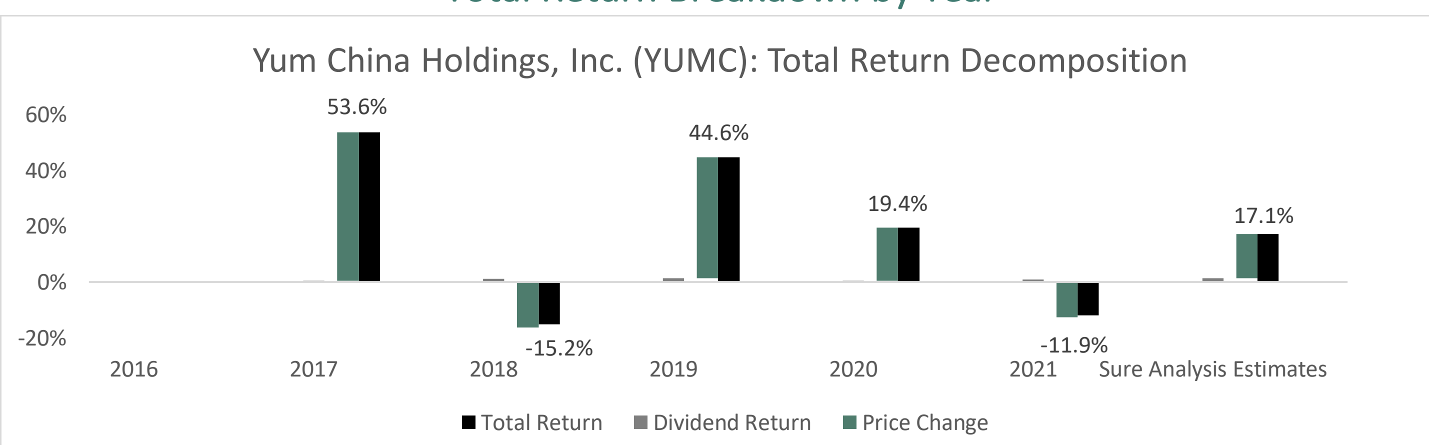
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	-	-	-	-	0%	10%	27%	26%	16%	39%	***53%***	***21%***

Yum China has a good payout ratio and has increased the dividends at a CAGR of 48.0% from 2017-2021. Yum China's most important competitive advantage is its high brand value. Moreover, the focus on menu innovations and efficient supply chain infrastructure, which results in cost advantages compared to other smaller brands, provides an edge to Yum China over other fast food restaurant businesses. In addition, Yum China, as the largest restaurant chain, benefits from economies of scale, which allows it to exert significant influence over suppliers and guarantee access to food and other raw materials at stable, reasonable pricing. We believe the business also operates in a recession-proof industry since everyone still requires food and drink to survive no matter the macro-economic situation.

Final Thoughts & Recommendation

We believe that the company's fundamental business model is solid and will continue to thrive in the future. The company has a solid balance sheet with $3.7 billion available in cash and short-term investments, which it can utilize to continue to expand and pay dividends to shareholders. Our Buy rating on the stock is premised upon the 17.1% annualized total returns for the medium term, derived from the forecasted earnings-per-share growth of 30.0% and 1.0% dividend yield.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue		6,905	6,934	6,909	7,075	7,769	8,415	8,776	8,263	9,853
Gross Profit		880	841	908	1,096	1,284	1,315	1,401	1,267	1,406
Gross Margin		12.7%	12.1%	13.1%	15.5%	16.5%	15.6%	16.0%	15.3%	14.3%
SG&A Exp.		356	389	395	429	495	456	487	479	564
D&A Exp.		394	411	425	402	409	445	428	450	516
Operating Profit		529	469	511	652	761	830	863	709	734
Op. Margin		7.7%	6.8%	7.4%	9.2%	9.8%	9.9%	9.8%	8.6%	7.4%
Net Profit		126	(7)	323	498	398	708	713	784	990
Net Margin		1.8%	-0.1%	4.7%	7.0%	5.1%	8.4%	8.1%	9.5%	10.0%
Free Cash Flow		782	775	913	866	884	1,333	1,185	1,114	1,131
Income Tax		135	54	168	156	379	214	260	295	369

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets			3,257	3,201	3,727	4,287	4,610	6,950	10,875	13,223
Cash & Equivalents			238	425	885	1,059	1,266	1,046	1,158	1,136
Acc. Receivable			60	33	74	79	80	88	99	67
Inventories			260	189	268	297	307	380	398	432
Goodwill & Int.			216	192	167	340	520	481	1,218	2,552
Total Liabilities			1,303	1,216	1,284	1,440	1,633	3,775	4,404	5,301
Accounts Payable			501	438	480	420	619	623	708	830
Long-Term Debt			-	-	-	-	-	-	-	-
Total Equity			1,888	1,921	2,377	2,765	2,873	3,077	6,206	7,056
LTD/E Ratio			-	-	-	-	-	-	-	-

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets				10.0%	14.4%	9.9%	15.9%	12.3%	8.8%	8.2%
Return on Equity				17.0%	23.2%	15.5%	25.1%	24.0%	16.9%	14.9%
ROIC				16.4%	22.5%	15.0%	24.3%	23.2%	16.3%	13.8%
Shares Out.	-	-	-	-	383.3	384.7	379.0	376.0	420.0	428.0
Revenue/Share		17.71	17.78	17.72	19.17	19.52	21.30	22.62	20.55	22.70
FCF/Share		2.01	1.99	2.34	2.35	2.22	3.37	3.05	2.77	2.61

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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