Yum China Holdings, Inc. (YUMC)

Updated February 20th, 2023, by Yiannis Zourmpanos

Key Metrics

Current Price:	$60	**5 Year CAGR Estimate:**	16.0%	**Market Cap:**	$25.47B
Fair Value Price:	$62	**5 Year Growth Estimate:**	15.0%	**Ex-Dividend Date:**	03/07/2023
% Fair Value:	98%	**5 Year Valuation Multiple Estimate:**	0.4%	**Dividend Payment Date:**	03/29/2023
Dividend Yield:	0.9%	**5 Year Price Target**	$124	**Years Of Dividend Growth:**	1
Dividend Risk Score:	C	**Retirement Suitability Score:**	F	**Rating:**	Buy

Overview & Current Events

Yum China Holdings, Inc. is the largest restaurant company in China, with more than 12,947 locations in 1,800 cities. The company's restaurant holding includes KFC (9,094 stores), Pizza Hut (2,903), and other brands, including Taco Bell (950). As of the end of the fourth quarter of 2022, the company owned and operated 86% of its restaurants (14% franchised). Yum, China separated from Yum! Brands in October 2016. The company reported $9.57 billion in revenues in 2022.

On February 7th, 2023, Yum China announced Q4 2022 results reporting non-GAAP diluted EPS of $0.13, in-line with market estimates. The revenue for the quarter was reported at $2.09 billion, down 9% as compared to $2.29 billion during the same period last year. In addition, the company recorded an operating profit of $41 million, a decrease of 93%, excluding F/X from Q4 2021.

The management noted that during the last quarter, there were significant shifts in COVID circumstances and regulations in China. Starting in October and continuing into November, isolated instances of COVID cases rapidly escalated into widespread outbreaks, resulting in stricter health protocols and lockdowns. The number of stores that had to close temporarily or only offer takeout and delivery services increased in October and November, reaching a high of over 4,300 by the end of November. In December, the government altered its COVID policies by removing mass testing, central quarantine, and travel restrictions. This caused a rapid increase in infections, especially in major cities like Beijing, Guangzhou, and Shanghai, and spread to other regions in the country. The outbreak led to a shortage of restaurant staff, causing over 1,300 stores to temporarily close or offer limited services. YUMC's system sales decreased by 4% year-over-year, with decreases of 1% at KFC and 6% at Pizza Hut, excluding F/X.

As the new year begins in 2023, Yum China is optimistic about the positive trend seen during the Chinese New Year holiday. Their popular golden bucket at KFC and holiday-themed pizza at Pizza Hut have become popular among those celebrating the occasion with their loved ones. The company has carefully planned its restaurant staffing and rider resources to maintain its operational efficiency and meet consumer demand. The company remains firm on its target of opening 1,100 to 1,300 net new stores during 2023. For 2023, the management expects capital expenditures in the range of approximately $700 million to $900 million for investments in digital, supply chain infrastructure, and store network expansion.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	-	-	-	$1.36	$1.01	$1.53	$1.84	$1.51	$1.22	$1.20	***$2.06***	***$4.13***
DPS	-	-	-	-	$0.10	$0.42	$0.48	$0.24	$0.48	$0.48	***$0.52***	***$0.62***
Shares	-	-	-	383.3	384.7	379.0	376.0	420.0	428.0	423.0	***421.4***	***416.0***

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, constituting only about 17% of restaurant spending compared with 61% in the US. We believe the trend will change in the coming years, driven by secular trends and Yum China. The company would be the biggest beneficiary gaining substantial brand value and market size as macro headwinds subside. However, we have revised our EPS growth rate to

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15.0%, which we believe is a fair reflection of the company's growth prospects as China opens up and reduces its lockdown measures. The company is continuing to expand its store count, which will be a catalyst for EPS growth in the next five years. In addition, we believe the company will be able to grow its dividends at a healthy pace in the future and have assumed a dividend growth rate of 20.0% for the next five years.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Avg. P/E	-	-	-	20.0	35.1	25.4	23.9	33.2	48.6	50.8	***29.4***	***30.0***
Avg. Yld.	-	-	-	-	0.3%	1.1%	1.1%	0.5%	0.8%	1.0%	***0.9%***	***0.5%***

Yum China is trading at a forward P/E of 29.4, significantly lower than the five-year average of 37.6. The stock seems to be trading at a discount due to the uncertain economic outlook of the Chinese economy. We expect the P/E to normalize as earnings continue to grow and have assumed a conservative P/E of 30.0 by 2028. We have a 5-year price target of $124 on the stock, suggesting a 107% upside potential from current levels.

Safety, Quality, Competitive Advantage, & Recession Resiliency

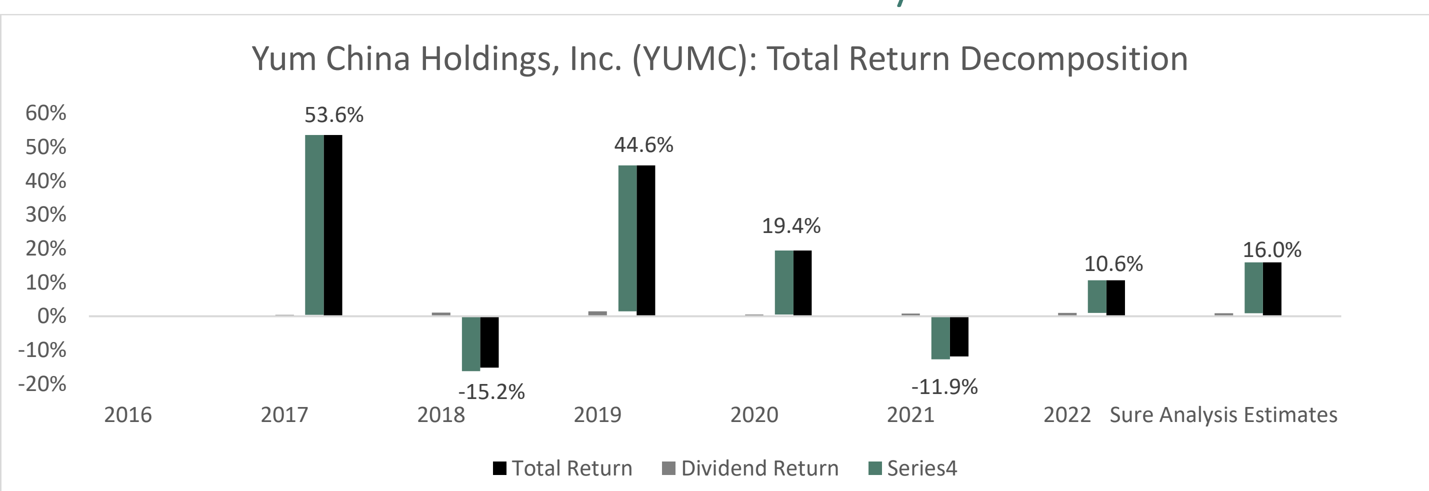
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	-	-	-	0%	10%	27%	26%	16%	39%	40%	***25%***	***15%***

Yum China has a good payout ratio and has increased the dividends at a CAGR of 48.0% from 2017-2022. 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 macroeconomic 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 $3.1 billion available in cash and short-term investments as of the end of the last quarter, which it can utilize to continue to expand and pay dividends to shareholders. We maintain our buy rating on the stock premised upon the 16.0% annualized total returns for the medium-term, with the forecasted earnings-per-share growth of 15.0%, 0.9% dividend yield, and small tailwind from multiple expansion.

Total Return Breakdown by Year



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Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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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.