Yum China Holdings, Inc. (YUMC)

Updated May 7th, 2023, by Yiannis Zourmpanos

Key Metrics

Current Price:	$63	**5 Year CAGR Estimate:**	15.2%	**Market Cap:**	$26.37B
Fair Value Price:	$62	**5 Year Growth Estimate:**	15.0%	**Ex-Dividend Date:**	05/26/2023
% Fair Value:	102%	**5 Year Valuation Multiple Estimate:**	-0.3%	**Dividend Payment Date:**	06/20/2023
Dividend Yield:	0.8%	**5 Year Price Target**	$124	**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 12,947 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 May 2nd, 2023, Yum China announced Q1 2023 results reporting non-GAAP diluted EPS of $0.68, beating market estimates by $0.20. The revenue for the quarter was reported at $2.91 billion, up 9% as compared to last year.

The company's main objectives are to increase sales, widen the network of stores, and strengthen its competitive moat. System wide sales grew 17% year-over-year, and have increased by 20% compared to 2019, and operational profit has increased by 37% likewise compared to 2019. Digital orders made up almost 89% of total sales in the first quarter as the company continued to enhance digital contact points for improved engagement with members. There are more than 430 million participants in loyalty programs, and these participants consistently generate around 60% of sales.

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 maintain our EPS growth rate to 15.0%, which we believe is a fair reflection of the company's growth prospects as China economy is recovering. 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.

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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	***30.5***	***30.0***
Avg. Yld.	-	-	-	-	0.3%	1.1%	1.1%	0.5%	0.8%	1.0%	***0.8%***	***0.5%***

Yum China is trading at a forward P/E of 30.5, 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 97% upside potential from current levels.

Safety, Quality, Competitive Advantage, & Recession Resiliency

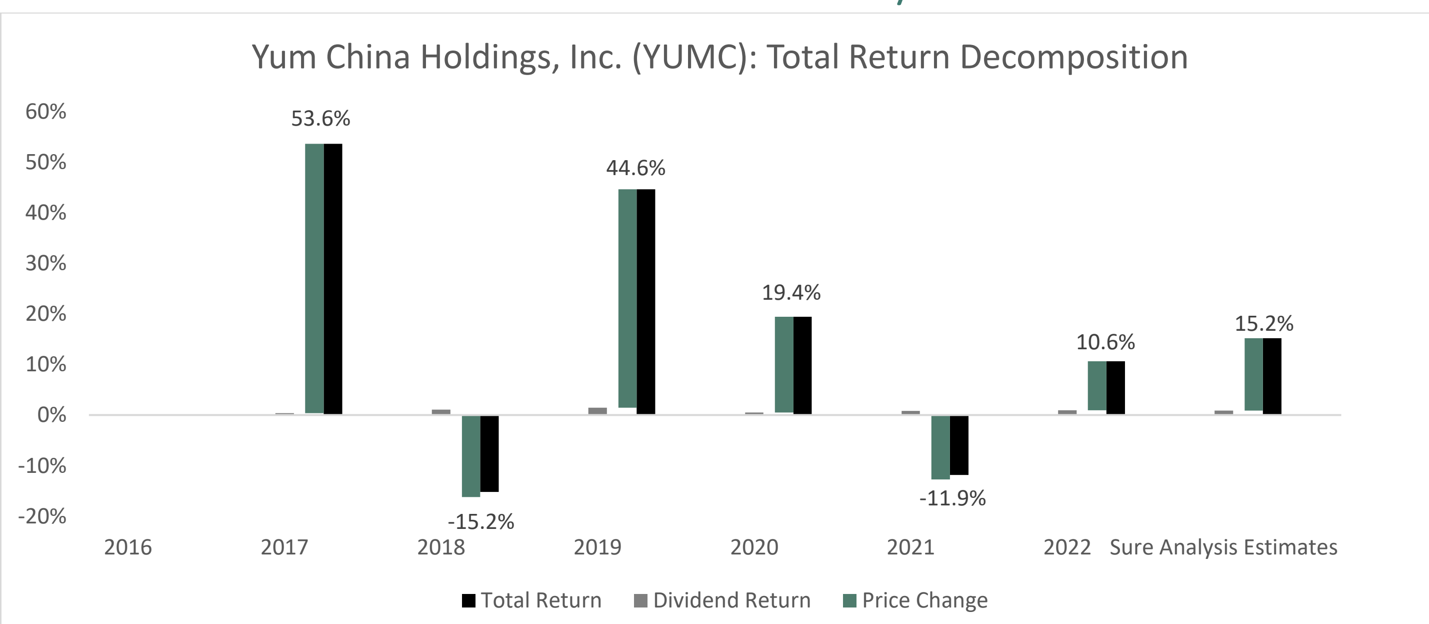
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	-	-	-	0%	10%	27%	26%	16%	39%	40%	***25%***	***15%***

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 15.2% annualized total returns for the medium-term, with the forecasted earnings-per-share growth of 15.0%, 0.8% dividend yield, and small headwind 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	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	6,905	6,934	6,909	7,075	7,769	8,415	8,776	8,263	9,853	9,569
Gross Profit	880	841	908	1,096	1,284	1,315	1,401	1,267	1,406	1,427
Gross Margin	12.7%	12.1%	13.1%	15.5%	16.5%	15.6%	16.0%	15.3%	14.3%	14.9%
SG&A Exp.	356	389	395	429	495	456	487	479	564	594
D&A Exp.	394	411	425	402	409	445	428	450	516	602
Operating Profit	529	469	511	652	761	830	863	709	734	658
Op. Margin	7.7%	6.8%	7.4%	9.2%	9.8%	9.9%	9.8%	8.6%	7.4%	6.9%
Net Profit	126	(7)	323	498	398	708	713	784	990	442
Net Margin	1.8%	-0.1%	4.7%	7.0%	5.1%	8.4%	8.1%	9.5%	10.0%	4.6%
Free Cash Flow	782	775	913	866	884	1,333	1,185	1,114	1,131	734
Income Tax	135	54	168	156	379	214	260	295	369	207

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets		3,257	3,201	3,727	4,287	4,610	6,950	10,875	13,223	11,830
Cash & Equivalents		238	425	885	1,059	1,266	1,046	1,158	1,136	1,130
Acc. Receivable		60	33	74	79	80	88	99	67	64
Inventories		260	189	268	297	307	380	398	432	417
Goodwill & Int.		216	192	167	340	520	481	1,218	2,552	2,270
Total Liabilities		1,303	1,216	1,284	1,440	1,633	3,775	4,404	5,301	4,666
Accounts Payable		501	438	480	420	619	623	708	830	727
Long-Term Debt		-	-	-	-	-	-	-	-	-
Total Equity		1,888	1,921	2,377	2,765	2,873	3,077	6,206	7,056	6,482
LTD/E Ratio		-	-	-	-	-	-	-	-	-

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets			10.0%	14.4%	9.9%	15.9%	12.3%	8.8%	8.2%	3.5%
Return on Equity			17.0%	23.2%	15.5%	25.1%	24.0%	16.9%	14.9%	6.5%
ROIC			16.4%	22.5%	15.0%	24.3%	23.2%	16.3%	13.8%	5.9%
Shares Out.	-	-	-	383.3	384.7	379.0	376.0	420.0	428.0	425.0
Revenue/Share	17.71	17.78	17.72	19.17	19.52	21.30	22.62	20.55	22.70	22.52
FCF/Share	2.01	1.99	2.34	2.35	2.22	3.37	3.05	2.77	2.61	1.73

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