Yum China Holdings, Inc. (YUMC)

Updated June 6th, 2024, by Yiannis Zourmpanos

Key Metrics

Current Price:	$35	**5 Year CAGR Estimate:**	30.8%	**Market Cap:**	$14.75 B
Fair Value Price:	$65	**5 Year Growth Estimate:**	15.0%	**Ex-Dividend Date:**	05/24/2024
% Fair Value:	54%	**5 Year Valuation Multiple Estimate:**	13.2%	**Dividend Payment Date:**	06/18/2024
Dividend Yield:	1.8%	**5 Year Price Target**	$131	**Years Of Dividend Growth:**	2
Dividend Risk Score:	D	**Retirement Suitability Score:**	F	**Rating:**	Buy

Overview & Current Events

Yum China Holdings, Inc. (YUMC) is China's largest restaurant company, with over 15,022 restaurants in over 2,000 cities. Yum China separated from Yum! Brands in October 2016.

On April 28th, 2024, Yum China announced Q1 2024 results reporting non-GAAP diluted EPS of $0.71, which beat market estimates by $0.06. The revenue for the quarter was reported at $2.96 billion, up 1.7% year-over-year.

Additionally, total system sales rose 6% year-over-year, excluding the impact of F/X, which was driven by an 8% net new unit contribution. The company opened 378 net new stores in the first quarter, driving the total count to 15,022, including 10,603 KFC stores and 3,425 Pizza Hut stores. Annual revenues were 1% ahead of the previous year, at $2.96bn, but without F/X impacts, this would have been 7% higher.

Operative profit stood at $374 million, and core operative profit edged up to $396 million, whereby the rate of increase is 1% YoY. The respective diluted EPS for Q2 increased by 4% to $0.71 or 10% at a constant foreign exchange rate. Delivery sales accelerated to 12%, now 38% of KFC and Pizza Hut; Digital sales were $2.5 billion, 89% of company sales. KFC and Pizza Hut membership grew to 485 million, with member sales now accounting for 65% of system sales. The total returned to shareholders through share repurchases and dividends was a record $745 million.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	-	-	$1.36	$1.01	$1.24	$1.84	$1.51	$1.22	$1.20	$1.97	***$2.17***	***$4.35***
DPS	-	-	-	$0.10	$0.42	$0.48	$0.24	$0.48	$0.48	$0.52	***$0.64***	***$0.77***
Shares[1]	-	-	383.3	384.7	379.0	376.0	420.0	428.0	423.0	420.0	***421.4***	***449.9***

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.

Yum China intends to open 1,500 to 1,700 net new stores in 2024 and allocate $700 million to $850 million for capital expenditures. The company has some very aggressive goals set from 2024 to 2026, increasing its store count to 20,000 by 2026, achieving a high-single to double-digit system sales and operating profit CAGR, as well as for EPS, based on 2023, excluding F/X. Beyond this, Yum China has a goal that at least $3 billion of capital will be returned to shareholders through dividends and share repurchases.

Therefore, we maintain our EPS growth rate at 15.0%, which reflects the company's growth prospects as China's economy is recovering. The company continues to expand its store count, which will catalyze EPS growth in the next five years. In addition, the company will be able to grow its dividends at a healthy pace in the future and we have assumed a dividend growth rate of 20.0% for the next five years.

[1] In millions.

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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Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	-	-	20.0	35.1	31.4	23.9	33.2	48.6	39.8	28.3	***16.2***	***30.0***
Avg. Yld.	-	-	-	0.3%	1.1%	1.1%	0.5%	0.8%	1.0%	0.9%	***1.8%***	***0.6%***

Yum China is trading at a forward P/E of 16.2, significantly lower than the five-year average of 34.7. The stock is trading at a discount due to the uncertain economic outlook of the Chinese economy. We expect the P/E to normalize as earnings grow and have assumed a conservative P/E of 30.0 by 2029, leading to our 5-year price target of $131.

Safety, Quality, Competitive Advantage, & Recession Resiliency

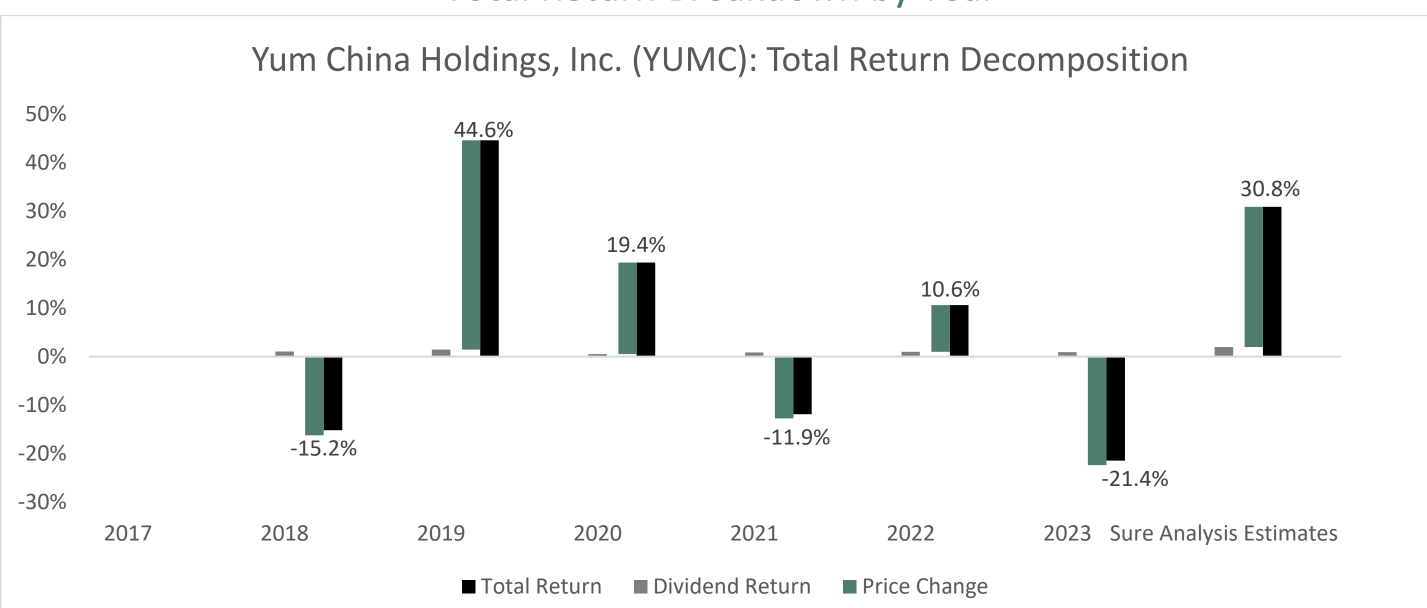
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	-	-	0%	10%	34%	26%	16%	39%	40%	26%	***30%***	***18%***

Yum China's most important competitive advantage is its high brand value. Moreover, focusing on menu innovations and efficient supply chain infrastructure, which results in cost advantages compared to smaller brands, gives Yum China an edge 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. The business also operates in a recession-proof industry since everyone still requires food and drink to survive, no matter the macroeconomic situation. Yum China has $1.5 billion available for future share repurchases, highlighting its commitment to shareholder value. In the first quarter of 2024, Yum China significantly increased its share repurchases, buying back 16.6 million shares of common stock for approximately $681 million. As of March 31, 2024, the company had $853 million remaining under the current share repurchase authorization program.

Final Thoughts & Recommendation

The company's fundamental business model is solid and will continue to thrive. The company has a solid balance sheet with $2.6 billion available in cash and short-term investments as of the last quarter, which it can utilize to continue to expand and pay dividends to shareholders. We maintain our buy rating premised upon the 30.8% annualized total returns for the medium-term, driven by forecasted earnings-per-share growth of 15.0%, a starting yield of 1.8%, and a valuation tailwind.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue	6,934	6,909	7,075	7,769	8,415	8,776	8,263	9,853	9,569	10,980
Gross Profit	841	908	1,096	1,284	1,315	1,401	1,267	1,406	1,427	1,885
Gross Margin	12.1%	13.1%	15.5%	16.5%	15.6%	16.0%	15.3%	14.3%	14.9%	17.2%
SG&A Exp.	389	395	429	495	456	487	479	564	594	638
D&A Exp.	411	425	402	409	445	428	450	516	602	453
Operating Profit	469	511	652	761	830	863	709	734	658	1,133
Op. Margin	6.8%	7.4%	9.2%	9.8%	9.9%	9.8%	8.6%	7.4%	6.9%	10.3%
Net Profit	(7)	323	498	398	708	713	784	990	442	827
Net Margin	-0.1%	4.7%	7.0%	5.1%	8.4%	8.1%	9.5%	10.0%	4.6%	7.5%
Free Cash Flow	775	913	866	884	1,333	1,185	1,114	1,131	734	763
Income Tax	54	168	156	379	214	260	295	369	207	329

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	3,257	3,201	3,727	4,287	4,610	6,950	10,875	13,223	11,830	12,030
Cash & Equivalents	238	425	885	1,059	1,266	1,046	1,158	1,136	1,130	1,128
Acc. Receivable	60	33	74	79	80	88	99	67	64	68
Inventories	260	189	268	297	307	380	398	432	417	424
Goodwill & Int.	216	192	167	340	520	481	1,218	2,552	2,270	2,197
Total Liabilities	1,303	1,216	1,284	1,440	1,633	3,775	4,404	5,301	4,666	4,912
Accounts Payable	501	438	480	420	619	623	708	830	727	786
Long-Term Debt	-	-	-	-	-	-	-	-	-	168
Total Equity	1,888	1,921	2,377	2,765	2,873	3,077	6,206	7,056	6,482	6,405
LTD/E Ratio	-	-	-	-	-	-	-	-	-	0.03

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets		10.0%	14.4%	9.9%	15.9%	12.3%	8.8%	8.2%	3.5%	6.9%
Return on Equity		17.0%	23.2%	15.5%	25.1%	24.0%	16.9%	14.9%	6.5%	11.6%
ROIC		16.4%	22.5%	15.0%	24.3%	23.2%	16.3%	13.8%	5.9%	11.5%
Shares Out.	-	-	383.3	384.7	379.0	376.0	420.0	428.0	425.0	420.0
Revenue/Share	17.78	17.72	19.17	19.52	21.30	22.62	20.55	22.70	22.52	26.14
FCF/Share	1.99	2.34	2.35	2.22	3.37	3.05	2.77	2.61	1.73	1.82

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