

Yum China (9987 HK)

Headwinds linger despite faster expansion

Even though Yum China revised up its store openings target in FY21E, we believe short-term headwinds (e.g. endless COVID-19 outbreaks, raw material and wages inflation) may lead to bumpy results in 4Q21E and 1Q22E. We downgraded it to HOLD and cut TP to HK\$ 438.86, based on 27x FY22E P/E (at par with industry average, down from 30x because of sector de-rating).

- 3Q21 results missed.** Sales grew by 9% YoY to USD 2.55bn in 3Q21, beating BBG est. by 5%, mainly due to rapid store expansions, even with a -7% SSSG. However, net profit in 3Q21 fell by 76% to USD 104mn, 18% below BBG est., because of miss in GP margin (at 70.9% vs BBG est. of 71.2%) and 32mn net investment losses of Meituan. In fact, OP in 3Q21 was roughly inline.
- We become more cautious on 4Q21E outlook.** KFC achieved an excellent catch up in Sep 2021, after the tough Aug 2021, thanks to robust off-premises sales, successful new products (e.g. wuhan reganmian and premium beef burger) and effective promotions. However, we believe the outlook can be even tougher in 4Q21E, because of: 1) high base in 4Q20 as recovery was smooth, 2) social distancing measures and travel restriction following the Inner Mongolia COVID-19 outbreak, 3) weakening macro environment and consumer sentiment, etc. SSSG in 3Q21 was at 87%/ 92% of FY19/ 20 level, for 4Q21E, a decline is still likely, according to management (CMBI est. -5%).
- And there are risks on margins and of operating deleverage.** We are concerned about GP margins in 4Q21E and FY22E, due to: 1) increase in all sources of input prices (e.g. poultry (about MSD increase) and packaging materials) and 2) continual efforts on promotion to draw traffic. OP margin can also be under pressure, due to: 1) labour (about HSD increase) and delivery costs inflation and 2) absence of COVID-19 related rental relief and benefits.
- The only bright spot is accelerated store expansions.** Stores opening target in FY21E was revised up from 1,300 to 1,700 because management is seeing more decent locations with great potential arise amid this industry downturn. We also believe the rapid 14%/ 10% YoY store number growth for KFC/ Pizza Hut in 3Q21 can stay fast in 4Q21E and even in FY22E. More new cities are being penetrated (KFC entered 150 new cities in the past 12 months and there are 1,200 or more potential cities to go) by the smaller sized or satellite store format (accounted for 70% of Pizza Hut's new stores).
- Downgrade to HOLD and adjust TP to HK\$ 438.86,** based on 27x FY22E P/E (revised down from 30x to factor in sector de-rating). We adjust FY21E/ 22E/ 23E net profit by -8%/ -9%/ +2%, to factor in: 1) lower SSSG, 2) lower GP and OP margins, but 3) faster stores expansion. YUMC is trading at 28x FY22E P/E, not too attractive, given a 17% EBIT CAGR in FY20-23E.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (USD mn)	8,776	8,263	9,952	11,545	13,258
YoY growth (%)	4.3	(5.8)	20.4	16.0	14.8
Net income (USD mn)	713	784	697	924	1,180
Diluted EPS (USD)	1.81	1.89	1.59	2.10	2.66
YoY growth (%)	1.8	4.5	(15.8)	31.8	27.0
Consensus EPS (USD)	n/a	n/a	1.74	2.25	2.62
P/E (x)	32.0	30.8	36.6	27.7	21.8
P/B (x)	6.9	4.1	3.7	3.3	2.9
Yield (%)	0.8	0.4	0.7	0.9	1.1
ROE (%)	22.5	13.0	10.4	12.4	13.9
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

HOLD (D/G)

Target Price	HK\$438.86
(Previous TP)	HK\$532.66)
Up/Downside	-2.7%
Current Price	HK\$451.00

China Catering Sector

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Stock Data

Mkt Cap (HK\$ mn)	191,224
Avg 3 mths t/o (HK\$ mn)	74.75
52w High/Low (HK\$)	544.00/ 404.20
Total Issued Shares (mn)	424.0

Source: Bloomberg

Shareholding Structure

Primavera Capital	5.7%
BlackRock	7.1%
Invesco	9.0%
Management	0.2%
Free Float	78.0%

Source: HKEx

Share Performance

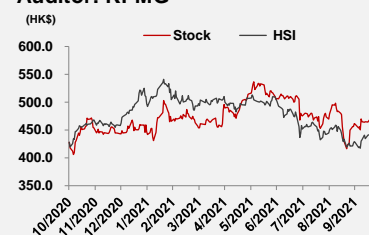
	Absolute	Relative
1-mth	-1.1%	-5.2%
3-mth	-6.0%	-6.3%
6-mth	-7.2%	5.6%
12-mth	8.6%	5.0%

Source: Bloomberg

12-mth Price Performance

Source: Bloomberg

Auditor: KPMG



Related Reports

- Yum China (9987 HK, BUY) – Guidance was in-line but coffee will accelerate – 24 Sep 2021
- Yum China (9987 HK, BUY) – Another hit taken, but stay mid-term positive – 16 Sep 2021
- Yum China (9987 HK, BUY) – Robust Pizza Hut and accelerated expansion – 30 Jul 2021

Earnings revision

Figure 1: Earnings revision

US\$ mn	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	9,952	11,545	13,258	9,873	11,233	12,412	0.8%	2.8%	6.8%
Gross profit	7,121	8,210	9,456	7,092	8,054	8,874	0.4%	1.9%	6.6%
Operating Profit	956	1,208	1,544	965	1,298	1,472	-1.0%	-6.9%	4.9%
Net profit	697	924	1,180	756	1,009	1,153	-7.8%	-8.5%	2.3%
EPS (US\$ cents)	1.592	2.098	2.665	1.726	2.292	2.604	-7.8%	-8.5%	2.3%
Gross margin	71.6%	71.1%	71.3%	71.8%	71.7%	71.5%	-0.3ppt	-0.6ppt	-0.2ppt
EBIT margin	9.6%	10.5%	11.6%	9.8%	11.6%	11.9%	-0.2ppt	-1.1ppt	-0.2ppt
Net profit att. margin	7.0%	8.0%	8.9%	7.7%	9.0%	9.3%	-0.7ppt	-1ppt	-0.4ppt

Source: Company data, CMBIS estimates

Figure 2: CMBIS estimates vs consensus

US\$ mn	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	9,952	11,545	13,258	9,969	11,424	12,645	-0.2%	1.1%	4.8%
Gross profit	7,121	8,210	9,456	7,141	8,171	9,047	-0.3%	0.5%	4.5%
Operating Profit	956	1,208	1,544	970	1,278	1,482	-1.5%	-5.5%	4.2%
Net profit	697	924	1,180	743	971	1,130	-6.2%	-4.9%	4.5%
EPS (US\$ cents)	1.592	2.098	2.665	1.742	2.249	2.616	-8.6%	-6.7%	1.9%
Gross Margin	71.6%	71.1%	71.3%	71.6%	71.5%	71.5%	-0.1ppt	-0.4ppt	-0.2ppt
Operating Margin	9.6%	10.5%	11.6%	9.7%	11.2%	11.7%	-0.1ppt	-0.7ppt	-0.1ppt
Net Margin	7.0%	8.0%	8.9%	7.5%	8.5%	8.9%	-0.5ppt	-0.5ppt	0ppt

Source: Company data, CMBIS estimates

Assumptions

Figure 3: CMBIS' assumptions

Major assumptions	FY18A	FY19A	FY20A	FY21E	FY22E	FY23E
Sales by segment (RMB mn)						
KFC - dine in sales	4,882	4,911	4,137	4,931	5,534	6,170
KFC - delivery sales	808	1,129	1,617	2,130	2,662	3,275
PH - dine in sales	1,611	1,527	1,146	1,327	1,508	1,730
PH- delivery sales	500	527	642	788	945	1,087
Others	614	682	721	778	896	996
Total	8,415	8,776	8,263	9,952	11,545	13,258
Sales by segment growth (%)						
KFC - dine in sales	9.2%	0.6%	-15.8%	19.2%	12.2%	11.5%
KFC - delivery sales	35.8%	39.7%	43.2%	31.7%	25.0%	23.0%
PH - dine in sales	-3.5%	-5.2%	-25.0%	15.8%	13.7%	14.7%
PH- delivery sales	18.1%	5.4%	21.7%	22.7%	20.0%	15.0%
Others	0.7%	11.1%	5.8%	7.8%	15.2%	11.2%
Total	8.3%	4.3%	-5.8%	20.4%	16.0%	14.8%
Sales network by brand						
KFC	5,910	6,534	7,166	8,371	9,461	10,341
Pizza Hut	2,240	2,281	2,355	2,695	3,035	3,275
Others	334	385	985	1,111	1,191	1,271
Total	8,484	9,200	10,506	12,177	13,687	14,887
Restaurant profit margin by brand						
KFC	17.3%	17.3%	15.8%	16.5%	16.1%	17.6%
Pizza hut	10.2%	11.1%	10.5%	12.0%	13.6%	14.7%
Others	0.0%	-0.4%	-0.4%	-4.5%	-0.2%	-0.2%
Total	15.7%	16.0%	14.8%	13.9%	14.3%	15.6%
Costs breakdown						
Food and paper/ sales	27.6%	28.2%	28.3%	28.4%	28.9%	28.7%
Payroll and employee benefits/ sales	20.4%	20.6%	20.9%	22.1%	21.9%	21.4%
Rental and other operating expenses/ sales	28.4%	27.0%	26.9%	26.4%	26.3%	26.2%
G & A expenses/ sales	5.4%	5.5%	5.8%	5.3%	5.3%	5.3%
Franchisees expenses/ sales	7.1%	7.3%	7.7%	6.4%	6.1%	5.8%
Effective tax rate	22.5%	25.9%	26.6%	26.0%	25.5%	25.0%
NP att. margin	8.4%	8.1%	9.5%	7.0%	8.0%	8.9%
NP att. growth (%)	77.9%	0.7%	10.0%	-11.1%	32.5%	27.7%

Source: Company data, CMBIS estimates

Valuation

Figure 4: Peers valuation table

Company	Ticker	Rating	12m TP (LC)	Price (LC)	Up/Down-side	Mkt. Cap (HK\$mn)	Year End	P/E (x)		P/B (x)		ROE (%)	3yrs PEG (x)	Yield (%)	
								FY1E	FY2E	FY1E	FY2E	FY1E	FY1E	FY1E	
Leading Greater China Catering															
Yum China	9987 HK	HOLD	438.86	451.00	-3%	191,224	Dec-20	36.6	27.7	3.7	3.3	17.0	3.0	0.7	
Jiumaojiu	9922 HK	BUY	30.47	19.74	54%	28,690	Dec-20	49.8	31.2	6.8	5.7	14.3	0.5	0.5	
Haidilao	6862 HK	BUY	34.06	22.55	51%	123,100	Dec-20	73.3	29.8	8.7	6.9	14.3	0.5	0.4	
Nayuki	2150 HK	BUY	17.10	10.36	65%	17,769	Dec-20	139.6	49.5	4.8	4.4	n/a	n/a	n/a	
Helens	9869 HK	NR	n/a	16.66	n/a	21,107	Dec-20	98.5	26.3	12.1	7.3	56.2	n/a	0.2	
Cafe De Coral	341 HK	BUY	19.05	14.14	35%	8,282	Mar-21	23.1	18.2	2.6	2.4	12.6	1.8	2.6	
Xiabuxiabu	520 HK	NR	n/a	5.83	n/a	6,328	Dec-20	31.1	12.2	2.1	1.9	9.6	0.1	1.5	
Yihai	1579 HK	BUY	108.52	43.10	152%	45,121	Dec-20	37.3	32.5	9.0	7.4	26.9	2.2	0.7	
Gourmet Master	2723 TT	NR	n/a	135.00	n/a	6,797	Dec-20	18.9	17.5	2.0	1.9	13.2	1.0	3.0	
								Avg.	56.5	27.2	5.8	4.6	20.5	1.3	1.2
								Med.	37.3	27.7	4.8	4.4	14.3	1.0	0.7
Other Greater China Catering															
Tai Hing	6811 HK	NR	n/a	1.64	n/a	1,646	Dec-20	9.4	8.0	1.5	1.3	14.3	0.3	7.0	
Ajisen China	538 HK	NR	n/a	1.36	n/a	1,484	Dec-20	n/a	n/a	n/a	n/a	2.6	n/a	n/a	
								Avg.	9.4	8.0	1.5	1.3	9.0	0.3	7.0
								Med.	9.4	8.0	1.5	1.3	8.4	0.3	7.0
Greater China Catering															
								Avg.	51.8	25.3	5.3	4.3	16.7	1.2	1.8
								Med.	36.9	27.0	4.2	3.9	14.3	0.8	0.7
International Catering															
Yum! Brands	YUM US	NR	n/a	124.46	n/a	286,168	Dec-20	27.5	25.1	n/a	n/a	n/a	1.2	1.6	
Mcdonald'S	MCD US	NR	n/a	243.87	n/a	1,416,380	Dec-20	26.3	24.4	n/a	n/a	n/a	1.3	2.1	
Starbucks Corp	SBUX US	NR	n/a	113.44	n/a	1,040,242	Sep-20	35.2	30.4	n/a	n/a	n/a	0.5	1.7	
Rest' Brands	QSR US	NR	n/a	56.99	n/a	203,967	Dec-20	20.5	18.6	8.2	8.7	30.9	0.7	3.7	
Chipotle	CMG US	NR	n/a	1781.5	n/a	389,807	Dec-20	70.6	54.2	22.2	18.2	34.5	1.5	0.0	
Darden	DRI US	NR	n/a	143.52	n/a	144,862	May-21	18.7	17.0	6.4	5.9	32.1	0.8	3.0	
Domino'S Pizza	DPZ US	NR	n/a	475.96	n/a	134,689	Jan-21	34.8	30.9	n/a	n/a	n/a	3.0	0.8	
Wendy'S Co	WEN US	NR	n/a	22.13	n/a	38,335	Jan-21	27.1	24.3	8.5	9.8	35.2	1.0	1.9	
Shake Shack	SHAK US	NR	n/a	70.89	n/a	23,187	Dec-20	n/a	207.3	7.5	7.1	(5.2)	n/a	n/a	
Wingstop Inc	WING US	NR	n/a	172.48	n/a	39,900	Dec-20	113.8	88.9	n/a	n/a	n/a	2.5	0.4	
Jollibee Foods	JFC PM	NR	n/a	241.20	n/a	41,118	Dec-20	77.2	43.3	4.7	4.4	2.3	(0.4)	0.5	
								Avg.	45.2	51.3	9.6	9.0	21.6	1.2	1.6
								Med.	31.1	30.4	7.9	7.9	31.5	1.1	1.6
H-shares Consumer Staples															
UPC	220 HK	NR	n/a	6.57	n/a	28,378	Dec-20	16.0	13.8	1.7	1.7	10.6	2.0	6.3	
Tingyi	322 HK	NR	n/a	14.56	n/a	81,945	Dec-20	17.7	15.9	3.2	3.2	19.7	2.2	6.9	
Want Want	151 HK	NR	n/a	5.95	n/a	70,937	Mar-21	14.0	13.9	3.7	3.4	27.6	1.8	4.7	
China Mengniu	2319 HK	NR	n/a	48.95	n/a	193,502	Dec-20	29.9	24.8	4.2	3.8	16.4	0.9	0.9	
Vitasoy	345 HK	NR	n/a	18.32	n/a	19,603	Mar-21	52.5	35.4	5.5	5.0	16.3	9.0	1.2	
Budweiser	1876 HK	NR	n/a	20.65	n/a	273,476	Dec-20	38.5	31.2	3.1	2.9	8.3	1.1	1.1	
Tsingtao	168 HK	NR	n/a	67.55	n/a	126,057	Dec-20	27.7	24.3	3.4	3.1	13.1	1.4	1.4	
CR Beer	291 HK	NR	n/a	63.00	n/a	204,383	Dec-20	39.0	35.6	6.9	6.2	18.4	0.9	1.1	
Dali Foods	3799 HK	NR	n/a	4.30	n/a	58,885	Dec-20	12.1	11.3	2.5	2.3	22.8	1.3	4.3	
								Avg.	27.5	22.9	3.8	3.5	17.0	2.3	3.1
								Med.	27.7	24.3	3.4	3.2	16.4	1.4	1.4

Source: Bloomberg, Company data, CMBIS estimates,

Financial Summary

Income statement

YE 31 Dec (USD mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	8,776	8,263	9,952	11,545	13,258
Company sales	7,925	7,396	9,045	10,554	12,184
Franchise fees and income	148	148	161	172	187
Fran. & uncol. affiliates sales	654	647	674	747	820
Other revenues	49	72	72	72	67
Cost of goods sold	(2,479)	(2,342)	(2,831)	(3,335)	(3,801)
Gross profit	6,297	5,921	7,121	8,210	9,456
Other net income	60	285	10	81	93
Operating expenses	(5,456)	(5,245)	(6,176)	(7,083)	(8,005)
Staff costs	(1,807)	(1,730)	(2,204)	(2,533)	(2,842)
Admin	(560)	(591)	(627)	(727)	(835)
Property rent & related	(877)	(814)	(977)	(1,140)	(1,316)
D & A	(428)	(404)	(447)	(499)	(559)
Other operating expenses	(1,784)	(1,706)	(1,921)	(2,184)	(2,453)
EBIT	901	961	956	1,208	1,544
Finance costs, net	39	43	70	79	91
JV & associates	-	-	-	-	-
Exceptional	63	104	(30)	23	27
Pre-tax profit	1,003	1,108	995	1,310	1,662
Income tax	(260)	(295)	(259)	(334)	(415)
Less: Minority interests	30	29	40	52	66
Net profit	713	784	697	924	1,180

Cash flow summary

YE 31 Dec (USD mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income	901	961	956	1,208	1,544
D&A	419	386	435	489	557
Change in working capital	74	(7)	93	93	91
Income tax paid	16	(295)	(259)	(334)	(415)
Others	(225)	234	77	111	119
Net cash from operating	1,185	1,279	1,302	1,567	1,896
Capex & investments	(435)	(578)	(697)	(693)	(795)
Associated companies	-	-	-	-	-
Interest received	-	-	-	-	-
Others	(475)	-	-	-	-
Net cash from investing	(910)	(578)	(697)	(693)	(795)
Equity raised	(265)	2,220	-	-	-
Change of Debts	-	-	-	-	-
Dividend paid	(181)	(181)	(95)	(168)	(222)
Others	(34)	-	-	-	-
Net cash from financing	(480)	2,039	(95)	(168)	(222)
Net change in cash	(205)	2,740	510	707	879
Beginning cash balance	1,266	1,046	3,786	4,296	5,003
Exchange difference	(15)	-	-	-	-
Cash at the end of the year	1,046	3,786	4,296	5,003	5,881

Balance sheet

YE 31 Dec (USD mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	4,691	4,797	5,021	5,216	5,453
Fixed asset	1,594	1,775	2,036	2,240	2,479
Intangible assets & goodwill	94	75	64	54	52
Prepaid lease payments	-	-	-	-	-
Interest in asso. & JV	89	89	89	89	89
Others	2,914	2,858	2,832	2,833	2,833
Current assets	2,259	4,934	5,556	6,373	7,361
Cash and cash equivalents	1,046	3,786	4,296	5,003	5,881
Inventories	380	321	388	457	521
Trade and other receivables	88	91	109	127	145
Prepayments	134	126	152	176	202
Others	611	611	611	611	611
Current liabilities	1,736	1,665	1,870	2,073	2,274
Borrowings	-	-	-	-	-
Trade payables	623	577	698	822	937
Accruals & other payables	437	411	496	575	660
Tax payables	45	45	45	45	45
Others	631	631	631	631	631
Non-current liabilities	2,039	2,039	2,039	2,039	2,039
Borrowings	-	-	-	-	-
Deferred income	-	-	-	-	-
Deferred tax	136	136	136	136	136
Others	1,903	1,903	1,903	1,903	1,903
Minority Interest	-	-	-	-	-
Total net assets	3,175	6,027	6,669	7,477	8,501
Shareholders' equity	3,175	6,027	6,669	7,477	8,501

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
Company sales	90.3	89.5	90.9	91.4	91.9
Franchise fees and income	1.7	1.8	1.6	1.5	1.4
Fran. & uncol. affiliates sales	7.5	7.8	6.8	6.5	6.2
Other revenues	0.6	0.9	0.7	0.6	0.5
Total	100.0	100.0	100.0	100.0	100.0
P&L ratios (%)					
Gross margin	71.8	71.7	71.6	71.1	71.3
Operating margin	10.3	11.6	9.6	10.5	11.6
Pre-tax margin	11.4	13.4	10.0	11.3	12.5
Net margin	8.1	9.5	7.0	8.0	8.9
Effective tax rate	25.9	26.6	26.0	25.5	25.0
Balance sheet ratios					
Current ratio (x)	1.3	3.0	3.0	3.1	3.2
Quick ratio (x)	1.1	2.8	2.8	2.9	3.0
Cash ratio (x)	0.6	2.3	2.3	2.4	2.6
Inventory turnover days	51	50	50	50	50
Trade receivables days	3	4	4	4	4
Trade payables days	91	90	90	90	90
Total debt / total equity ratio (%)	0	0	0	0	0
Net debt / equity ratio (%)	Net	Net	Net	Net	Net
Returns (%)					
ROE	22.5	13.0	10.4	12.4	13.9
ROA	10.3	8.1	6.6	8.0	9.2
Per share					
EPS (USD)	1.81	1.89	1.59	2.10	2.66
DPS (USD)	0.48	0.23	0.40	0.52	0.67
BVPS (USD)	8.44	14.35	15.78	17.59	19.88

Source: Company data, CMBIS estimates

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