

Yum China Holdings, Inc. (09987.HK)

2Q2024FY revenue and operating profit hit 2Q record highs

China | Consumer

24 October 2024

Neutral

CMP HKD351.00

(Closing price as of 18 October)

Target HKD 337.00 (-4.0%)

COMPANY DATA

O/S SHARES (MN) :	381.297961
MARKET CAP (HKD MN) :	128497.4
52 - WK HI/LO (HKD):	416.04/233.95

SHARE HOLDING PATTERN, %

Primavera Capital Management Ltd	5.70%
GIC	5.95%
BlackRock Inc.	4.90%

Yum China Holdings, Inc. (09987) is the largest restaurant company in China in terms of 2023 system sales, with 15,423 restaurants covering over 2,100 cities primarily in China as of June 30, 2024. Its growing restaurant network consists of our flagship KFC and Pizza Hut brands, as well as emerging brands such as Lavazza, Huang Ji Huang, Little Sheep and Taco Bell. The company has the exclusive right to operate and sublicense the KFC, Pizza Hut and Taco Bell brands in China (excluding Hong Kong, Macau and Taiwan), and own the intellectual property of the Little Sheep and Huang Ji Huang concepts outright. The company also established a joint venture with Lavazza Group, the world-renowned family-owned Italian coffee company, to explore and develop the Lavazza coffee concept in China.

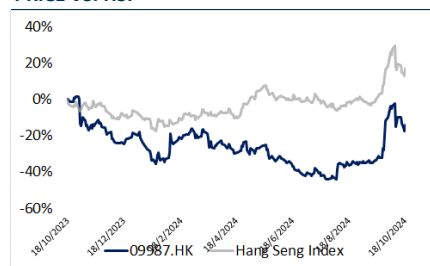
2Q2024FY revenue and operating profit hit 2Q record highs

2Q2024FY, total system sales grew 4% YoY, excluding foreign currency translation ("F/X"), on top of last year's high base. The growth was primarily attributable to 8% of net new unit contribution. The Company opened 401 net new stores in the quarter. 99 net new stores, or 25%, were opened by franchisees. Total revenues increased 1% YoY to \$2.68 billion, a record-high for the second quarter. Excluding F/X, total revenues would have been \$85 million higher, or a 4% increase YoY. Same-store sales reached 96% of the prior year's level. Same-store transactions grew 4% YoY. Operating profit grew 4% YoY to \$266 million, a record level for the second quarter. Excluding F/X, operating profit would have been \$9 million higher, or a 7% increase YoY. Core operating profit grew 12% YoY to \$275 million. OP Margin was 9.9%, an increase of 20 basis points YoY, supported by resilient restaurant margins and savings in G&A expenses. Restaurant margin was 15.5%. Excluding \$12 million in items affecting comparability, restaurant margin was approximately the same as the second quarter last year. Improvement in operational efficiencies supported margin stability. Diluted EPS increased 17% YoY to \$0.55, a record level for the second quarter, or up 19% YoY excluding F/X. Delivery sales grew 11% YoY, maintaining the double-digit growth Yum China has carried over the past decade. Delivery contributed ~38% of KFC and Pizza Hut's Company sales.

System sales for KFC grew 5% YoY for the Q2, on top of high base last year, primarily driven by net new unit contribution of 8%. KFC opened 328 net new stores during the quarter. 74 net new stores, or 23%, were opened by franchisees. Total store count reached 10,931 as of June 30, 2024. Operating profit was \$264 million. Core operating profit was \$273 million for the quarter, up 4% YoY. Restaurant margin was 16.2% for the quarter. Excluding items affecting comparability, restaurant margin decreased by 60 basis points against a strong comparison in the second quarter of 2023, primarily due to increased value-for-money offerings to drive traffic and wage inflation, partially offset by favorable commodity prices and improved operational efficiency. Delivery sales grew 12% YoY, contributing ~38% of KFC's Company sales for the quarter. Off-premises dining accounted for ~67% of KFC's Company sales.

System sales for Pizza Hut grew 1% YoY for the quarter, on top of high base last year, primarily driven by net new unit contribution of 8%. Pizza Hut opened 79 net new stores during the quarter. Total store count reached 3,504 as of June 30, 2024. Operating profit grew 13% YoY to \$40 million, a record level for the second quarter. Core operating profit was \$41 million, up 23% YoY. Restaurant margin was 13.2% for the quarter. Excluding items affecting comparability, restaurant margin was up 110 basis points YoY. Higher operational efficiency offset the impact of increased value-for-money offerings and wage inflation, resulting in an increased margin. Delivery sales grew 6%, contributing ~38% of Pizza Hut's Company sales for the quarter. Off-premises dining accounted for ~48% of Pizza Hut's Company sales.

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

USD mn	FY22	FY23	FY24E	FY25E
Revenue	9,569	10,978	11,078	11,816
Net profit	442	827	866	939
Reported EPS	1.04	1.97	2.09	2.29
P/E ratio, x	42.8	22.6	21.3	19.4
Dividend Yield, %	1.1%	1.2%	1.5%	1.5%

Source: Company reports, Phillip Securities Est.

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Total revenues for the year to date ended June 30, 2024 increased 1%, or 5% excluding the impact of F/X. The increase in Total revenues excluding the impact of F/X, was driven by 8% net new unit contribution, partially offset by same-store sales decline, resulting from lower ticket average and same-store transaction growth. Same-store sales reached 97% of the prior year's level, against a strong performance in the same period last year. Operating profit decreased 5% YoY, or was almost flat with prior year excluding F/X. Savings in G&A partially offset the lower Restaurant margin, which was 16.6% year to date. Core operating profit grew 5% to \$671 million. Diluted EPS increased 10% YoY to \$1.26, or 14% excluding F/X. 1H2024FY, the Company returned a record \$994 million to shareholders, including buying back 21.7 million shares of common stock, which is equivalent to over 5% of its outstanding shares as of December 31, 2023.

Full-year guidance remains unchanged

The Company's targets for the 2024 fiscal year remain unchanged from the prior period's disclosures. Open ~1,500 to 1,700 net new stores. Make capital expenditures in the range of approximately \$700 million to \$850 million. Return a Company record-setting \$1.5 billion to shareholders through quarterly cash dividends and share repurchases.

Investment Thesis

The company achieved our most profitable second quarter since the spin-off, with core operating profit growing by 12% despite challenging industry dynamics. Total membership of KFC and Pizza Hut exceeded 495 million. Member sales accounted for over 65% of KFC and Pizza Hut's system sales in aggregate. KFC has successfully gained market share on delivery platforms by expanding its price range and lowering delivery fees. Pizza Hut attracted value-conscious customers with its entry-price pizzas and solo diners with its Pizza Dough Burger. Its business model breakthroughs enabled the company to broaden our addressable market and capture more customer occasions. With its industry-leading capabilities and scale, by reducing the complexity of menus and operations, and harnessing the power of automation and AI, the company improved operational efficiency, which help the company turning challenges into a greater competitive advantage in the context of a sluggish consumer market. We expect FY2024E-FY2025E EPS to be \$2.11 and \$2.31 respectively, with PT of HKD337.00, implies a FY2024E P/E of 20.5x (~1-yr historical average + 1 standard deviation). Our investment rating is "Neutral".

Risk factors

1) The price of raw materials continues to rise; 2) market competition intensifies; 3) Food safety risks; and 4) New store expansion falls short of expectations.

Financial
Consolidated Statement of Profit or Loss

Dec Y/E, USD mn	FY21	FY22	FY23	FY24E	FY25E
Revenue	9,853	9,569	10,978	11,078	11,816
COGS	(2,812)	(2,836)	(3,224)	(3,338)	(3,476)
Gross Profit	7,041	6,733	7,754	7,740	8,340
Staff costs	(2,258)	(2,389)	(2,725)	(2,747)	(2,880)
Occupancy and other operating expenses	(2,664)	(2,604)	(2,752)	(2,750)	(2,947)
General and administrative expenses	(564)	(594)	(638)	(592)	(659)
Franchise expenses	(64)	(34)	(36)	(38)	(40)
Expenses for transactions with franchisees	(649)	(279)	(356)	(385)	(397)
Other operating costs and expenses	(65)	(78)	(112)	(113)	(121)
Closures and impairment expenses, net	(34)	(32)	(29)	(28)	(29)
Other income, net	643	(94)	-	-	-
Operating Profit	1,386	629	1,106	1,088	1,267
Interest income, net	60	84	169	145	127
Investment loss	(54)	(26)	(49)	31	(9)
Profit before tax	1,392	687	1,226	1,264	1,385
Income tax	(369)	(207)	(329)	(339)	(372)
Shareholders Net profit	990	442	827	866	939
Reported EPS, Diluted	2.28	1.04	1.97	2.09	2.29
DPS	0.48	0.49	0.55	0.67	0.68
Payout ratio	21%	47%	28%	32%	30%

Key Financial Data

Dec Y/E, USD mn	FY21	FY22	FY23	FY24E	FY25E
Valuation Ratio					
P/S ratio, x	1.9	2.0	1.7	1.7	1.5
P/E ratio, x	19.2	42.8	22.6	21.3	19.4
Dividend Yield, %	1.1%	1.1%	1.2%	1.5%	1.5%

Per share data (USD)

Basic EPS	2.35	1.05	1.99	2.11	2.31
BVPS	16.72	15.40	15.40	15.58	16.11
DPS (HKD)	3.74	3.83	4.30	5.20	5.35

Growth & Margin

Growth					
Revenue Growth	19.2%	-2.9%	14.7%	0.9%	6.7%
Gross Profit Growth	19.4%	-2.1%	14.5%	1.5%	6.1%
Net Profit Growth	26.3%	-55.4%	87.1%	4.7%	8.4%
Margin					
Gross Profit Margin	71.5%	70.4%	70.6%	69.9%	70.6%
Net Profit Margin	10.0%	4.6%	7.5%	7.8%	7.9%

Key Ratios

ROE	14.9%	6.5%	12.8%	13.5%	14.5%
ROA	8.2%	3.5%	6.9%	7.1%	7.7%

Consolidated Statement of Financial Position

Dec Y/E, USD mn	FY21	FY22	FY23	FY24E	FY25E
Non Current Asset					
PPE	2,251	2,118	2,310	2,473	2,574
Right-of-use assets	2,612	2,219	2,217	2,199	2,192
Others	3,644	3,549	4,073	4,114	4,155
Total Non Current Assets	8,507	7,886	8,600	8,786	8,921
Current Asset					
Cash & cash equivalents	1,136	1,130	1,128	1,163	1,091
Trade receivables	67	64	68	74	78
Inventories	432	417	424	439	475
Others	3,081	2,329	1,811	1,768	1,729
Total Current Assets	4,716	3,940	3,431	3,444	3,373
Total Assets	13,223	11,826	12,031	12,231	12,293
Current Liabilities					
Payables	2,332	2,098	2,164	2,281	2,199
Borrowings	-	-	168	305	331
Other Non-current Liabilities	51	68	90	115	137
Total current Liabilities	2,383	2,166	2,422	2,701	2,667
Non Current Liabilities					
Lease liabilities	2,326	1,948	1,943	1,912	1,891
Deferred income tax liabilities	425	390	390	390	390
Others	167	162	157	126	105
Total Non-Current Liabilities	2,918	2,500	2,490	2,429	2,385
Equity					
Redeemable Noncontrolling Interest	14	12	13	13	13
Shareholders' equity	7,056	6,482	6,405	6,403	6,545
Non-controlling interests	852	666	701	685	684
Total equity	7,908	7,148	7,106	7,088	7,229
Total Liabilities and Equity	13,223	11,826	12,031	12,231	12,293

Consolidated Statement of Cash Flow

Dec Y/E, USD mn	FY21	FY22	FY23	FY24E	FY25E
CFO					
Profit before income tax	1,023	478	901	925	1,013
D&A add-back	312	1,037	857	977	1,053
Others	(922)	(1,348)	(1,406)	(1,627)	(1,544)
Net (inc)/dec working capital	718	1,246	1,121	1,377	1,088
Net cash flow from operating activities	1,131	1,413	1,473	1,652	1,610
CFI					
Purchase of PP&E	(689)	(679)	(710)	(721)	(742)
Others	(166)	157	(33)	190	212
Net cash flow from investing activities	(855)	(522)	(743)	(531)	(530)
CFE					
Dividends paid	(203)	(202)	(216)	(229)	(274)
Others	(110)	(642)	(500)	(857)	(878)
Net cash flows from financing activities	(313)	(844)	(716)	(1,085)	(1,152)
Net Change in Cash	(37)	47	14	35	(73)
Cash and CE at Y/E	1,136	1,130	1,128	1,163	1,091

Current Price as of: October 18

Source: PSHK Est.

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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