

## Yum China

## Expert call takeaways: 2024 operational focus – expansion, value &amp; profitability

Reiterate Rating: BUY | PO: 53.60 USD | Price: 37.48 USD

## Expert call takeaways

We hosted an expert call with a YUMC delivery vendor, with the following takeaways. 1) YUMC is committed to faster expansion despite macro uncertainties and competition, as the best defense is a good offense. 2) Value is critical, with a focus on TC over TA (for both overall and delivery businesses). The impact on SSSG remains to be seen. 3) Profitability matters the most, with aggressive cost savings underway to facilitate above initiatives, or to counter margin impact from such initiatives. In our view, 1Q24 will be a key quarter, given 1Q's materiality (30-35% of full-year earnings) and tough comps. We understand the bearish market views, but we forecast 1Q's NPAT to decline by just single digit given self-help and positive calendar impact (late CNY + leap year), and FY24 NPAT growth to be positive (on easier 2H comps). Reiterate Buy.

## Committed to expansion; best defense is a good offense

YUMC sticks to the 20k store target by 2026, to outgrow peers and defend shares. For example, the expert expects Eastern China to see mid-teens net unit growth in 2024, despite highest unit density. Most new stores will be smaller formats with better UE.

## TC over TA for now; value is critical

The expert expects YUMC to prioritize TC over TA in 2024, in a promotional market. Value campaigns take various forms, such as Crazy Thursday, weekend promotions, "Old Friends" (vintage SKU promotions), "OK" combo, TikTok coupons, etc. So far, Crazy Thursday is the most effective value offer, and in 2024 this event could include more SKUs and cover more days. The expert also witnesses rising momentum from TikTok coupons since 2H23, and estimates MSD-HSD sales contribution in 2023.

## Changes to delivery: still TC over TA

The expert expects delivery TA for KFC to move from >RMB60 to <RMB60 in 2024, through value and menu re-design (such as smaller combo with fewer items), to drive up TC (the TA of >RMB60 is more for sharing, and in the future YUMC will expand to in-home meals for 1 or 2 person). As a result, YUMC will adopt two changes. 1) In 2024, YUMC will switch to a combination of exclusive and platform (Meituan, etc.) riders (vs. only exclusive riders before), in order to leverage platforms' capability for more orders. 2) It will also lower delivery fees (charged by delivery vendors) by c.10%, via the use of platform vendors and rate renegotiation with original exclusive delivery vendors.

## Profitability matters most: lots of cost savings underway

**Restaurant expenses.** The expert expects falling labor/sales in 2024 (vs. >3% increase since 2019), on 1) Mega (one restaurant manager team running several stores), 2) fee cut of delivery and 3) conversion of some full-time employees to contractors. **Overhead.** The expert estimates the absolute value of G&A and logistics expenses to decline YoY, through digital, clean energy, outsourcing, function mergers and head count cuts.

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## Equity

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## Stock Data

Price (NYS / HKG)	37.48 USD / 296.80 HKD
Price Objective	53.60 USD / 416.00 HKD
Date Established	4-Jan-2024 / 4-Jan-2024
Investment Opinion	B-1-7 / B-1-7
52-Week Range	37.22 USD-64.70 USD
Market Value (mn)	15,267 USD
Shares Outstanding (mn)	407.3 / 407.3
Average Daily Value (mn)	127.96 USD
Free Float	96.5%
BofA Ticker / Exchange	YUMC / NYS
BofA Ticker / Exchange	XYUMF / HKG
Bloomberg / Reuters	YUMC US / YUMC.N
ROE (2023E)	11.8%
Net Dbt to Eqty (NAA)	-15.2%

## Acronyms

TC: ticket count

TA: ticket average

SSSG: same store sales growth

CNY: Chinese New Year

NPAT: net profit after tax

UE: unit economics

SKU: stock keeping unit

MSD: mid-single digit

HSD: high-single digit

G&amp;A: general and administrative expense

## Price objective basis & risk

### Yum China (YUMC / XYUMF)

Our PO is US\$53.6/share (HK\$416/share), based on an equal blend of P/E, DCF and EV/EBITDA. Our DCF value for YUMC is US\$57.9/share, derived from a 9.8% WACC, 0.8x beta and 3% terminal growth rate. Our P/E-based valuation is US\$47.9/share, based on a 22x 2024E P/E, 20% below its historical average giving rising competition. Our EV/EBITDA value is US\$55/share, based on 10x 2024E EV/EBITDA, also 20% below its historical average giving rising competition. We assume US\$/HK\$ exchange rate at 7.76. Upside risks: better-than-expected SSSG, better than expected macro, lower than expected cost inflation, less competition amid industry consolidation trend. Downside risks: weaker than expected SSSG, weaker than expected macro, higher than expected cost inflation, rising competition, new waves of pandemic outbreak.

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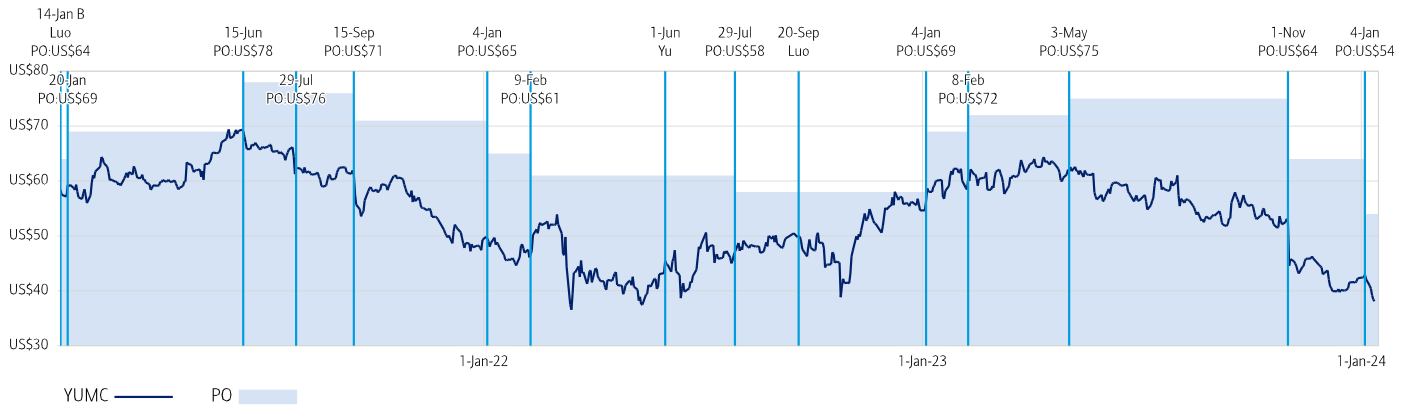
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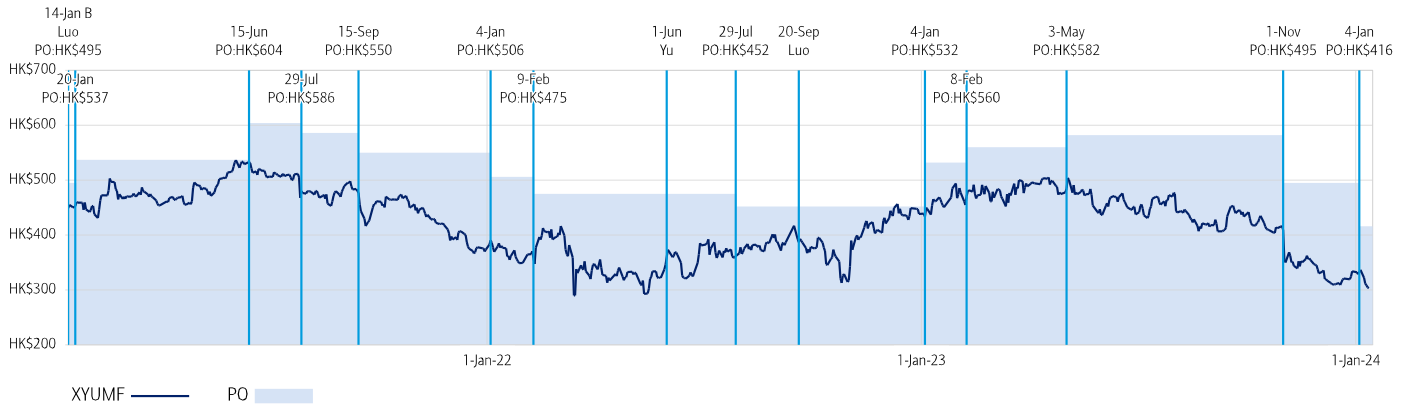
### Yum China (YUMC) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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### Yum China (XYUMF) Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	21	58.33%	Buy	10	47.62%
Hold	10	27.78%	Hold	3	30.00%
Sell	5	13.89%	Sell	4	80.00%

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Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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