



Rating
Buy

Asia
China

Consumer
Food & Beverage

Company
Yum China

Reuters
YUMC.N

Bloomberg
YUMC US

Exchange
NYS

Ticker
YUMC

Date
15 October 2018

Company Update

Price at 12 Oct 2018 (USD)	32.90
Price target - 12mth (USD)	39.00
52-week range (USD)	48.18 - 31.94
S & P 500	2,767

3Q18 preview - high base expected; higher dividend might be a surprise

Maintaining Buy

We believe the market is aware of slower performance in 3Q/4Q18. In the current market, we believe any gesture in terms of increasing the dividend payout will be a help. We expect the company to raise DPS by 10% from 3Q18. We expect 2018 /19 payout to reach 35% (from 30%) and 50% (maintain). This compares to market estimates of 28% / 29% respectively for the same period.

Although its yield might not look very attractive at the current price, the continued move to a higher payout and the buybacks will send a positive signal to investors, in our view, especially under current market conditions. We thus maintain our Buy rating.

YUMC is scheduled to announce its 3Q18 results on 30 Oct 2018 US ES time

We largely maintain our forecasts in 3Q18 with NP/sales down 0.3%/0.3% to USD177m/2193m. We maintain our forecast of SSSg of -1% for the group with -1% for KFC and -3% for Pizza Hut for this quarter. In addition, management resources and staff morale are likely distorted by the acquisition event.

We believe the KFC business will be affected by a tougher base in 3Q17 and keener competition, evidenced by more aggressive promotion campaigns and network acceleration from peers. For Pizza Hut, we believe it still needs more time for a decent recovery and the path will not be linear during the restructuring period. That said, as it increased its food investment in 2H17 especially in 4Q, the yoy impact on GPM will be more subdued in the following quarters.

On a full-year basis, we fine-tune NP/sales by -0.6%/-0.5% to USD628m/8356m in 2018, only based on currency changes. For 2019, we also fine-tune sales and NP on the latest currency trends (Figure 1).

Will new coffee delivery chains impact YUMC and what is YUMC's potential in the coffee market?

The fast development of Luckin Coffee and Coffee Box suggest that Chinese consumers have demand for coffee and there are challenges/ opportunities for other chains like KFC. We thus spoke to multi-industry experts so as to get a better understanding.

We understand consumer demand is more diverse, and that includes coffee. The price range for a cup of takeaway coffee can range from RMB15-RMB80 these days. We believe the coffee market has promising potential in China and

Valuation & Risks

Anne Ling

Research Analyst
+852-2203 6177

Louise Li

Research Associate
+852-2203 6152

Key changes

TP	39.20 to 39.00	↓	-0.5%
Sales (FYE)	8,400 to 8,356	↓	-0.5%
Op prof margin (FYE)	-	↓	-0.1%
Net profit (FYE)	631.9 to 628.3	↓	-0.6%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	1.3	-10.0	-23.4
S & P 500	-4.2	-1.1	8.5

Source: Deutsche Bank

Key indicators (FY1)

ROE (%)	22.5
Net debt/equity (%)	-46.4
Book value/share (USD)	7.49
Price/book (x)	4.4
Net interest cover (x)	-
Operating profit margin (%)	9.6

Source: Deutsche Bank

15 October 2018
Food & Beverage
Yum China



has attracted new investment (especially from private equity and ecommerce companies) over the past several months. One of the examples is Luckin Coffee. Due to the difference in locations and price points, Luckin Coffee affected Starbucks more than YUMC's coffee, in our view. YUMC's KFC is also developing a coffee+snack chain called COFFii & Joy, but it is still testing its business model.

Forecasts and ratios

Year End Dec 31	2016A	2017A	2018E	2019E	2020E
Sales (USDm)	7,075.0	7,769.0	8,356.4	8,679.6	9,283.4
Reported NPAT (USDm)	498.0	398.0	628.3	592.9	651.7
Reported EPS FD(USD)	1.30	1.03	1.58	1.51	1.66
OLD DB EPS FD (USD)	1.30	1.03	1.59	1.54	1.70
% Change	0.0%	0.0%	-0.6%	-2.0%	-1.9%
DB EPS growth (%)	–	-21.0	53.6	-4.3	10.2
DPS (net) (USD)	0.00	0.20	0.58	0.78	0.86
Yield (net) (%)	0.0	0.6	1.8	2.4	2.6

Source: Deutsche Bank estimates, company data

15 October 2018

Food & Beverage

Yum China



Valuation and risks

We believe the market is aware of slower performance in 3Q/4Q18, as our 2018 sales/NP forecast is similar to market consensus. The company has a net cash level of USD1.4bn by the end of 18 (DBe), apart from the share buyback (USD349m outstanding as of 2Q18); we expect the company to raise its DPS after its one-year payout anniversary. To recap, it has paid an absolute dividend of USD0.1 per quarter since 3Q17. Depending on its timing to lower the withholding tax requirement to 5%, we expect the company to raise DPS by 10% from 3Q18. **We expect 2018/19 payout to reach 35% (from 30%) and 50% (maintain),** suggesting a yield of 1.8%/2.4% respectively. **This compares to market estimates of a 28% / 29% payout respectively for the same period.**

In the current market, we believe any gesture in terms of increasing the dividend payout will help. Although its yield might not look very attractive at the current price, the continued move to a higher payout and buybacks should send a positive signal to investors, in our view, especially under current market conditions. **We thus maintain our Buy rating.** We believe the company, as a key fast food chain, remains one of the relatively resilient companies in any down-cycle, supported by good cashflow, a healthy balance sheet and a higher dividend payout.

Our revised DCF-based TP is USD39, down 0.5% from USD39.2 previously, reflecting currency impact. This translates into a P/E of 25/26x for 2018/2019F or 11/11x EV/EBITDA for 2018/19F, given its high net cash level.

Key downside risks: 1) intense competition; 2) changes in consumer preferences; 3) negative news or publicity (food safety issues and Sino-US tensions); 4) a failure to pass on cost increases; 5) a failure to revamp Pizza Hut; and 6) RMB depreciation and repatriation of cash outside China.

Figure 1: DB forecast vs. market consensus

	DB forecast			DB forecast (old)			Market consensus			Difference					
	2018F	2019F	2020F	2018F	2019F	2020F	2018F	2019F	2020F	vs DB forecast (old)			vs Market consensus		
YE Dec USDm										2018F	2019F	2020F	2018F	2019F	2020F
Sales	8,356	8,680	9,283	8,400	8,805	9,419	8,456	8,878	9,573	-0.5%	-1.4%	-1.4%	-1.2%	-2.2%	-3.0%
EBIT	805	750	823	810	765	840	829	858	934	-0.6%	-2.0%	-2.0%	-2.8%	-12.6%	-11.9%
Op profit	870	816	894	876	833	912	845	861	923	-0.6%	-2.0%	-2.0%	3.0%	-5.2%	-3.2%
Net profit	628	593	652	632	605	665	633	646	665	-0.6%	-2.0%	-2.0%	-0.7%	-8.3%	-2.0%
EPS	1.58	1.51	1.66	1.59	1.54	1.70	1.55	1.64	1.80	-0.6%	-2.0%	-2.0%	1.5%	-7.8%	-7.4%

Source: Deutsche Bank estimates, Bloomberg Finance LP

3Q18 preview

KFC

We expect -1% SSSg for KFC in 3Q, mainly **dragged by transaction volume, given traffic dilution due to store opening acceleration, intensified competition and higher growth from delivery.**

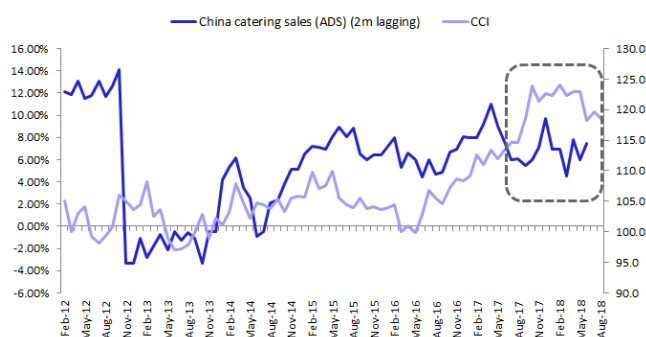
- To recap, the company accelerated store opening for KFC from 550-600 to 600-650 for 2018 at the beginning of the year. This might dilute the traffic growth of existing stores.

15 October 2018
Food & Beverage
Yum China



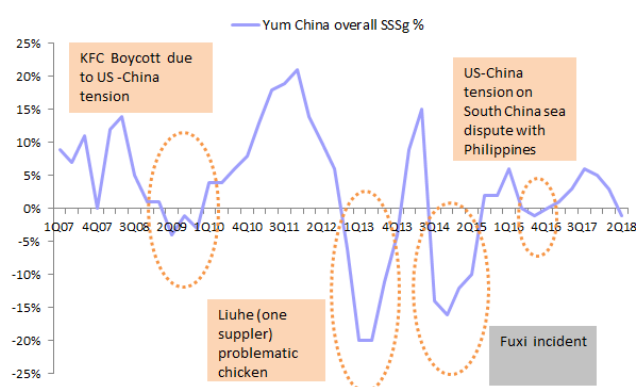
- We also observed that **most restaurants launched aggressive promotions in 3Q**, which led to intense competition. For instance, MCD offered RMB5 hamburgers in Aug for 28 days, which was well received during the period. KFC also launched a membership-only promotion called Crazy Thursday from Aug. Members can buy different items at a promotional price of RMB9.9 on Thursdays. But, we do not expect this will impact ticket prices, as there has been a price hike/product mix shift over the past couple of years.
- **Delivery is seeing a solid trend** although the growth rate might be normalized, as 70% of KFC stores have delivery services already, i.e. the penetration is high. In Tier I cities, delivery might contribute as much as 20% of restaurant sales. We found that the **daily active users for the KFC app have been increasing since May 2018**. This is in line with company's intention of directing more online orders from aggregator platforms to its self-run apps and increasing the user frequency. As ticket size is much higher than offline, it thus impacts the overall transaction volume and per ticket ASP.
- We believe **macro headwinds affected overall consumer sentiment** in the catering segment in 3Q, but they mainly affected mid/high-end restaurants and likely KFC in lower tier cities (but less for higher tier cities). By **city tier**, **Tier 1 cities continued to see a relatively resilient trend**, which is similar to the trend observed in 1H. Our channel checks show that **Tier 2/3 cities** might be affected by the delivery aggregators' penetration in some of the regions. e.g. Meituan and Ele.me, as consumers who order online have more choices other than just KFC. But we expect the new stores opened in **Tier 4 and below cities** have been seeing better performance this year, as the competition is less intensive and KFC has been the first mover in these markets, to benefit from consumption upgrade.

Figure 2: Consumer confidence leads China catering sales (ADS) by 2m



Source: CEIC, NBS

Figure 3: Historical SSSg affected by major incidents



Source: Deutsche Bank, Company data

Into 4Q18, the macro environment becomes more uncertain due to China-US tension and weak consumer sentiment (Figure 2 shows consumer sentiment is leading catering sales (above designated sales) by two months). To recap, China-US tension has been one of the political risks for KFC historically which

15 October 2018

Food & Beverage

Yum China

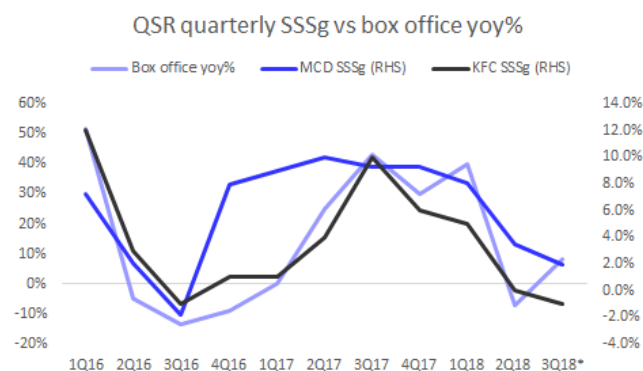


directly affected its SSSg in 4Q07 and 3Q16. All in all, we remain cautious on 4Q momentum and budget a flat SSSg. However, we believe the fast food chain remains more resilient, especially in Tier 1 cities (17-18% of store sales based on the data from its website).

Competition from MCD

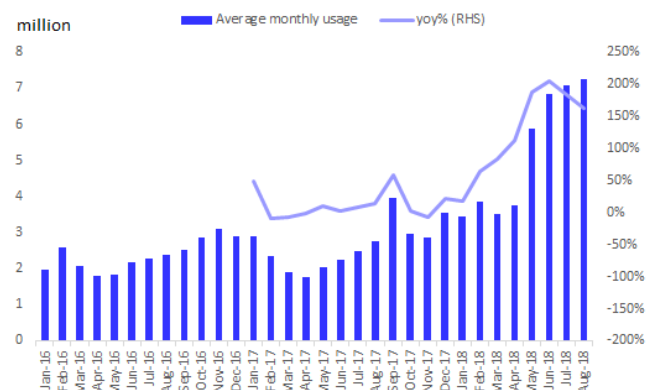
McDonald's (MCD) has seen store openings accelerate this year. We believe competition mainly comes from three aspects: 1) in some regions, this might potentially increase the competition for good locations and operating costs for KFC, as MCD has teamed up with a lot of local property companies since MCD was bought by Citi, 2) although it has similar sales per store based on our understanding, MCD's product **price is historically lower than KFC's, by 10%, while its traffic has been higher than KFC's** due to lower store density than KFC. MCD might gain more traffic from KFC due to its more competitive price points particularly in an economic downcycle, 3) MCD has a closer relationship with Meituan and Ele.me, **as the majority of its online orders are from third-party aggregators vs. half for KFC**. Meituan and Ele.me might help MCD more in accelerating its online growth, given its large user base. That said, KFC still maintains its advantages on new product launch, more advanced digital strategy/ know how and first-mover advantages in lower tier cities.

Figure 4: KFC and MCD quarterly SSSg vs. box office yoy%



Source: Deutsche Bank, company data, entgroup. Note: 3Q18 SSSg for KFC and MCD is DBE.

Figure 5: KFC app average monthly usage has seen acceleration since May 2018



Source: Deutsche Bank, Iresearch

Pizza Hut

For Pizza Hut, we believe the restructuring initiated from May 2017 is still ongoing and the effectiveness is not linear but more volatile. It expects to complete the consolidation between Pizza Hut Home Delivery and Casual Dining by this year. It is still focusing on four pillars, including digitalization (CRM and other digital systems have made progress), menu adjustment (ongoing), store design and format adjustment (it has accelerated remodeling, including partial remodeling and mini remodeling; and testing different formats), and delivery business (it still relies on third-party for its delivery order fulfillment and targets to build up its own rider capacity over time).

Pizza Hut officially unveiled its new look with a theme “always something new” at the weekend, as a part of its revitalization plan. Specifically,

15 October 2018
Food & Beverage
Yum China



- It redesigned its logo;
- It collaborated with Anna Sui, a New York fashion designer, to launch exclusive uniforms for Pizza Hut store crew nationwide.
- New store design with new elements including open kitchen, dining room, bar, indoor garden, family dens, table side ordering, etc. can help to refresh the brand image and improve operating efficiency.
- The pioneer concept store, newly opened in Nanjing, serves as a product testing site. It plans to open more pioneer concept stores in different regions.
- It recently launched a smaller new format dedicated to delivery in lower tier cities.

While we believe these are good initiatives, Pizza Hut is in a very competitive segment, within casual dining, where consumers continue to look for newness. New competitors continuously emerge, such as La Cesar Pizzeria and Champion pizza. We understand Pizza Hut is putting efforts into its brand revitalization programme and we might need more time to monitor the progress and factor in a decent recovery.

Overall

We believe GPM will be under pressure as it provides more promotions. It continues to invest into food, which was initiated from Aug 2017, thus the impact on GPM from Aug 2018 will be easier. We expect GPM will be slightly down, from 74% in 3Q17 to 73%.

It will be cautious on an LFL price hike despite the chicken price hike and CPI recovery in general. It normally locks in the chicken price one quarter in advance. Thus, the impact from the recent chicken price hike will be minor. It maintains low single-digit inflation guidance for raw materials on a full year basis.

Similarly, it also maintains its labor cost inflation guidance of high single digit (LFL, excluding the impact of staff no. increase from store opening acceleration). We expect overall operating margin will erode 90 bps yoy in 3Q. The company believes the new social security benefit reform will not affect its P&L as it already largely pays the social benefit based on the actual salary, except some riders in Daojia.com.

Going forward, we believe the company will be able to maintain a decent GPM as it still has room to hike prices. The major challenge comes from labor costs.

We also expect the company to **review its dividend policy** and raise its dividend payout as it will be its one-year anniversary for its current dividend policy in 3Q18.

Can KFC benefit from the increase in coffee-drinking culture?

We recently talked with multi-catering industry experts to capture the latest industry trends, including coffee. The coffee business is an emerging market with significant growth potential, benefiting from consumption upgrades. Different from the global coffee market, the coffee market in China is dominated by instant coffee (84%); fresh coffee, which is normally consumed in coffee shops, only accounts for 16% but is growing fast (Figure 8). Starbucks, who entered into the China market as early as 1999, is the No.1 coffee shop with 59% market share

15 October 2018

Food & Beverage

Yum China



as of 2017, followed by 6% for McCafe, 4% for Costa. KFC's coffee can still see double-digit growth (accounting for less than 10% of overall sales).

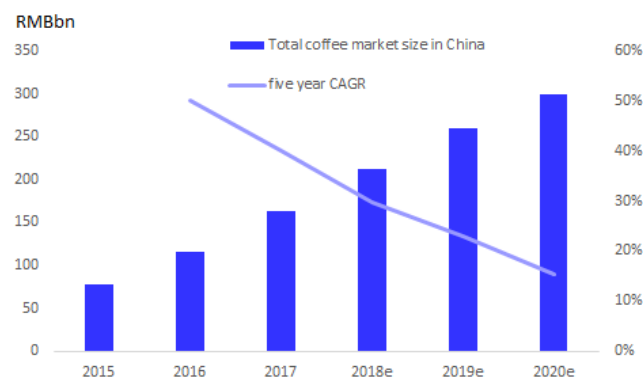
In 2018, coffee business has become one of the most popular targets for the PE/VC market. As of May 2018, the coffee industry had attracted RMB322m VC investment, which is twice the total amount in 2017. This enabled the industry to display some new trends, which might be prevailing in the forthcoming years.

- **New coffee chains' focus on delivery emerged, leveraged by new retail format and heavy capital inflow**, e.g. Luckin Coffee, which opened its first store in Dec 2017 and currently owns over 1000 stores in nearly 20 cities. It targets to have 2000-3000 stores by the end of 2018. Different from traditional coffee chains with store space over 300sqm, which offer an area for social functions, Luckin Coffee stores are normally no more than 100 sqm and do not offer dining areas. It only offers takeaway and delivery. The delivery orders placed via its app contribute 70% of its total sales. It is still at the investment stage and has a robust store expansion pace. As it offers aggressive subsidies to consumers, e.g. first cup free, cash coupons, buy five get five free, free delivery above RMB35, etc., its effective ASP is as low as RMB15 (retail price ranging from RMB21-27 per cup of coffee). They mainly target university students and white-collar workers. We thus believe its network might overlap with Starbucks and other coffee chains. **But we don't view it as a competitor to KFC. KFC coffee has a lower price point** (RMB15 on average) and is mainly offered in the breakfast day part, which is different from Luckin Coffee.
- **Boutique coffee houses, which are catering for savvy coffee consumers, is another trend**. Greybox Coffee, Seesaw Coffee, 3W Coffee, Peet's Coffee, and numerous independent coffee shops, which offer more premium coffee, have emerged as consumers become more knowledgeable about coffee. This only happens in Tier 1 /2 cities at this moment. **KFC also opened a coffee shop called COFFii & Joy targeting coffee consumers. There are only five stores and the company is still testing the model.**
- **More coffee delivery collaboration**. To counter intensified competition and cater for increasing demand for coffee delivery, **Starbucks** teamed up with Alibaba and Ele.me to officially launch its delivery business, on 20 Sep 2018. Our experts believe its better control in product quality and operations will prove more competitive in the mid to long run, compared with emerging coffee delivery, given its stronger brand image, consistency in product quality (there is lots of news regarding complaints on Luckin Coffee spilling coffee during delivery) and product innovation capabilities. Based on our channel checks, the sales per store for Luckin Coffee are already peaking, selling ~200 cups per day (vs. 500 for Starbucks). On 8 Oct, **McCafe** also announced that it will launch a coffee delivery service via Meituan, Ele.me and Wechat mini programme starting from Shanghai, given the potential demand.

15 October 2018
Food & Beverage
Yum China

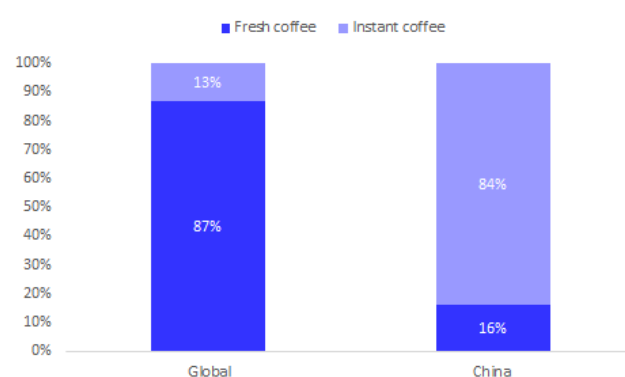


Figure 6: Total coffee market size expected to reach RMB300bn by 2020



Source: Deutsche Bank, CBDdata

Figure 7: Fresh coffee only accounts for 16% of total coffee consumption in China vs. 87% in the world



Source: Deutsche Bank, CBDdata

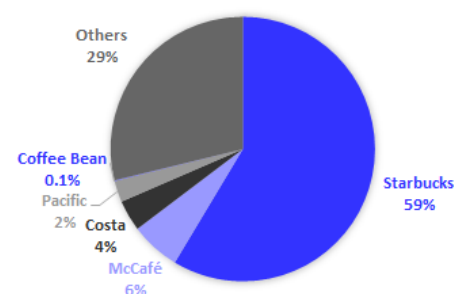
Figure 8: Coffee shop market size also expected to reach RMB42bn as of 2020



Source: Deutsche Bank, CBDdata

Figure 9: Starbucks dominated the coffee shop market in China in 2017

MARKET SHARE OF COFFEE SHOP IN CHINA IN 2017



Source: Deutsche Bank, Euromonitor

15 October 2018

Food & Beverage

Yum China

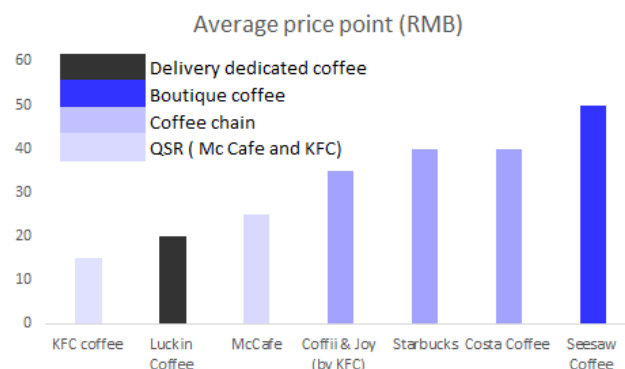


Figure 10: Starbucks saw first negative quarterly SSSG in China in 2Q18?



Source: Company data, note: SSSG is based on calendar year

Figure 11: Average price comparison between different coffee shop formats



Source: Deutsche Bank, Dianping, company data

Figure 12: Quarterly forecast assumptions

YE Dec	Annual forecast					Quarterly forecast							
	2016	2017	2018	2019	2020	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18
USD m	A	A	F	F	F	A	A	A	A	A	A	E	E
Key assumptions													
Macro data													
CPI *	2.0	1.6	2.7	2.4	-	1.4	1.5	1.4	1.7	2.1	3.1	4.1	5.1
CPI (food)	4.6	(1.4)	4.6	4.2	-	na	na	na	na	na	na	na	na
Currency - USD/RMB	0.150	0.148	0.151	0.144	0.144	0.145	0.146	0.150	0.152	0.157	0.157	0.147	0.144
% change	-5.5%	-1.4%	2.0%	-4.4%	0.0%	-5.2%	-3.8%	0.1%	4.0%	8.2%	7.2%	-2.2%	-4.9%
Overall													
No of restaurants	7,983	7,983	8,484	8,978	9,472	7,653	7,704	7,813	7,983	8,112	8,199	8,307	8,484
KFC	5,224	5,488	5,851	6,154	6,457	5,277	5,324	5,393	5,488	5,602	5,696	5,767	5,851
Pizza Hut Casual Dining	2,081	2,195	2,316	2,487	2,658	2,105	2,122	2,157	2,195	2,214	2,210	2,243	2,316
Others	678	300	317	337	357	271	258	263	300	296	293	297	317
% growth		0.0%	6.3%	5.8%	5.5%					6.0%	6.4%	6.3%	6.3%
System sales growth (%) ex FX	5%	8%	5%	7%	7%	4%	7%	12%	9%	6%	3%	5%	5%
SSS (%)	flat	4%	0%	2%	2%	1%	3%	8%	5%	3%	-1%	-1%	-1%
KFC													
SSS (%)	24%	20%	9%			1%	4%	10%	6%	5%	0%	-1%	0%
System sales (USDm)	5,997	6,422	6,989	7,222	7,739	1,594	1,531	1,766	1,531	1,874	1,727	1,839	1,548
Sales	4,757	5,066	5,610	5,902	6,335	1,250	1,206	1,402	1,208	1,498	1,400	1,476	1,236
Restaurant profit	745	880	950	993	1,064	249	203	265	160	301	227	268	154
Restaurant margin	16.3%	18.1%	17.6%	17.4%	17.4%	20.8%	17.5%	19.7%	13.8%	20.8%	16.8%	18.9%	12.9%
Operating profit	641	802	865	903	973	245	182	256	119	296	199	256	113
% growth													
System sales (USDm)		9.0%	6.7%	8.1%	7.2%					8.6%	5.2%	6.5%	6.3%
Sales		6.5%	10.7%	5.2%	7.3%					19.8%	16.1%	5.3%	2.4%
Restaurant profit		18.1%	7.9%	4.5%	7.1%					20.9%	11.8%	1.1%	-3.9%
Operating profit		25.1%	7.8%	4.4%	7.8%					20.8%	9.3%	0.1%	-4.7%
Pizza Hut Casual Dining													
SSS (%)	-7%	1%	-4%	0%	1%	3%	0%	1%	1%	-5%	-4%	-3%	-3%
System sales (USDm)	2,023	2,157	2,196	2,212	2,368	537	507	578	535	574	528	570	524
Sales	1,996	2,093	2,127	2,145	2,299	528	498	569	498	565	528	558	476
Restaurant profit	266	292	213	215	224	104	74	81	33	60	58	68	27
Restaurant margin	13.4%	14.0%	10.0%	10.0%	9.8%	19.7%	14.9%	14.3%	6.6%	10.6%	11.0%	12.1%	5.7%
Operating profit	149	157	79	84	88	80	39	54	(16)	34	20	40	(15)
% growth													
System sales (USDm)		8.6%	-0.2%	5.3%	7.0%					-1.2%	-2.9%	0.8%	2.9%
Sales		4.9%	1.6%	0.9%	7.2%					7.0%	6.0%	-1.9%	-4.4%
Restaurant profit		9.8%	-27.2%	1.1%	4.3%					-42.3%	-21.6%	-16.4%	-18.5%
Operating profit		5.4%	-49.4%	5.9%	4.7%					-57.5%	-48.7%	-25.5%	na

Source: Deutsche Bank estimates, Company data

15 October 2018
Food & Beverage
Yum China



Figure 13: P&L

YE Dec USD m	Annual forecast					Quarterly forecast							
	2016 A	2017 A	2018 F	2019 F	2020 F	1Q17 A	2Q17 A	3Q17 A	4Q17 A	1Q18 A	2Q18 A	3Q18 E	4Q18 E
P&L as reported													
Sales	7,075	7,769	8,356	8,680	9,283	1,926	1,841	2,130	1,872	2,221	2,068	2,193	1,875
Company sales	6,622	6,993	7,563	7,884	8,477	1,738	1,664	1,924	1,667	2,016	1,888	1,987	1,671
Franchise fees and income	129	141	144	139	147	36	33	38	34	40	34	36	33
Company restaurant expenses	(5,612)	(5,822)	(6,400)	(6,674)	(7,183)	(1,384)	(1,388)	(1,577)	(1,473)	(1,655)	(1,602)	(1,651)	(1,492)
Restaurant profit	1,010	1,171	1,163	1,210	1,294	354	276	347	194	361	286	337	179
Restaurant margin	15.3%	16.7%	15.4%	15.4%	15.3%	20.4%	16.6%	18.0%	11.6%	17.9%	15.1%	16.9%	10.7%
Operating profit	634	778	870	816	894	296	171	264	47	395	193	251	31
Interest income	11	25	30	34	40	4	4	8	9	8	10	8	5
Interest expense	-	-	-	-	-	-	-	-	-	-	-	-	-
exceptional	21	-	-	-	-	-	-	-	-	-	-	-	-
Profit before tax	666	803	901	850	934	300	175	272	56	403	203	259	36
Tax	(156)	(379)	(243)	(229)	(252)	(90)	(43)	(87)	(159)	(107)	(53)	(71)	(12)
PAT	510	424	657	620	682	210	132	185	(103)	296	150	187	24
Minorities	(12)	(26)	(29)	(28)	(30)	(6)	(7)	(9)	(4)	(8)	(7)	(10)	(4)
Net Profit	498	398	628	593	652	204	125	176	(107)	288	143	177	20
% growth in USD													
Sales		9.8%	7.6%	3.9%	7.0%					15.3%	12.3%	3.0%	0.1%
Company restaurant expenses		3.7%	9.9%	4.3%	7.6%					19.6%	15.4%	4.7%	1.3%
Restaurant profit		15.9%	-0.7%	4.1%	6.9%					2.0%	3.6%	-3.0%	-7.5%
Operating profit		22.7%	11.9%	-6.2%	9.5%					33.4%	12.9%	-4.9%	-33.7%
ETR		-47.2%	-27.0%	-27.0%	-27.0%					-26.6%	-26.1%	-27.5%	-33.0%
Net Profit		-20.1%	57.9%	-5.6%	9.9%					40.9%	14.4%	0.8%	-118.9%
% growth in RMB													
Sales		11.1%	5.7%	7.9%	7.0%					7.7%	5.5%	5.0%	4.8%
Company restaurant expenses		5.1%	8.1%	8.3%	7.6%					12.4%	8.8%	6.7%	5.9%
Restaurant profit		17.1%	-2.8%	8.1%	6.9%					-6.8%	-3.9%	-0.8%	-2.5%
Operating profit		23.8%	10.0%	-1.8%	9.5%					27.5%	6.1%	-2.7%	-27.5%
Net Profit		-18.4%	57.0%	-1.2%	9.9%					35.6%	7.8%	3.0%	-108.8%
Common size of company sales													
Sales	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Company sales	93.6%	90.0%	90.5%	90.8%	91.3%	90.2%	90.4%	90.3%	89.0%	90.8%	91.3%	90.6%	89.1%
Franchise fees and income	1.8%	1.8%	1.7%	1.6%	1.6%	1.9%	1.8%	1.8%	1.8%	1.8%	1.6%	1.7%	1.8%
Company restaurant expenses	-79.3%	-74.9%	-76.6%	-76.9%	-77.4%	-71.9%	-75.4%	-74.0%	-78.7%	-74.5%	-77.5%	-75.3%	-79.6%
Restaurant profit	14.3%	15.1%	13.9%	13.9%	13.9%	18.4%	15.0%	16.3%	10.4%	16.3%	13.8%	15.3%	9.6%
Restaurant margin	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
G&A	-6.1%	-6.4%	-5.8%	-5.8%	-5.6%	-5.1%	-6.4%	-5.8%	-8.3%	-5.1%	-4.9%	-5.5%	-8.2%
Operating profit	9.0%	10.0%	10.4%	9.4%	9.6%	15.4%	9.3%	12.4%	2.5%	17.8%	9.3%	11.5%	1.7%
Interest income	0.2%	0.3%	0.4%	0.4%	0.4%	0.2%	0.2%	0.4%	0.5%	0.3%	0.5%	0.3%	0.3%
Interest expense	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
exceptional	0.3%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Profit before tax	9.4%	10.3%	10.8%	9.8%	10.1%	15.6%	9.5%	12.8%	3.0%	18.1%	9.8%	11.8%	1.9%
ETR	-23.4%	-47.2%	-27.0%	-27.0%	-27.0%	-30.0%	-24.6%	-32.0%	-283.9%	-26.6%	-26.1%	-27.5%	-33.0%
PAT	7.2%	5.5%	7.9%	7.1%	7.3%	10.9%	7.2%	8.7%	-5.5%	13.3%	7.3%	8.6%	1.3%
Minorities	-0.2%	-0.3%	-0.3%	-0.3%	-0.3%	-0.3%	-0.4%	-0.4%	-0.2%	-0.4%	-0.3%	-0.5%	-0.2%
Net Profit	7.0%	5.1%	7.5%	6.8%	7.0%	10.6%	6.8%	8.3%	-5.7%	12.9%	6.9%	8.1%	1.1%

Source: Deutsche Bank estimates, Company data

15 October 2018

Food & Beverage

Yum China



Model updated: 15 October 2018

Running the numbers

Asia

China

Food & Beverage

Yum China

Reuters: YUMC.N

Bloomberg: YUMC US

Buy

Price (12 Oct 18) USD 32.90

Target Price USD 39.00

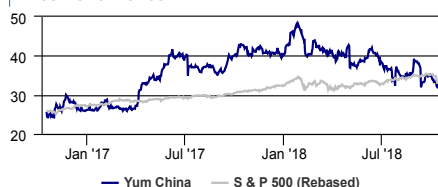
52 Week range USD 31.94 - 48.18

Market cap (m) USDm 12,612
EURm 10,783

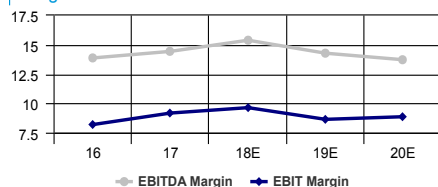
Company Profile

The company is of a spin-off entity of Yum! Brands (YUM.N) which is listed in US. It owns the franchise of Yum! Brands business in China and operates KFC, Pizza Hut, Taco Bell, East Dowing, Little Sheep stores.

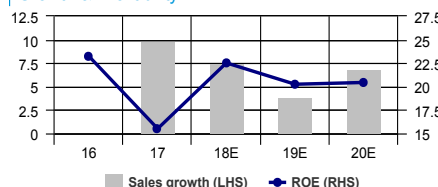
Price Performance



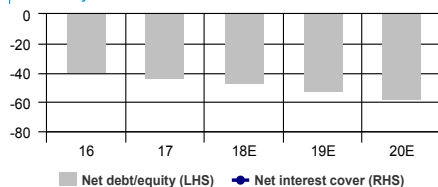
Margin Trends



Growth & Profitability



Solvency



Anne Ling

+852 2203 6177

anne.ling@db.com

Fiscal year end 31-Dec

Financial Summary

	2016	2017	2018E	2019E	2020E
DB EPS (USD)	1.30	1.03	1.58	1.51	1.66
Reported EPS (USD)	1.30	1.03	1.58	1.51	1.66
DPS (USD)	0.00	0.20	0.58	0.78	0.86
BVPS (USD)	6.2	7.1	7.5	8.1	8.9
Weighted average shares (m)	368	388	385	380	378
Average market cap (USDm)	9,823	13,702	12,612	12,612	12,612
Enterprise value (USDm)	8,887	12,466	11,236	10,960	10,579

Valuation Metrics

P/E (DB) (x)	20.5	34.4	20.9	21.8	19.8
P/E (Reported) (x)	20.5	34.4	20.9	21.8	19.8
P/BV (x)	4.23	5.63	4.39	4.08	3.69
FCF Yield (%)	3.9	3.0	4.9	5.3	5.6
Dividend Yield (%)	0.0	0.6	1.8	2.4	2.6
EV/Sales (x)	1.3	1.6	1.3	1.3	1.1
EV/EBITDA (x)	9.0	11.1	8.7	8.8	8.3
EV/EBIT (x)	15.3	17.5	14.0	14.6	12.9

Income Statement (USDm)

Sales revenue	7,075	7,769	8,356	8,680	9,283
Gross profit	5,156	5,736	6,091	6,322	6,752
EBITDA	982	1,122	1,286	1,240	1,274
Depreciation	402	409	481	490	452
Amortisation	0	0	0	0	0
EBIT	580	713	805	750	823
Net interest income/(expense)	11	25	30	34	40
Associates/affiliates	54	65	65	66	71
Exceptionals/extraordinary	21	0	0	0	0
Other pre-tax income/(expense)	0	0	0	0	0
Profit before tax	666	803	901	850	934
Income tax expense	156	379	243	229	252
Minorities	12	26	29	28	30
Other post-tax income/(expense)	0	0	0	0	0
Net profit	498	398	628	593	652
DB adjustments (including dilution)	0	0	5	5	5
DB Net profit	498	398	633	597	656

Cash Flow (USDm)

Cash flow from operations	819	847	1,128	1,066	1,114
Net Capex	-436	-440	-504	-410	-414
Free cash flow	383	407	624	656	699
Equity raised/(bought back)	460	-125	-320	-102	0
Dividends paid	-357	-38	-165	-277	-318
Net inc/(dec) in borrowings	-6	0	0	0	0
Other investing/financing cash flows	59	56	0	0	0
Net cash flow	539	300	140	277	381
Change in working capital	-17	-28	45	25	47

Balance Sheet (USDm)

Cash and other liquid assets	964	1,264	1,404	1,680	2,061
Tangible fixed assets	1,814	1,900	1,923	1,843	1,806
Goodwill/intangible assets	0	0	0	0	0
Associates/investments	344	480	545	611	683
Other assets	628	643	672	687	717
Total assets	3,750	4,287	4,543	4,822	5,266
Interest bearing debt	28	28	28	28	28
Other liabilities	1,289	1,412	1,551	1,608	1,696
Total liabilities	1,317	1,440	1,579	1,636	1,724
Shareholders' equity	2,367	2,765	2,853	3,048	3,374
Minorities	66	82	111	139	169
Total shareholders' equity	2,433	2,847	2,965	3,187	3,543
Net debt	-936	-1,236	-1,376	-1,652	-2,033

Key Company Metrics

Sales growth (%)	nm	9.8	7.6	3.9	7.0
DB EPS growth (%)	na	-21.0	53.6	-4.3	10.2
EBITDA Margin (%)	13.9	14.4	15.4	14.3	13.7
EBIT Margin (%)	8.2	9.2	9.6	8.6	8.9
Payout ratio (%)	0.0	19.8	35.4	50.2	50.0
ROE (%)	23.2	15.5	22.5	20.2	20.4
Capex/sales (%)	6.2	5.7	6.0	4.7	4.5
Capex/depreciation (x)	1.1	1.1	1.0	0.8	0.9
Net debt/equity (%)	-38.5	-43.4	-46.4	-51.9	-57.4
Net interest cover (x)	nm	nm	nm	nm	nm

Source: Company data, Deutsche Bank estimates

15 October 2018
Food & Beverage
Yum China



Appendix 1

Important Disclosures

*Other information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Yum China	YUMC.N	32.90 (USD) 12 Oct 2018	NA

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <https://research.db.com/Research/Disclosures/CompanySearch>. Aside from within this report, important risk and conflict disclosures can also be found at <https://research.db.com/Research/Topics/Equities?topicId=RB0002>. Investors are strongly encouraged to review this information before investing.

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Historical recommendations and target price. Yum China (YUMC.N)

(as of 10/12/2018)



Current Recommendations

Buy
Hold
Sell
Not Rated
Suspended Rating

** Analyst is no longer at Deutsche Bank

1. 02/23/2017	Buy, Target Price Change USD 31.48 Anne Ling	6. 02/08/2018	Buy, Target Price Change USD 48.30 Anne Ling
2. 04/06/2017	Buy, Target Price Change USD 34.72 Anne Ling	7. 04/25/2018	Buy, Target Price Change USD 50.90 Anne Ling
3. 07/06/2017	Downgraded to Hold, Target Price Change USD 36.61 Anne Ling	8. 05/03/2018	Buy, Target Price Change USD 47.40 Anne Ling
4. 09/08/2017	Hold, Target Price Change USD 37.09 Anne Ling	9. 07/04/2018	Buy, Target Price Change USD 44.30 Anne Ling
5. 10/06/2017	Upgraded to Buy, Target Price Change USD 45.30 Anne Ling	10. 08/02/2018	Buy, Target Price Change USD 39.20 Anne Ling

15 October 2018

Food & Beverage

Yum China



Equity Rating Key

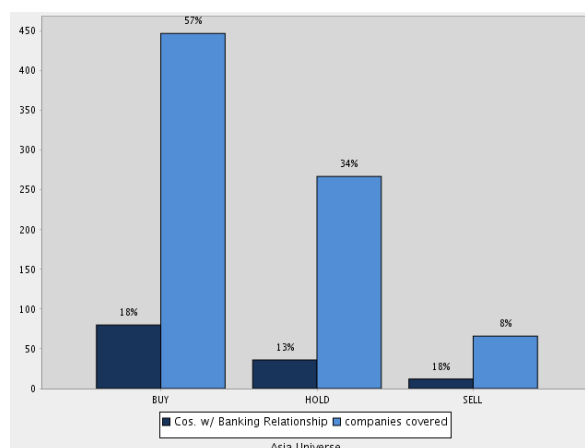
Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships



15 October 2018
Food & Beverage
Yum China



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15 October 2018

Food & Beverage

Yum China



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15 October 2018
Food & Beverage
Yum China



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15 October 2018

Food & Beverage

Yum China



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David Folkerts-Landau

Group Chief Economist and Global Head of Research

Pam Finelli
Global Chief Operating Officer
Research

Michael Spencer
Head of APAC Research

Steve Pollard
Head of Americas Research
Global Head of Equity Research

Anthony Klarman
Global Head of
Debt Research

Kinner Lakhani
Head of EMEA
Equity Research

Joe Liew
Head of APAC
Equity Research

Jim Reid
Global Head of
Thematic Research

Francis Yared
Global Head of
Rates Research

George Saravelos
Head of FX Research

Peter Hooper
Global Head of
Economics Research

Andreas Neubauer
Head of Germany Research

Spyros Mesomeris
Global Head of Quantitative
and QIS Research

International Production Locations

Deutsche Bank AG

Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG

Mainzer Landstrasse 11-17
60329 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG

Filiale Hongkong
International Commerce Centre,
1 Austin Road West, Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.

2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank AG London

1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.

60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500