

Yum! Brands, Inc.(YUM)

\$105.40 (As of 01/17/20)

Price Target (6-12 Months): **\$111.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/01/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:D

Value: D

Growth: C

Momentum: C

Summary

Yum Brands' shares have underperformed the industry in the past six months. The downtrend might persist as it reported lower-than-expected third-quarter 2019 results. The company's top and the bottom line lagged analysts' expectations as well as declined on a year-over-year basis. The downfall was caused by a write down in the value of its investment in GrubHub. However, over the next three years, it continues to expect to return additional \$6.5-\$7 billion to its shareholders and predicts earnings per share of at least \$3.75 in 2019. Particularly, increased franchising is anticipated to stabilize earnings, increase profit margins, lower capital requirements and a strengthen cash flow. Further, solid focus on restaurant development bode well. However, of late, earnings estimate for 2020 have witnessed downward revisions.

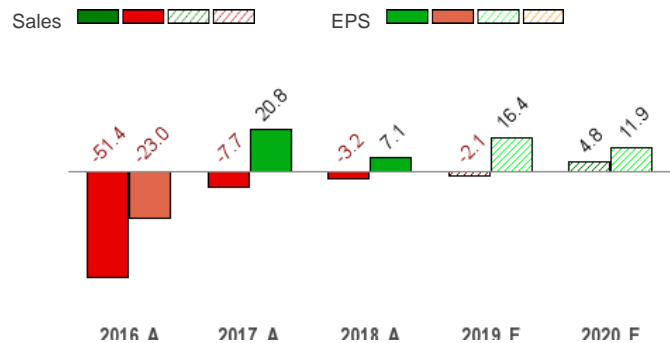
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$119.72 - \$88.52
20 Day Average Volume (sh)	1,279,565
Market Cap	\$31.9 B
YTD Price Change	4.6%
Beta	0.44
Dividend / Div Yld	\$1.68 / 1.6%
Industry	Retail - Restaurants
Zacks Industry Rank	Top 40% (101 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-14.9%
Last Sales Surprise	-0.5%
EPS F1 Est- 4 week change	-0.6%
Expected Report Date	02/06/2020
Earnings ESP	-1.0%

P/E TTM	35.7
P/E F1	25.5
PEG F1	2.1
P/S TTM	5.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	1,326 E	1,384 E	1,430 E	1,681 E	5,841 E
2019	1,254 A	1,310 A	1,339 A	1,669 E	5,571 E
2018	1,371 A	1,368 A	1,391 A	1,558 A	5,688 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.87 E	\$1.01 E	\$1.05 E	\$1.23 E	\$4.13 E
2019	\$0.82 A	\$0.93 A	\$0.80 A	\$1.12 E	\$3.69 E
2018	\$0.90 A	\$0.82 A	\$1.04 A	\$0.40 A	\$3.17 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/17/2020. The reports text is as of 01/20/2020.

Overview

Louisville, KY-based YUM! Brands Inc. – formerly Tricon Global Restaurants, Inc. – was spun off from PepsiCo in October 1997. YUM! Brands is the global leader in multi-branding and offers consumers more choice and convenience at one outlet. The company presently reports through three segments – KFC (46.5% of total revenues in 2018), Pizza Hut (17.4%) and Taco Bell (36.1%). Notably, Yum! Brands now owns, operates and franchises over 48,000 fast food stores under KFC, Pizza Hut and Taco Bell brands in more than 135 countries and territories. As of Dec 31, 2018, the company's 98% of units were operated by independent franchisees or licensees under the terms of franchise or license agreements.

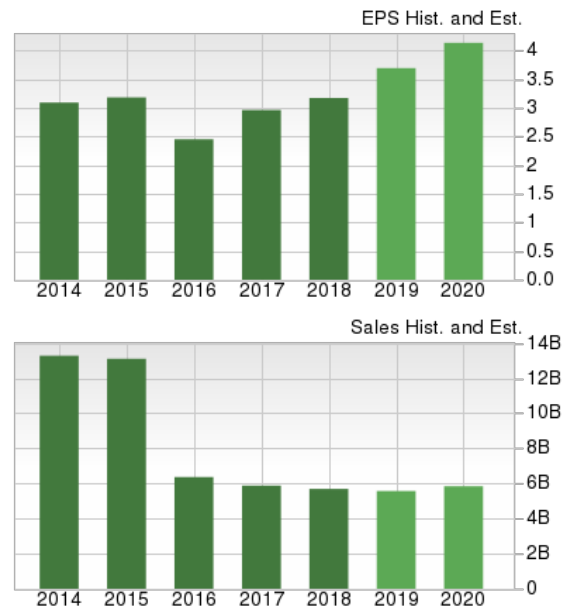
The company opened 1,757 net new units in 2018 and added 1,282 Telepizza, reflecting 7% year-over-year net unit growth. Yum! Brands refranchised 660 restaurants — including 364 KFC, 97 Pizza Hut and 199 Taco Bell units — for pre-tax proceeds of \$825 million, recording net refranchising gains of \$540 million.

The company exercises store-level franchise and master franchise programs to grow its businesses. Nearly 30% of its franchised units operate under master franchise programs. The remaining franchised units operate under store-level franchise agreement.

On Oct 31, 2016, Yum! Brands' completed the spin-off of the China business into an independent, publicly-traded company. Yum China Holdings began trading as an independent company, effective Nov 1, 2016, on the New York Stock Exchange (NYSE), under the ticker symbol "YUMC".

In February 2018, Yum! Brands announced a partnership with online food delivery platform Grubhub, to enhance online sales and delivery from its restaurants. As part of the deal, Yum! Brands will acquire \$200 million of Grubhub stock. The proceeds are used by Grubhub to speed up the expansion of its delivery capacity.

Yum! Brands was 98% franchised by the end of 2018. The company will have the provision to triple its unit count in the long term, with strong growth from emerging markets.



Reasons To Buy:

- ▲ **Transformation Initiatives Drive Growth:** Yum! Brands has a three-year strategic transformation plan to drive growth at KFC, Pizza Hut and Taco Bell brands. Notably, the company's transformation and growth strategy involve employing greater focus on the development of its three iconic global brands, increasing its franchise ownership and creating a leaner, more efficient cost structure. It is also focusing on restaurant development to drive continued growth.

By relying extensively on the four key drivers of growth — distinctive, relevant and easy brands; unmatched franchise operating capability; bold restaurant developments; and unrivaled culture and talent — the company remains on track to achieve its long-term target.

- ▲ **Strong Digital & Delivery Services to Enhance Guest Experience:** The digital wave has hit the U.S. fast-casual restaurant sector. More and more restaurants are deploying technology to enhance guest experience. Yum! Brands is also not far behind in the race as the company is continuing the transformation process toward a single point-of-sale system in the United States. Further, it updated its mobile app and Hut Rewards. It also has more than 12 million active users in the loyalty program.

Yum! Brands announced a partnership with online food delivery platform Grubhub to enhance online sales and delivery from its restaurants. Additionally, the company implemented various digital features in mobile and online platforms across all its brand segments to enhance guest experience. Yum! Brands has also worked toward making its delivery services swifter and the results have been positive so far. The company currently has 2,700 KFCs, offering delivery, and 3,700 restaurants available for click-and-collect on the Grubhub marketplace. Pizza Hut has 700 locations on the Grubhub marketplace. For Taco Bell, delivery exists in more than 4,800 restaurants.

- ▲ **Refranchising Strategy Safeguards Earnings:** Yum! Brands has adopted a de-risking strategy by reducing its ownership of restaurants through refranchising. In fact, the China division's spin-off has largely made Yum! Brands a more asset-light company, as many company-owned restaurants have been in the Chinese market. In the third quarter of 2019, the company opened 389 net new units, reflecting 7% net new unit growth. Moreover, Yum! Brands refranchised 331 restaurants at the end of 2018, including 227 KFC and 104 Taco Bell units for pre-tax proceeds of \$380 million. At the end of 2018, the company's global franchise ownership mix grew to 98%.

We note that refranchising a large portion of the system reduces the company's capital requirements and facilitates earnings per share growth and ROE expansion. Alongside, free cash flow will continue to grow, facilitating reinvestments to increase brand recognition and shareholder return. Remarkably, this shift to refranchising has substantially benefited the company's operating margin over the years. Thus, Yum! Brands expects to become a "pure play" franchisor with more stable earnings, higher profit margins, lower capital requirements and stronger cash flow conversion. Moreover, since a major portion of its business is refranchised, Yum! Brands will be less affected by food inflation than most of its peers.

- ▲ **Increased Efficiency:** Yum! Brands' aims to revamp its financial profile and thereby improve the efficiency of its organization and cost structure globally. It believes that a "slimmer Yum Brands" would lead to efficiency gains. Management expects to cut capex to about \$100 million by 2019, increase free cash flow conversion to 100%, and reduce General and Administrative (G&A) expenditure by approximately \$300 million (or 1.7% of system sales). In addition, the company aims to maintain an optimized capital structure, with the leverage of five times EBITDA. Over the next three years, it is committed to returning additional \$6.5-\$7 billion to shareholders through share repurchases and dividend payouts. Resultantly, the company expects EPS to be at least \$3.75 in 2019.
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Yum! Brands' strategic transformation plan to drive growth, efforts to boost the domestic business through various digital initiatives and refranchising efforts bode well.

Reasons To Sell:

- ▼ **Dismal Performance at Pizza Hut U.S. Division:** Despite effective innovation across its products, marketing and promotions, Pizza Hut sales trend has been choppy in the recent quarter. In third-quarter 2019, Pizza Hut U.S. sales and same-store sales declined 2% and 3%, respectively. YUM! Brands is focusing on transforming its Pizza Hut business to a modern delivery asset base in the United States. It is also restructuring as well as upgrading its franchisee base. The company believes that the choppy sales trend will continue through 2020. Moreover, the company is likely to temporarily shut down hundreds of Pizza Hut stores across the United States.
- ▼ **De-Risking Strategy Weighs on Near-Term Revenues:** Yum! Brands' revenues in the third quarter of 2019 declined 3.7% year over year, following a decline of 4% in the second quarter due to sales slump. The decline stemmed from its continued refranchising initiatives. The company's de-risking strategy to reduce the ownership of restaurants by expanding franchise is expected to affect revenues in the near term and boost earnings.
- ▼ **High Costs:** An increase in the cost of employee wages, benefits and insurance as well as other operating costs such as rent and energy costs led to significant pressure on the company's margins. A competitive retail environment also puts pressure on the restaurants' costs. Moreover, with relentless expansion, the company is prone to face profit margin pressure.
- ▼ **Lackluster ROE:** Yum! Brands' trailing 12-month return on equity (ROE) undercuts its growth potential. The company's ROE of negative 11.69% compares unfavorably with ROE of 8.47% for the industry, reflecting that it is less efficient in using shareholders' funds.
- ▼ **Overvalued:** Yum! Brands' valuation looks a bit stretched compared with its industry average. Looking at the company's forward 12-month price-to-earnings (P/E) ratio, which is one of the most commonly used valuation ratios and is best suited for evaluating restaurants, investors might not want to pay any further premium. It currently has a forward 12-month P/E ratio of 25.35. So, the stock is relatively overvalued right now compared with its peers as the industry's average PE is 23.25 currently.
- ▼ **Industry Susceptible to Consumer Discretionary Spending:** Yum Brands operates in the retail restaurant space that is highly dependent on consumer discretionary spending. Consumers' propensity to spend largely depends on the overall macroeconomic scenario. Although higher disposable income and increased wages are favoring the industry right now, it can change with the slightest disruption in the economy. The company, therefore, is highly vulnerable to the inconsistent nature of consumer discretionary spending. If it does not make pragmatic use of advanced technologies to innovate across value chains, it has high chances of fading out like many other restaurant retailers.

Yum! Brands have been facing declining revenues at its Pizza Hut division. Decline in net new unit growth and low system sales have been affecting comps as well.

Last Earnings Report

YUM! Brands Misses Q3 Earnings & Revenues Estimates

Quarter Ending **09/2019**

YUM! Brands' adjusted earnings of 80 cents per share missed the Zacks Consensus Estimate of 94 cents by 14.9%. Also, the bottom line declined 23.1% on a year-over-year basis. The company recorded \$60 million of pre-tax investment expense related to the change in fair value of its investment in Grubhub. This resulted in a negative impact of 15 cents on EPS. When coupled with \$94 million of pre-tax investment income recorded in the year-ago quarter, the company's Grubhub investment unfavorably impacted EPS growth by 37 cents on a year-over-year basis.

Report Date	Oct 30, 2019
Sales Surprise	-0.46%
EPS Surprise	-14.89%
Quarterly EPS	0.80
Annual EPS (TTM)	2.95

Its total revenues of \$1,339 million were down 4% year over year and missed the consensus estimate of \$1,345 million by 0.5%. This downside was caused by a decline in sales, owing to continued refranchising initiatives.

Worldwide system sales — excluding foreign currency translation — increased 8% year over year, with KFC, Pizza Hut and Taco Bell growing 8%, 7% and 7%, respectively. Also, the company opened 389 net new units, reflecting 7% unit growth.

Segmental Performance

YUM! Brands reports results under three segments — KFC, Pizza Hut and Taco Bell.

Revenues from KFC totaled \$609 million, down 6% on a year-over-year basis. Comps at this division rose 3% from the year-ago quarter's growth of 3% and the second quarter's gain of 6%.

This segment's operating margin was up 610 basis points (bps) year over year to 44.3%, owing to refranchising and same-store sales growth. Unit growth also facilitated its margins.

In the quarter under review, the segment opened 411 gross new restaurants in 52 countries.

At Pizza Hut, revenues amounted to \$241 million, up 5% on a year-over-year basis. Comps were flat with the year-ago quarter's decline of 1%. Comps growth was 2% in the second quarter of 2019.

The segment's operating margin was down 270 bps year over year to 36% due to higher provisions for past owing to receivables and related higher G&A, partially offset by lower advertising spend associated with the U.S. Transformation agreement.

Pizza Hut Division opened 205 gross new restaurants in 43 countries in the third quarter.

Taco Bell's revenues were \$489 million, down 5% from the year-ago quarter. Comps rose 4% in the reported quarter, comparing unfavorably with the year-ago quarter's growth of 5%. In second-quarter 2019, the segment's comps gained 7% year over year.

This segment's operating margin was up 140 bps year over year to 32.9%.

Taco Bell recorded 67 gross new restaurants openings in 13 countries during the quarter.

Other Financial Details

Cash and cash equivalents as of Sep 30, 2019 totaled \$691 million compared with \$292 million on Dec 31, 2018. Long-term debt at the end of the reported quarter was \$10,491 million compared with \$9,751 million at 2018-end. During the quarter, the company repurchased 1.5 million shares for \$174 million.

2019 Guidance

The company expects adjusted EPS to be at least \$3.75 for the year.

Recent News

YUM! Brands to Acquire Habit Burger Grill For \$375 Million- Jan 06,2020

YUM! Brands, Inc. entered into a definitive agreement to acquire fast-casual concept operator, The Habit Restaurants, Inc. (HABT). The addition will enable YUM! Brands to extend its reach in a unique fast-casual concept — The Habit Burger Grill.

The transaction, which is expected to be completed by the end of second-quarter 2020, is valued at approximately \$375 million. The purchase price of \$14 a share suggests a 33% premium over Habit Restaurant's Jan 3, 2020 closing price. Notably, YUM! Brands stated that it will fund the transaction using cash on hand and available borrowing capacity under its credit facilities.

Valuation

Yum! Brands' shares are up 14.1% in the year-to-date period. Over the past year, the Zacks sub-industry gained 22% while the sector gained 18.2%.

The S&P 500 index is up 23.8% in the past year.

The stock is currently trading at 25.35x forward 12-month Price to Earnings value, which compares with 25.41x for the Zacks sub-industry, 25.66x for the Zacks sector and 19.2x for the S&P 500 index.

Over the past five years, the stock has traded as high as 29.27x and as low as 14.84x, with a 5-year median of 23.62x. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$111 price target reflects 26.68x forward 12-month Price to Earnings value.

Valuation Multiples - YUM					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	25.35	25.41	25.66	19.2
	5-Year High	29.27	26.41	26.23	19.34
	5-Year Low	14.84	20.45	19.07	15.17
	5-Year Median	23.62	23.25	22.95	17.44
P/S F12M	Current	5.44	3.66	1.09	3.57
	5-Year High	6.62	3.85	1.11	3.57
	5-Year Low	1.65	2.91	0.8	2.54
	5-Year Median	4.63	3.25	0.91	3
P/CF	Current	26.12	17.61	14.66	23.36
	5-Year High	77.54	20.39	15.17	23.36
	5-Year Low	12.75	8.5	10.73	11.78
	5-Year Median	24.88	16.49	12.85	16.25

As of 01/17/2020

Industry Analysis Zacks Industry Rank: Top 40% (101 out of 254)



Top Peers

Cracker Barrel Old Country Store, Inc. (CBRL)	Neutral
Dominos Pizza Inc (DPZ)	Neutral
JAKKS Pacific, Inc. (JAKK)	Neutral
McDonalds Corporation (MCD)	Neutral
Papa Johns International, Inc. (PZZA)	Neutral
Red Robin Gourmet Burgers, Inc. (RRGB)	Neutral
The Wendys Company (WEN)	Neutral
Yum China Holdings Inc. (YUMC)	Neutral

Industry Comparison Industry: Retail - Restaurants				Industry Peers		
	YUM Neutral	X Industry	S&P 500	DPZ Neutral	MCD Neutral	YUMC Neutral
VGM Score	D	-	-	B	D	A
Market Cap	31.88 B	432.15 M	24.65 B	11.72 B	159.64 B	18.74 B
# of Analysts	9	5.5	13	11	10	3
Dividend Yield	1.59%	0.00%	1.73%	0.91%	2.36%	0.96%
Value Score	D	-	-	D	D	C
Cash/Price	0.02	0.03	0.04	0.02	0.01	0.09
EV/EBITDA	17.17	14.96	14.11	23.69	19.77	12.22
PEG Ratio	2.08	2.08	2.08	1.97	2.97	2.97
Price/Book (P/B)	NA	3.04	3.39	NA	NA	6.02
Price/Cash Flow (P/CF)	27.92	11.93	13.81	27.92	21.25	17.98
P/E (F1)	25.52	22.15	19.19	27.08	25.01	26.75
Price/Sales (P/S)	5.84	0.96	2.69	3.30	7.64	2.16
Earnings Yield	3.92%	4.44%	5.21%	3.69%	4.00%	3.73%
Debt/Equity	-1.30	0.94	0.72	-1.23	-5.20	0.01
Cash Flow (\$/share)	3.77	1.53	6.94	10.26	9.97	2.77
Growth Score	C	-	-	B	C	A
Hist. EPS Growth (3-5 yrs)	0.29%	7.71%	10.56%	30.90%	11.79%	NA
Proj. EPS Growth (F1/F0)	11.94%	8.29%	7.57%	12.75%	8.14%	6.07%
Curr. Cash Flow Growth	-9.66%	7.73%	14.73%	37.70%	13.21%	8.02%
Hist. Cash Flow Growth (3-5 yrs)	-11.09%	6.24%	9.00%	19.72%	1.40%	NA
Current Ratio	1.57	0.63	1.24	1.44	0.84	1.37
Debt/Capital	NA%	61.12%	42.99%	NA	NA	0.76%
Net Margin	20.88%	3.14%	11.14%	10.79%	28.09%	8.05%
Return on Equity	-11.69%	8.47%	17.16%	-12.92%	-85.71%	21.63%
Sales/Assets	1.18	1.17	0.55	3.23	0.49	1.40
Proj. Sales Growth (F1/F0)	4.86%	3.15%	4.16%	7.37%	2.90%	5.89%
Momentum Score	C	-	-	A	D	B
Daily Price Chg	3.17%	0.00%	0.27%	-0.31%	0.54%	0.44%
1 Week Price Chg	-0.16%	0.78%	0.39%	-1.89%	3.59%	0.78%
4 Week Price Chg	5.59%	3.94%	2.95%	-1.89%	7.57%	3.94%
12 Week Price Chg	-3.26%	3.32%	7.76%	8.68%	8.14%	15.55%
52 Week Price Chg	16.21%	3.61%	22.29%	10.63%	17.04%	40.70%
20 Day Average Volume	1,279,565	175,890	1,536,375	514,056	2,934,734	1,320,602
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.24%	0.00%	0.18%
(F1) EPS Est 4 week change	-0.60%	0.00%	0.00%	0.46%	-0.06%	0.36%
(F1) EPS Est 12 week change	-2.55%	0.00%	-0.40%	0.50%	-2.71%	0.09%
(Q1) EPS Est Mthly Chg	-0.08%	0.00%	0.00%	-0.12%	0.05%	1.75%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	C
Momentum Score	C
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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