

ALPHA CHALLENGE
Kenan-Flagler Business School
The University of North Carolina

December 1st, 2022

Students: Spencer Goldman, Esther Osinaiya,
and Pranay Udutha



Investment Thesis

Thesis: YUM is a best in class, scaled, and diversified restaurant operator who we expect to see spread tightening thanks to an improving credit profile owing to robust same store sales growth, unit count growth, and continued conservative financial policies. We see a probabilistic IRR for the YUM 32s at 3.5% versus 2.8% for the High Yield index.

Company: **Yum! Brands, Inc (Yum)**
 Price: **\$91.70**
 S&P Rating: **BB**
 YTW: **6.57 %**

Probabilistic Spread Performance Versus Broader High Yield							
Scenario	Weight	HY Spread Move	BB Spread Move	YUM Spread Move	HY IRR	BB IRR	YUM IRR
Recession	63%	315	221	134	-3%	-3%	-1%
Status Quo	19%	-	-	(20)	9%	7%	9%
Retightening	19%	(150)	(85)	(90)	17%	12%	13%
Probabilistic IRR					2.8%	1.9%	3.5%

*YUM IRR vs HY breakeven is at 49% chance of recession

Assumptions:

- 1) Recession probability derived from Bloomberg's median forecasted probability of recession as of 11/16/2022.
- 2) High Yield spread move of 315 is reflective of the peak spreads of 800bps for the index.
- 3) In historical analysis of 2020, 2018, 2016, and 2008 YUM bonds capture on average 49% of index widening.
- 4) Improvements in YUM's credit profile will drive 20 basis points of incremental spread tightening in all 3 scenarios .

Relative Value

YUM's credit profile benefits from its large scale, strong loan-to-value, and healthy leverage ratio. Furthermore, as investors come to appreciate the business model's durability in an inflationary environment and recession resistance relative to other restaurant and BB peers, we see 20 basis points of spread tightening potential.

Security	Coupon	Outstanding	Maturity	YTW	OAS/DM	Price	Rating	LTM EBITDA	Leverage	LTV
US High Yield Index			1/28/2029	8.85%	465	\$ 86.2	B1			
US HY BB Index			12/28/2029	7.20%	300	\$ 89.1	BB2			
<i>YUM</i>										
YUM TL B	S + 175	1,478	3/15/2028	5.69%	186	\$ 99.4	BBB-/Baa3	2,231	0.9x	4%
KFC Holding/Pizza Hut	4.75%	750	6/1/2027	5.70%	120	\$ 96.2	BB+/Ba2	2,231	5.0x	25%
YUM	4.75%	800	1/15/2030	6.30%	236	\$ 90.8	BB/Ba3	2,231	5.0x	25%
YUM	5.38%	1,000	4/1/2032	6.57%	251	\$ 91.7	BB/Ba3	2,231	5.0x	25%
BCULC 1L	3.50%	750	2/15/2029	6.31%	233	\$ 85.7	BB+/Ba2	2,345	3.5x	20%
BCULC 2L	4.00%	2,900	10/15/2030	6.83%	292	\$ 82.9	B+/B2	2,345	5.7x	32%
ARGIHC 1L	7.00%	750	6/15/2025	6.59%	167	\$ 100.6	B2/B+	1,990	5.9x	
PZZA	3.88%	400	9/15/2029	3.88%	278	\$ 85.1	BB-/B1	221	2.5x	16%
BALL	3.13%	850	9/15/2031	6.12%	236	\$ 79.8	BB+/Ba1	2,130	4.4x	35%
MAT	3.75%	600	4/1/2029	6.24%	237	\$ 87.1	BB+/Baa3/BB+	1,056	2.8x	31%
PFGC	4.25%	500	6/1/2030	6.67%	267	\$ 87.1	B+/B3	1,268	3.7x	34%

*Pricing as of 11/19/2022

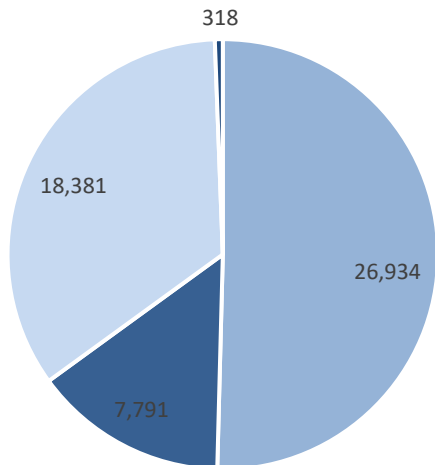
About YUM Brands

YUM is the third largest restaurant company globally with 53,000 restaurants in 157 countries operating under the four concepts of **KFC**, **Taco Bell**, **Pizza Hut** and **The Habit Burger Grill**.

- The company operates a highly franchised model with approximately 98% of its global restaurants under franchisee control.
- YUM has a strong international presence with 67% of its units outside of the United States primarily through its Pizza Hut and KFC banners.

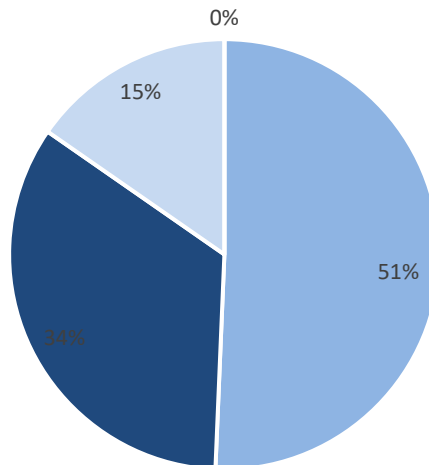
Unit Count by Brand

■ KFC ■ Taco Bell ■ Pizza Hut ■ Habit



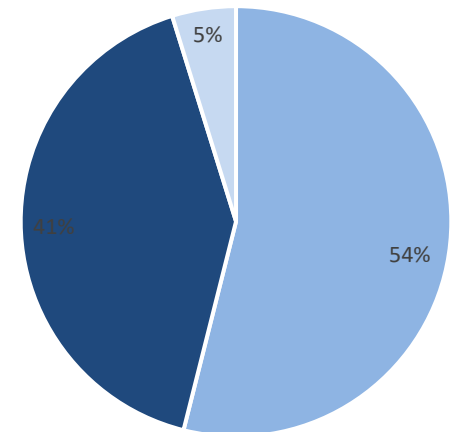
EBIT by Brand

■ KFC ■ Taco Bell ■ Pizza Hut ■ Habit



Sales by Geography

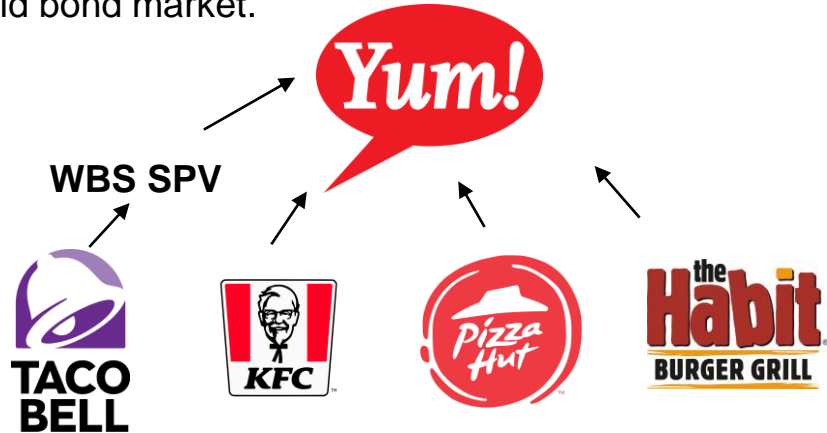
■ United States ■ International (ex-China) ■ China



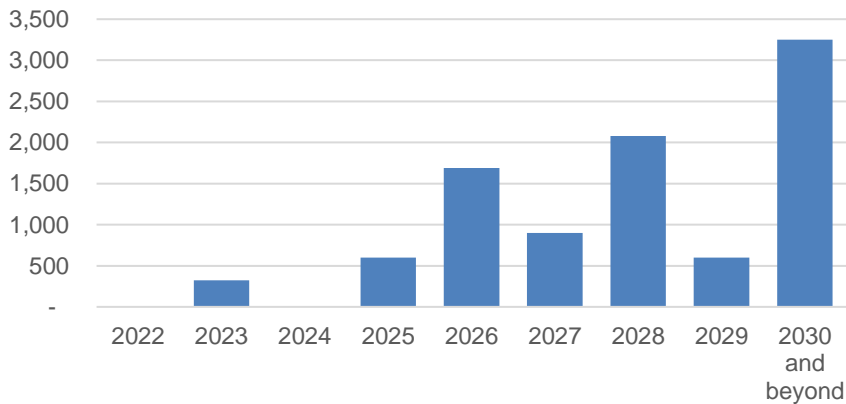
Capital Structure

YUM is well diversified across capital markets drawing on bank financing, the leveraged loan market, whole business securitizations and the high yield bond market.

	Coupon	Amt. Out.	Net Lev.
<i>Cash</i>		410	
Rev 1L 04/05/2025	S+100	-	
USD 1L TLA 03/15/2026	S+100	736	
USD 1L TLB 03/15/2028	S+175	1,475	
Senior Secured Debt		2,210	0.8x
WBS Note Due 2026	4.97%	955	
WBS Note Due Feb 2027	1.95%	893	
WBS Note due Nov 2028	4.94%	602	
WBS Note due Feb 2029	2.29%	596	
WBS Note due Aug 2031	2.54%	750	
Securitization + Secured Debt		6,005	2.5x
Senior Unsec March 2023	3.88%	325	
Senior Unsec Jun 2027	4.75%	750	
Senior Unsec Jan 2030	4.75%	800	
Senior Unsec March 2031	3.63%	1,050	
Senior Unsec Jan 2032	4.63%	1,100	
Senior Unsec April 2032	5.28%	1,000	
Senior Unsec Nov 2037	6.88%	325	
Senior Unsec Nov 2043	5.25%	275	
Total Debt		11,630	5.0x
<i>EBITDA</i>		<i>2,232</i>	



YUM Has Few Looming Maturity Walls

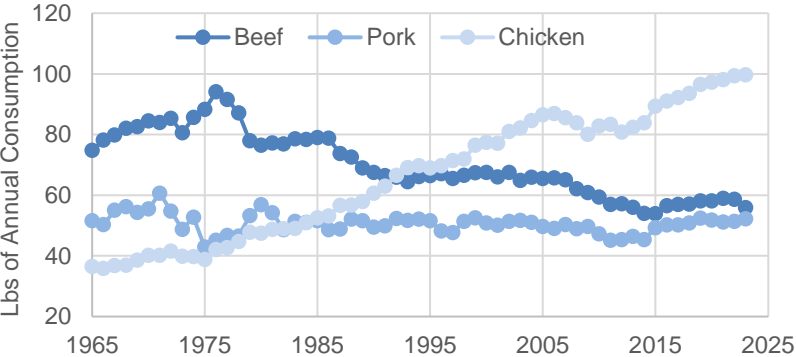


Source: Company Filings, Bloomberg

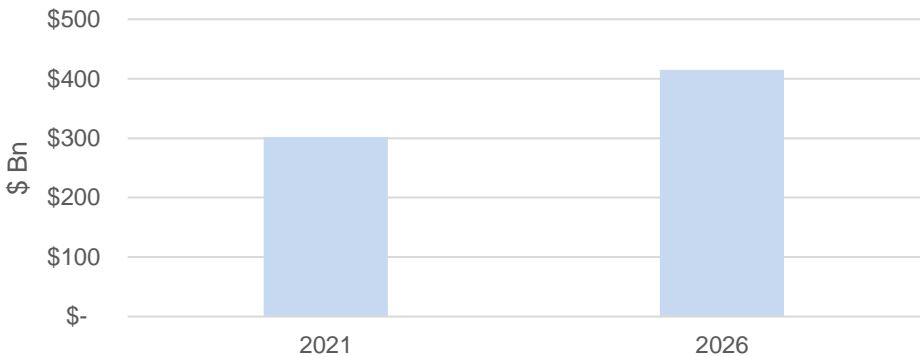
Strong Secular Growth Trends Support Continued Growth

KFC and Taco Bell (representing 85% of YUM EBIT) benefit from strong secular growth trends in both chicken consumption and Mexican food.

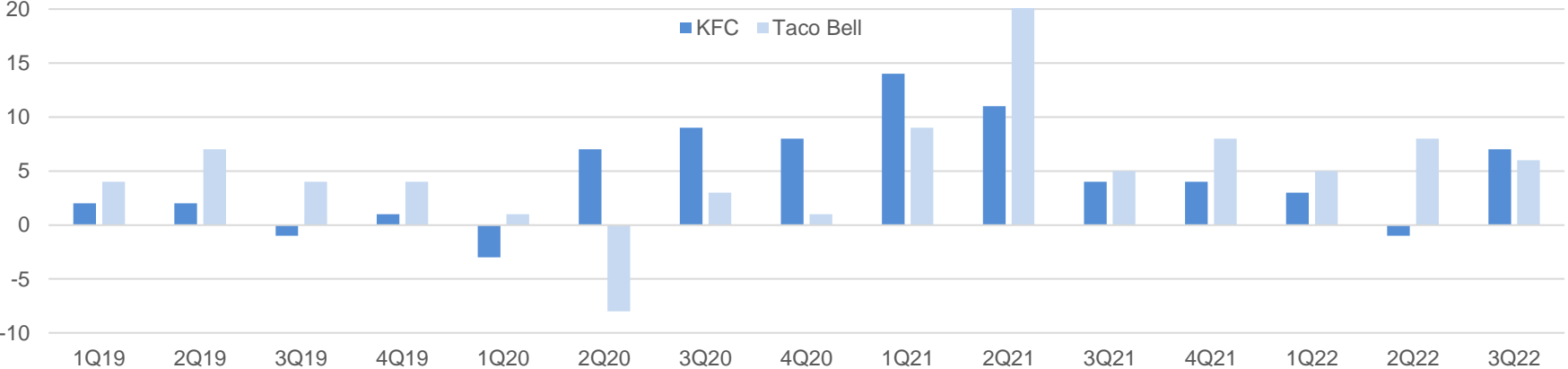
Chicken is the Fastest Growing Protein Globally



Mexican Food the Fastest Growing Ethnic Category



KFC and Taco Bell Have a Long Track Record of Same Store Sales Growth

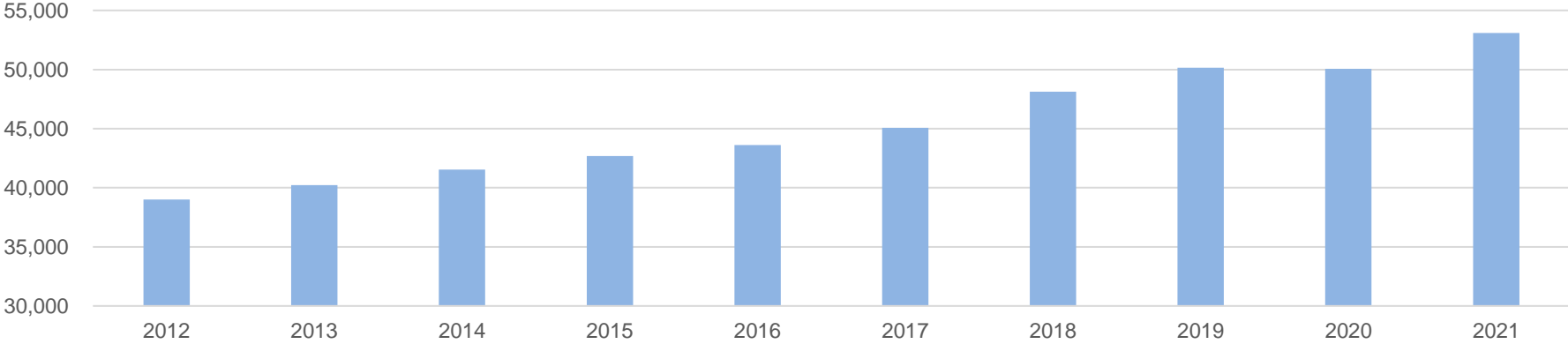


Source: Poultry Producers of America, Technovio, Company Filings

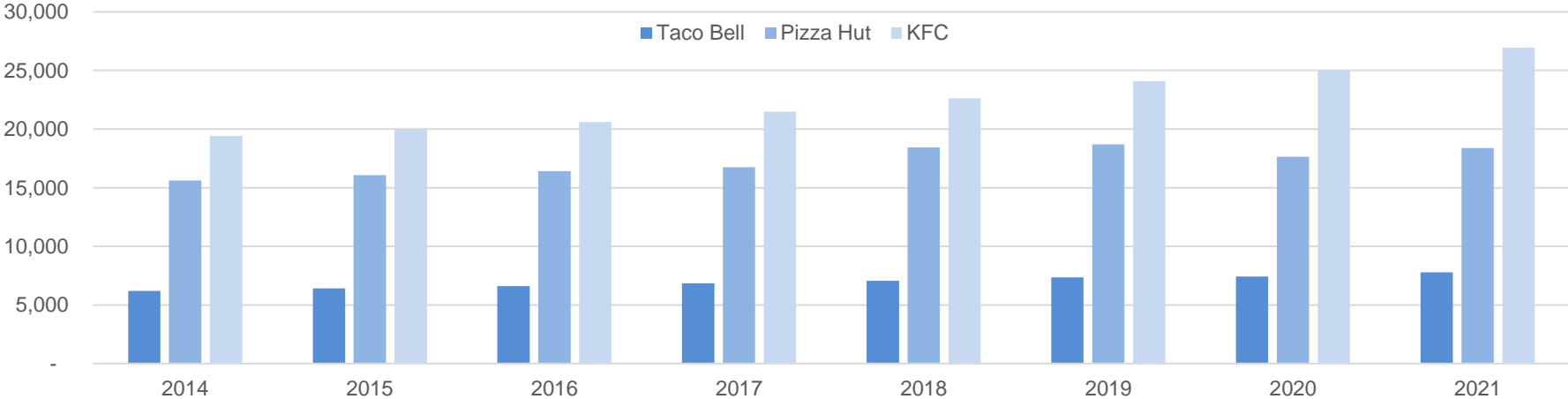
Unit Count Growth Remains a Strong Growth Lever

YUM has averaged 4% unit count growth over the last decade, growing to more than 52,000 restaurants today.

Unit Count has Risen From 38,000 in 2012 to more than 52,000 Today



Restaurant Counts Have Grown Across All Three Banners

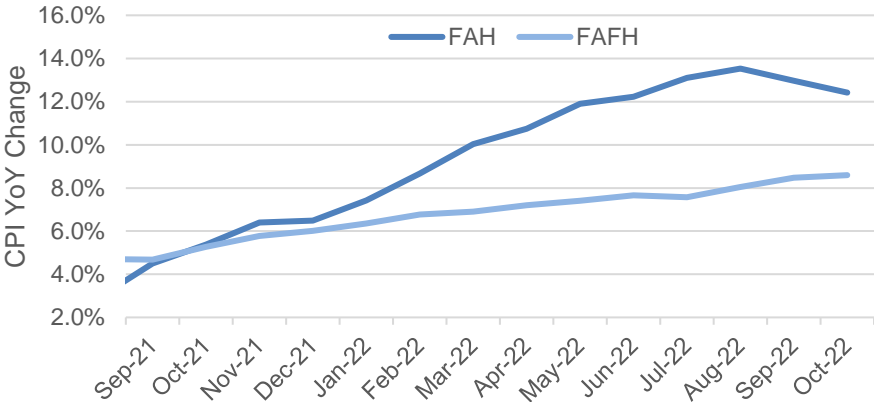


Source: Company Filings, Bloomberg

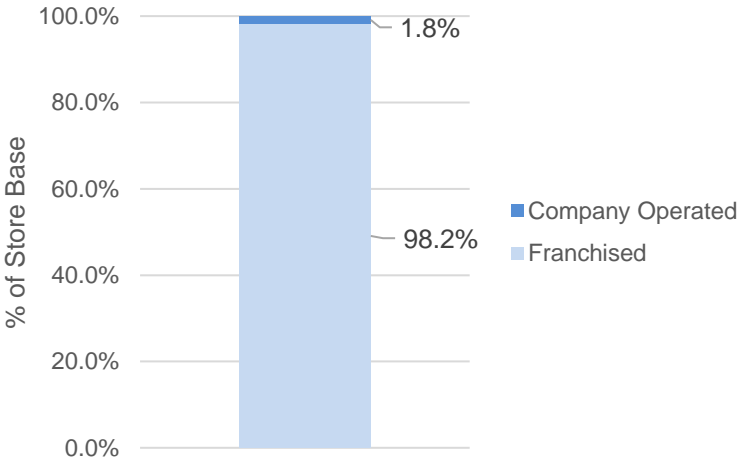
YUM is an Inflation Beneficiary

The restaurant industry as a whole has seen less inflation than other food options, driving more customers through the door. Furthermore, YUM has been a net beneficiary of inflation thanks to its franchised business model.

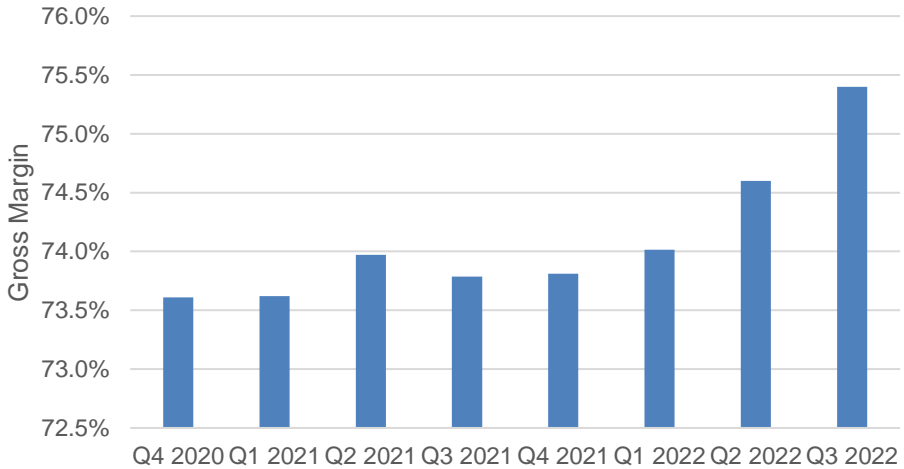
Food at Home Inflation vs Restaurant Inflation



YUM's Heavily Franchised Business Model



Has Enabled Margin Expansion in the Face of Inflation



Source: Company Filings, Bloomberg, St. Louis Fed

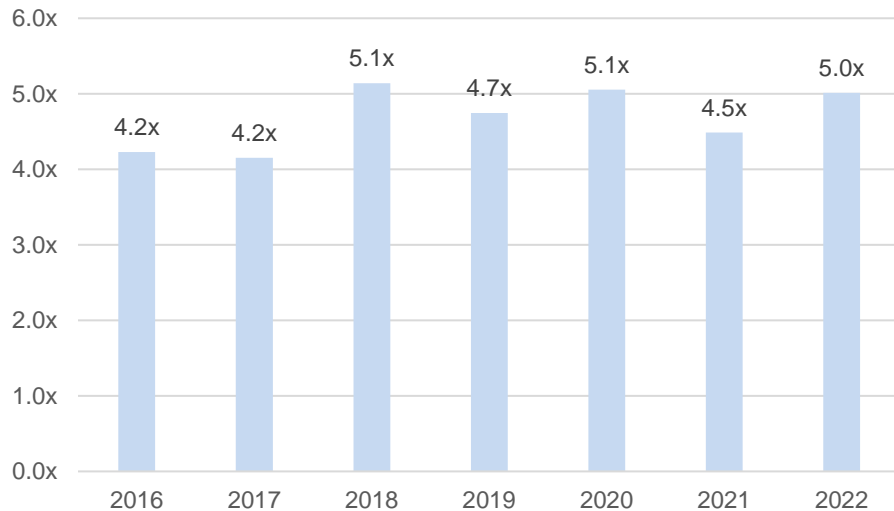
Conservative Financial Policies Drive Credit Strength

Yum has shown strong financial policy discipline relative to large high yield peers Restaurant Brands International and Inspire Brands. The company has eschewed transformative M&A and has kept net leverage within a tight range.

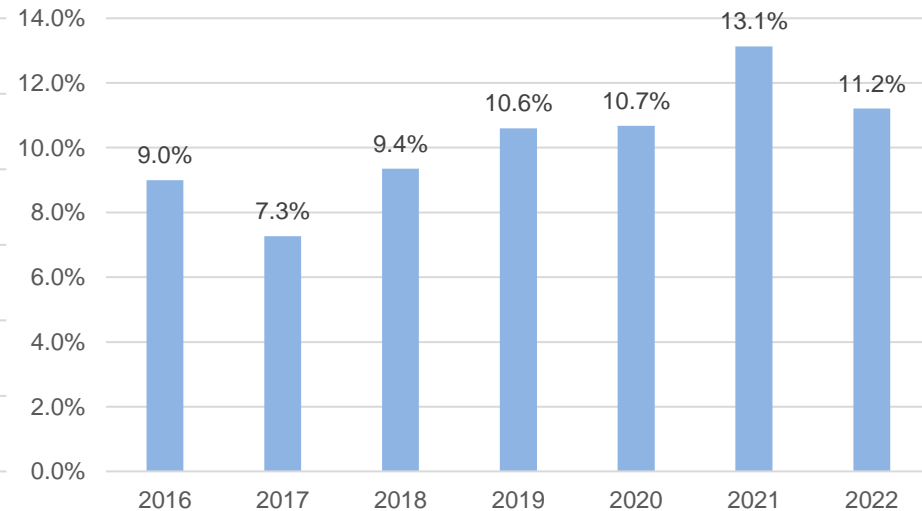
Largest Transactions by YUM, QSR, and Inspire

Rank	Company	Date	Target	Value (\$ mm)
1	QSR	Aug-14	Tim Hortons	12,112
2	Inspire	Oct-20	Dunkin	11,701
3	Inspire	Sep-18	Sonic	2,263
4	QSR	Feb-17	Popeyes	1,800
5	QSR	Nov-21	Firehouse Subs	1,000
6	YUM	Jan-20	Habit	447
7	YUM	Feb-18	Grubhub	200
8	QSR	Jul-18	MegaFood SA	116
9	YUM	Dec-18	QuikOrder	77
10	YUM	May-21	Dragontail	54

YUM Net Leverage Has Remained Stable



FCF As a Percent of Debt Is Exceptional



Event Risk/Levering M&A

While event risk and transformative M&A is an ever-present risk in as a credit investor in the restaurant industry, YUM's management team has proven themselves to be among the most conservative in the space.

Pizza Hut

Pizza Hut has seen tepid growth over the last decade as the company converts its red roof locations to delivery focused units and due to market share gains by DPZ. However, YUM has a track record of turning around brands which is best exhibited by the performance of KFC.

Food Safety

Food safety is a significant risk in the restaurant industry that can cause serious harm to the brand. YUM Brands and more specifically Taco Bell has been considered an industry leader in terms of food safety thanks to actions taken after its infamous 2006 E. Coli outbreak.

Priming with Additional WBS Debt

While peers such as Inspire finance the majority of their capital structure in ABS markets, YUM management has made it clear that only the Taco Bell banner will utilize WBS financing. Furthermore, the WBS market with just \$40bn in assets would be significantly burdened by an additional \$3+ billion of KFC or Pizza Hut debt.

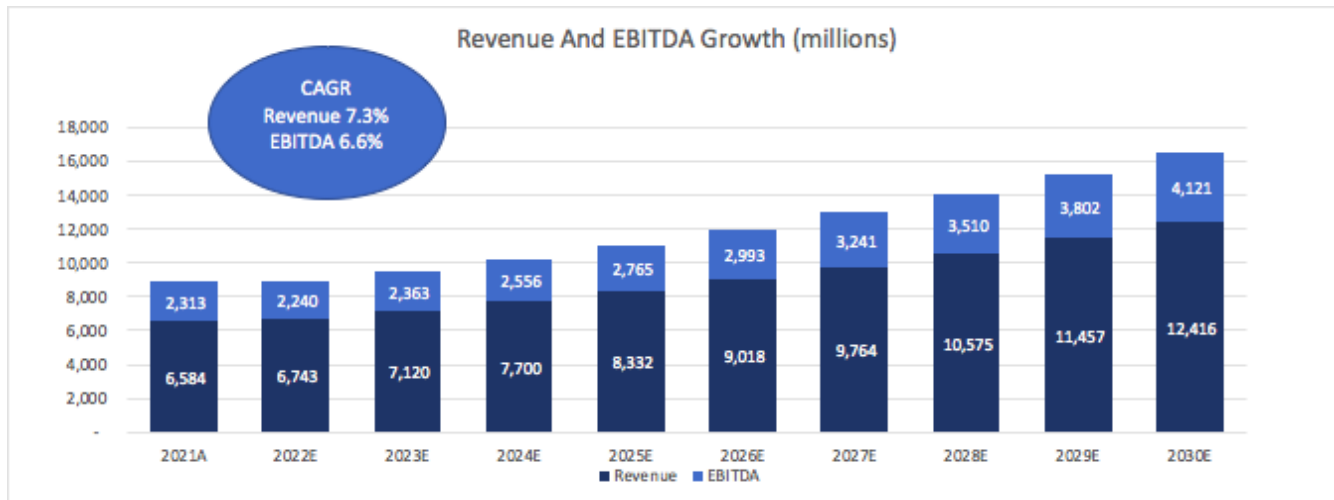
ALPHA **CHALLENGE**
Kenan-Flagler Business School
The University of North Carolina



Appendix

Financial Projections

Fiscal Year	2020A	1QA	2QA	3QA	4QA	2021A	2022E	2023E	2024E	2025E	2026E	2027E
		Mar-21	Jun-21	Sep-21	Dec-22							
End date												
KFC Division	2272	625	682	692	794	2,793.00	2,795.30	2,891.96	3,152.23	3,435.93	3,745.17	4,082.23
Pizza Hut Division	1002	251	249	247	281	1,028.00	985.76	1,000.76	1,030.79	1,061.71	1,093.56	1,126.37
Taco Bell Division	2031	488	532	534	684	2,238.00	2,430.24	2,648.96	2,887.37	3,147.23	3,430.48	3,739.23
Habit Division	443	121.9	138.76	132.73	130.715	524.11	530.24	577.97	629.98	686.68	748.48	815.85
Company Sales	1800	476	520	513	597	2,106.00	2,054.24	2,169.57	2,346.54	2,538.89	2,747.99	2,975.32
Franchise Revenues	2519.44	657.9	705.76	715.73	820.715	2,900.11	3,044.71	3,213.81	3,475.92	3,760.81	4,070.51	4,407.21
Franchise Advertising revenues	1332.36	352.225	376.24	377.27	472.285	1,578.02	2,009.42	3,203.61	3,464.54	3,748.52	4,057.21	4,392.83
Total Sales	5,651.80	1,486.13	1,602.00	1,606.00	1,890.00	6,584.13	6,742.59	7,119.65	7,700.37	8,331.56	9,017.69	9,763.67
COGS	1,506.00	392.00	417.00	421.00	495.00	1,725.00	1,721.66	1,817.96	1,966.25	2,127.42	2,302.62	2,493.10
Gross Profit	4,145.80	1,094.13	1,185.00	1,185.00	1,395.00	4,859.13	5,020.93	5,301.68	5,734.12	6,204.14	6,715.08	7,270.58
SG&A	949.00	206.00	228.00	249.00	371.00	1,054.00	1,144.74	1,210.43	1,309.19	1,416.53	1,533.21	1,660.08
Franchise and License Expenses	143.00	23.00	27.00	31.00	36.00	117.00	126.56	133.56	144.45	156.29	169.16	183.15
Franchise Advertising Expenses	1,314.00	343.00	372.00	375.00	486.00	1,576.00	1,646.52	1,739.74	1,881.67	2,035.93	2,203.62	2,385.93
Closure & Impairment (Inc)/Exp	(32.00)	(13.00)	(5.00)	1.00	(15.00)	(32.00)	(26.23)	(28.05)	(30.34)	(32.83)	(35.55)	(38.49)
Other (Income)/Expense	2.00	(6.00)	(4.00)	(2.00)	7.00	(5.00)	42.11	44.69	48.34	52.31	56.62	61.31
EBIT	1,769.80	541.13	567.00	531.00	510.00	2,149.13	2,087.24	2,201.31	2,380.81	2,575.92	2,788.01	3,018.60
Depreciation and Amortization	146.00	39.00	39.00	39.00	47.00	164.00	153.23	161.85	175.05	189.40	205.00	221.96
EBITDA	1,915.80	580.13	606.00	570.00	557.00	2,313.13	2,240.47	2,363.16	2,555.87	2,765.32	2,993.01	3,240.56





Jamia Cammeron

**Former Manager of Internal and Executive Communications
Lead of Inspire Brands**

(Arby's, Buffalo Wild Wings, Sonic Drive-In, Jimmy John's, Rusty Taco, Mister Donut, Dunkin' Donuts and Baskin-Robbins restaurant chains)

“I think the overall restaurant specifically fast food did very well over the past couple. However, this is still a competitive industry and it is up to the business to adapt to customer’s taste if they want sustain growth”

Additional Steps in Research Framework:

- Product tasting Pizza Hut, Taco Bell, and KFC against competitors
- Company investor relation documents + financial statements

ESG Considerations

Yum! among Restaurant Peers

Leading:
 Water Management
 Energy Management
 Sustainable Product

Lagging:
 Waste Management

Environmental
 5.54/10 score

Leading:
 Data Security &
 Customer Privacy
 Marketing & Labeling

Lagging:
 Customer Welfare
 Labor & Employment
 Practices

Social
 5.01/10 score

Governance
 7.84/10 score

Leading:
 Incentive Structure
 Audit Outcome

Lagging:
 Board Diversity
 External Auditor
 Pay for Performance

