

# Why Investors Are Skeptical About Yum Brands Stock

Yum's China division accounts for half of its revenue, but will be spun off by the end of 2016.



"Eating out in China is still a relative luxury," one analyst says, "so it's important that the economy shows a little bit of improvement from where it is now, and that the consumer remains confident."

By [Christine Giordano](#)

Oct. 26, 2015 | 10:21 a.m. EDT



Last week's announcement that Yum Brands would spin off its lucrative China division into a separate publicly traded company in 2016 is raising doubts among investors about the short- and medium-term benefits of holding YUM stock (ticker: YUM), and in investing in the new company amid [Beijing's economic struggles](#).

"It does not solve the issues that they're having in China, dealing with slowing sales and slowing earnings growth there," says Jack Russo, senior consumer analyst for St. Louis-based Edward D. Jones & Co., which has a "hold" recommendation on the stock.

"But what it does do, it does separate the two businesses. It will allow the management teams of each business to focus more intently on their individual business units. And it separates a high-growth business – a potentially high-growth business in China – from a lower-growth business, which is what you'll see in the non-China segment," he says.

**YUM stock's earnings woes.** YUM stock, already wounded by a worse-than-expected earnings report, continued to tumble following the Oct. 20 announced spinoff of the company's China operation, which accounts for half of the company's revenue and a third of its operating revenue. Yum owns KFC, Taco

Bell and Pizza Hut restaurants.

Moody's Investors Service downgraded Yum's senior unsecured notes from Baa3 to Ba1, citing the company's announcement that it is "committed to returning substantial capital to shareholders in conjunction with the separation."

This will likely make its interest costs of future financings go up and will also put them in a highly leveraged category, which could unnerve investors. To gain a higher rating, Yum would need to show "a demonstrated and sustained improvement in same-store sales, specifically at KFC China, while showing continued improvement in operating performance in the U.S. and international divisions," according to Moody's.

Yum, which opened its first Chinese KFC in 1987, once saw its revenue in the country rising as high as 35 percent in 2011. But since 2012, Yum in China faced a series of public relations nightmares, mostly about [chicken](#).

It started when CCTV reported a supplier was treating chickens with excess antibiotics and growth hormones. In 2014, the avian flu scared customers away, and last summer, a supplier was accused of selling expired meat to Yum and other chains, leading to consecutive and unpredictable disappointments: a fourth-quarter revenue decline of 16 percent in 2014 and a 12 percent drop in the first quarter of this year.

"Obviously, the more of those you have, it pings your brand. And I think the challenge in operating in China is you're going to have those issues," says Jerry Braakman, chief investment officer of First American Trust in Santa Ana, California.

In August, Yum replaced its head of China operations with Mickey Pant, a former chief executive of KFC with a strong marketing background. By the third quarter, the company reported year-over-year growth, but in the single digits – less than its projection of 10 percent growth. It took hits throughout September with same-store sales in China that were weaker than expected.

On Oct. 7, Yum disappointed Wall Street by reporting same-store growth of 2 percent when investors were expecting 9.6 percent growth. The stock tumbled by more than 16 percent as investors fled, setting the stage for Yum's board of directors to add activist investor Keith Meister, the founder of Corvex Management, on Oct. 15.

Meister had been urging the spinoff of the China division for months and has a 5 percent stake in Yum, valued around \$1.5 billion.

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