Yum offers fast growth, tasty profits

James Burns
Contributing writer

"I think of dieting, then I eat pizza."
— Lara Stone, Dutch model

Although my dining tastes do not generally gravitate to fast food, I find it very tasteful to make money in my investments. So, while I am not a regular customer at Taco Bell, Kentucky Fried Chicken, or Pizza Hut, I am a satisfied and long-term investor in their parent company, Yum! Brands.

Yum's explosive restaurant growth, high profit margins, and rising earnings power should provide tasty returns to local investors for at least the next few years.

By way of background, Yum! Brands (symbol: YUM) was founded in 1997 when it was spun off from the PepsiCo Corp. The stock has been a superb wealth creator, outperforming the S&P 500 by almost a 2 to 1 margin over the last 10 years. In fact, since the "Trump Bump" in the stock market post-election, Yum! stock is up 16.5 percent versus the S&P 500 Index at 11.7 percent.

Two out of the three Yum! Brands' restaurants are firing on all cylinders. In Yum's latest earnings report on May 3, the company touted strong results from Taco Bell, which had an 8 percent jump in sales and a 19 percent increase in operating profit, and KFC, which reported core operating profit growth of 13 percent. Pizza Hut has struggled somewhat in recent years, particularly in the United States. To bring Pizza Hut up to par with its two main counterparts, Yum! Brands is implementing several changes, including faster delivery times, a renewed focus on fresh, all-natural ingredients, and optimizing the chain's asset base.

It should be noted that over 90 percent of Yum! Brands' Pizza Hut, KFC and Taco Bell restaurants are franchised-owned businesses.

This makes Yum! Brands both an appealing and relatively low-risk stock, with a consistent, annuity-like earnings stream.

Because franchisees help bear the cost of opening new restaurants, Yum! is free to use the high excess cash from the restaurants' earnings to invest for growth, increase dividends, and buy back their stock. Furthermore, Yum! Brands has just rolled out a new franchise model and is expected to cut capital expenditures by over $100 million by 2019 and allow for an even faster roll-out of new restaurants.

As a result, earnings are expected to ramp up for Yum! Brands over the next few years. They recently reported first-quarter 2017 earnings of 65 cents a share, which surpassed analyst estimates by over 6 cents and over the past 12 months, earnings increased a powerful 17 percent.

Sales were also up nicely due to its growing number of franchises worldwide. In fact, over the next five years, estimates suggest earnings could grow 14 percent per annum.

Operating a business in distant geographical locations remains a daunting task for many multinational corporations, but especially for Yum! which had over 7,500 KFC restaurants in China alone. In October 2016, Yum! spun off its Chinese operation giving current Yum! investors shares in Yum China (symbol: YUMC). I like this stock as well.

The main catalyst for Yum China's growth is the demographics of China itself. China has 350 million middle-class consumers who will grow to almost 700 million over the next decade. The continuing trend of urbanization means more of these consumers will flock to cities, with Chinese KFC restaurants seeing more customers. Buy more Yum China if you already own it from the spinoff, or mix and match with traditional Yum! Brands if you don't.

Yum! Brands currently pays a dividend of 1.8 percent, which is lower than rival McDonald's but higher than the industry average. However, Yum! has higher growth projection than McDonalds. In fact, Yum! Brands opens an average of six new stores each day, making it a leader in global restaurant development. I believe the company's dividend growth will accelerate as Yum! Brands' returns increased profits to shareholders.

Over the next few years, both Yum! Brands and Yum China will see their earnings rise, the number of shares outstanding decline, and new restaurants open more efficiently. That's a yummy recipe for making money!

Jim Burns is president of J.W. Burns & Co. The opinions expressed here are his and do not necessarily reflect those of The Post-Standard. Readers should do research before deciding on an investment.

Columnist Jim Burns says Yum Brands' explosive restaurant growth, high profit margins and rising earnings should provide tasty returns to investors for the next few years. *Paul Sakuma/Associated Press*