

Yum Brands Expanding To China's Smaller Cities

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NEW YORK (AP) — The owner of KFC and Pizza Hut is taking its fast-food menus to the lesser-known regions of China, with plans to set up shop in smaller cities throughout the key market.

After expanding in China's biggest cities in recent years, Yum Brands Inc. is focusing on populating the country's less urbanized areas. Building in those outposts of the developing nation will give it the kind of infrastructural advantage that McDonald's established decades ago in the U.S., CEO David Novak said at the company's investor conference Thursday.

Yum, which also owns Taco Bell in the United States, is already the biggest Western fast-food chain in China, with about 5,400 locations, compared with 1,600 for McDonald's. The nation's booming economy has been a boon for Yum, helping its profits increase at least 10 percent over the last several years. But with competition intensifying and economic growth slowing, Yum has hit a snag as well, with investors fearing its brands could be losing their luster.

Last week, Yum said it expects a key sales figure to fall 4 percent in China in the fourth quarter, marking its first decline since 2009. A year earlier, sales at established restaurants had surged 21 percent. The company's stock dropped 10 percent after the announcement.

Also pressuring results in China are the company's rising labor and rental costs in big cities such as Shanghai, Beijing, Guangzhou and Shenzhen. As a result, the company said it would be more selective about expansion in such metropolitan areas.

But executives noted that there is still plenty of room for growth in smaller cities, with the Chinese government investing heavily in transportation infrastructure. While Yum has nine restaurants for every 1 million people in larger cities, it has just two per million people in smaller cities.

Within the first three years of opening, the company noted that new restaurants in smaller cities bring in annual sales of about \$1.4 million to \$1.5 million, showing there's an appetite for its fried chicken and pizza even less urbanized areas of China.

"We're only on the ground floor of China's development opportunity," said Weiwei Chen, Yum's chief financial officer of China.

In 2013, Yum plans to build 700 restaurants in China. This year, the company had predicted it would build 650 but ended up building more than 800.

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To cultivate loyalty amid intensifying competition, Yum is working to cater to local tastes. For example, the company introduced rice as a side dish in KFC. Next year, it plans to extend the line with premium rice offerings.

Although KFC accounts for the bulk of its business in China, Pizza Hut is expected to play a bigger role in the coming year with the number of openings to double to 220. That's about the same number of restaurants McDonald's is expected to build in the country, Chen noted.

Part of the pizza chain's growth will be fueled by its expanding delivery service. The company noted that its name for the service translates to "Must Win Homes Fast Delivery" in Chinese— and does not include the word "pizza," which is not as widely eaten in the country as in the U.S. Food other than pizza — fried shrimp, soups, steak — accounts for about half of sales at Pizza Huts in China.

In addition to its flagship U.S. brands, Yum has two smaller Chinese food chains — East Dawning and Little Sheep. Chen noted those chains are important to the company because "the Chinese consumer will always eat more Chinese food than Western food."

Overall, Yum, based in Louisville, Ky., expects sales at restaurants open at least a year to grow in the mid-single digits in China for 2013. Growth is expected to be softer in the first half of the year, and pick up in the second half.

"We feel good about it," said Novak, noting the worries Yum's forecast raised last week.

Beyond China, Yum sees India as its next big region for growth. It also noted that it also has a bigger presence than McDonald's in other developing nations, such as South Africa. And about half its operating profits now come from emerging markets, compared with 40 percent in 2009.

Yum's stock added \$1.02 to close at \$66.92.

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