Yum Brands Falls After Warning of China Sales Drop

NEW YORK (AP) — Shares of Yum Brands Inc. fell Tuesday after the parent company of KFC said issues surrounding two of its small chicken suppliers hurt sales more than expected in China.

The company, based in Louisville, Ky., now expects sales at locations open at least a year to be down 6 percent, compared with the 4 percent drop it warned of in November.

Yum, which also owns Pizza Hut and Taco Bell, is the biggest Western fast-food chain in China, with about 5,400 locations, compared with 1,600 for McDonald's Corp. 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 month, the company noted in a statement that it was cooperating with the Chinese government's review of two of its poultry suppliers that provided chicken with unapproved levels of antibiotics to KFC. The company noted that the suppliers represent "an extremely small percentage" of its products at KFC. Yum said in a statement Tuesday that it was continuing to work with Shanghai authorities as they wrap up their review.

Without providing details, the company also said it planned to use a variety of outreach, including mainstream media, to ensure customers of the safety of its foods.

Howard Penney, an analyst with Hedgeye Risk Management, noted that Yum's Taco Bell was also hurt in the U.S. in 2011 when a lawsuit alleged the chain's beef had too much filler to be called beef. Taco Bell's response was aggressive; it took out full-page ads in at least nine major newspapers, aired television spots and launched a YouTube campaign to proclaim its taco filling is 88 percent beef. Executives said they spent between $3 million and $4 million in advertising to counter the accusations.

The suit was ultimately dropped, and Yum said no money was exchanged in the process.

With the China situation, Penney said he expects Yum to respond "with even more urgency," given China's importance to the company's overall profitability.

The expected decline in the fourth quarter would nevertheless be the first drop since 2009. A year earlier, sales at established restaurants had surged 21 percent.

The company also said it expects earnings per share of for 2012 to come in at $3.24, below analyst estimates of $3.26.

At an investor conference last month, executives expressed confidence that there was plenty of room for growth in China, particularly in smaller cities where middle-class populations are expanding. The said growth was expected to be stronger in the back half of 2013.

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

Janney analyst Mark Kalinowski lowered his fourth quarter and full year estimates by 2 cents each, to 82 cents and $3.24, respectively. But he kept his "Buy" rating on the company, citing its growth potential in emerging markets. He also noted the strong sales momentum at the company's Taco Bell unit in the United States.

R.W. Baird analyst David Tarantino lowered his estimate for 2012 by a penny to $3.24 per share. He kept his "Outperform" rating, noting the brand's strong positioning in China could overcome the setback over time.

Raymond James analyst Bryan Elliott reiterated his "Underperform" rating. He said that until the company mounts a public relations campaign that successfully regains the trust of Chinese consumers, sales will be at risk.

Shares of Yum fell $2.99, or 4.4 percent, to $64.90 in morning trading.

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