

Globally Local

Rather than providing a dogmatic answer, successful companies are often those that ask the interesting questions. Constantly learning. Multi-nationals have been at the forefront of striking the balance between global economies of scale, local tastes and risks. Through trial and error (hopefully learning from others), businesses are discovering better corporate structures, local awareness, and risk management.

An early example of getting the balance wrong, led to Walmart deciding to leave Germany. This, despite spectacular success in standardising retailing in America, and deep cultural connections to Europe (about 46 million Americans claim German ancestry making it the largest group reported in the American Community Survey). There are various explanations given, but after opening in 1997, they decided to leave in 2006. The lesson here was the ultimate power of the customer to decide what they want.

Companies around the world are having to feel their way as customers, media and governments flex local muscle.

Yum! Brands has over 43,500 restaurants in 135 countries. With KFC, Pizza Hut and Taco Bell, the company is the world leader in chicken, pizza and Mexican-style food. In China, Yum! Brands was spectacularly well received. There was less cultural opposition, with what is seen as brash Americanism in Europe is instead seen as aspirational by the fast growing new, middle class in China.

New lessons arose, however. In December 2012 and July 2014, there were two supply chain incidents that damaged Yum's business. The first came after state media accusations about growth hormones used to boost chickens. As they recovered (responding with tighter management), there was an avian flu out-break.

The response has been to create a spin-off to get the best of both worlds: a national focus, with local knowledge, and a global network of shared knowledge and expertise. Yum China will be a pure play Chinese investment with no meaningful external debt. New Yum! Brands will focus on the franchise model with the increased stability of franchising and license fees permitting a different capital structure. Stable cash flow allows debt of \$5 for every \$1 increase in earnings, providing significant capacity for capital deployment.

At Credo, we also had some concerns about Chinese risk, but problems are not permanent unless one does nothing about them. Price movements can overstate the long-term impact of events as investors attempt to buy based on what they expect in the next year, rather than the long-term. In general, excessively good times and bad times both pass. The new corporate structure allows better risk control, and the brands remain well loved with 743 new KFC restaurants opened in 2015 (KFC represents 75% of the operating profit).

The key is to look at whether the price reflects management's ability to learn, execute and deliver in an effective manner. Yum! Brands has a long history of success, and at today's price we believe that sustainable earnings and dividend growth should provide an attractive return to shareholders.

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Data Source:

<http://www.yum.com/investors/>

https://en.wikipedia.org/wiki/German_Americans

<http://www.reuters.com/article/us-yumbrands-strategy-idUSKCN12B1FH>

http://www.huffingtonpost.com/david-macaray/why-did-walmart-leave-ger_b_940542.html