Shakeys Pizza Asia Ventures, Inc.

Everybody loves PIZZA

THU 21 SEP 2017

Initiating coverage with a BUY rating. We are initiating coverage on PIZZA with a BUY rating and a fair value estimate of Php16.30/sh. We like PIZZA given its dominant position in the full-service pizza industry, as well as its attractive growth outlook. At our fair value estimate, implied 18E P/E is 29.1X, in line with the historical average P/E of its global and domestic peers. We believe that PIZZA deserves to trade at least at the same level with its global and domestic peers given its ability to match, if not exceed, the industry's earnings growth in the next few years. We are forecasting revenues and core profits to increase by a CAGR of 14.4% and 12.8% from 2016 to 2019E respectively, driven by store openings and healthy same store sales growth.

Market leader in the chained full-service restaurant industry. PIZZA is currently the largest chained full-service restaurant in the Philippines, both for the pizza and for the total full-service restaurant categories in terms of value. In 2016, PIZZA had a market share of 28.2% for the Php31.6 Bil chained full-service restaurant industry and a dominant 63.4% market share of the Php14.8 Bil pizza full-service restaurant industry. PIZZA's market share has also grown from only 16.7% for the full-service restaurant industry and 48.2% for the pizza full-service industry in 2011, implying an annual growth of around 24.0% and showing the company's ability to succeed despite intensifying competition.

Three-pronged growth strategy. The company remains optimistic about its growth prospects, especially this 2017, as it expects to maintain its market leadership position and continue its double-digit top line growth. It plans to achieve this by expanding its stores, growing its delivery business, and increasing its efforts in finding local and international franchisees that fit the company's vision and goals.

Attractive valuations. At its current price of Php13.30/sh, PIZZA is trading at 23.7X 18E P/E, a discount to the historical average P/E of domestic and global peers of around 27.0X to 29.0X. At our fair value estimate of Php16.30/sh, implied 2018E P/E is at 29.1X, at par with its peers' historical average P/E. We think that PIZZA deserves to trade at least in line with its domestic and global peers given its similarly attractive outlook. Note that we forecast a 13.2% EPS growth in 2018, broadly in line with its peers' median EPS growth of 15.1%.

FORECAST SUMMARY

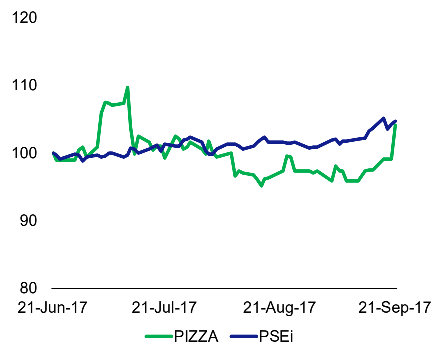
Year to December 31 (Php Mil)	2014	2015	2016	2017E	2018E	2019E
Revenues	**4,697**	**5,244**	**5,946**	**6,971**	**7,958**	**8,903**
% change y/y	*13.1*	*11.7*	*13.4*	*17.2*	*14.2*	*11.9*
Gross profit	**1,058**	**1,196**	**1,787**	**2,082**	**2,338**	**2,583**
% change y/y	*15.8*	*13.0*	*49.4*	*16.5*	*12.3*	*10.5*
Gross margin (%)	*22.5*	*22.8*	*30.1*	*29.9*	*29.4*	*29.0*
EBITDA	**695**	**864**	**1,197**	**1,407**	**1,575**	**1,745**
% change y/y	*15.5*	*24.4*	*38.5*	*17.6*	*11.9*	*10.8*
EBITDA margin (%)	*14.8*	*16.5*	*20.1*	*20.2*	*19.8*	*19.6*
Operating income	**531**	**613**	**802**	**1,231**	**1,369**	**1,509**
% change y/y	*17.2*	*15.6*	*30.8*	*53.4*	*11.2*	*10.2*
Operating margin (%)	*11.3*	*11.7*	*13.5*	*17.7*	*17.2*	*16.9*
Net Income	**429**	**480**	**759**	**759**	**859**	**960**
% change y/y	*16.9*	*11.7*	*58.3*	*-0.1*	*13.2*	*11.8*
Net profit margin (%)	*9.1*	*9.1*	*12.8*	*10.9*	*10.8*	*10.8*
EPS (in Php)	**1.16**	**0.62**	**0.88**	**0.50**	**0.56**	**0.63**
% change y/y	*16.0*	*-46.6*	*41.9*	*-43.7*	*13.2*	*11.8*
RELATIVE VALUE						
P/E(X)	*11.5*	*21.5*	*15.1*	*26.8*	*23.7*	*21.2*
P/BV(X)	*3.9*	*6.5*	*3.4*	*5.2*	*4.4*	*3.8*
ROE(%)	*30.2*	*19.4*	*20.8*	*17.7*	*17.1*	*16.5*
Dividend Yield (%)	*2.7*	*1.5*	*9.6*	*0.9*	*0.9*	*1.0*

source: PIZZA

BUY

TICKER:	**PIZZA**
FAIR VALUE:	**16.30**
CURRENT PRICE:	**13.30**
UPSIDE:	**22.56**

SHARE PRICE MOVEMENT



ABSOLUTE PERFORMANCE

	1M	3M	YTD
PIZZA	8.12	4.14	18.09
PSEi	3.34	5.05	21.10

MARKET DATA

Market Cap	20,795.34Mil
Outstanding Shares	1,531.32Mil
52 Wk Range	10.90 - 14.80
3Mo Ave Daily T/O	17.32Mil

ANDY DELA CRUZ
RESEARCH ANALYST
andy.delacruz@colfinancial.com

Initiating coverage with a BUY rating

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Company description. Shakey's Pizza Asia Ventures Inc. (PIZZA) is currently the largest chained pizza brand in the Philippines, outperforming several large brands such as Greenwich and Pizza Hut in terms of sales value, garnering a dominant market share of 33.0% in 2016. After first opening its doors in the Philippines in 1975, PIZZA now has a total of 195 restaurants nationwide as of end-1H17, 78 of which are franchised stores.

Exhibit 1: Store network

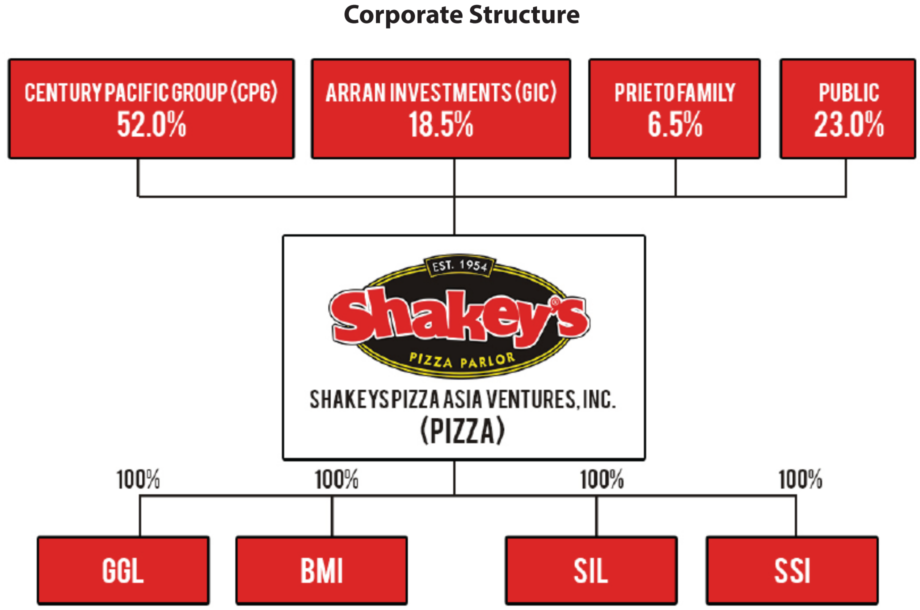
	2012	2013	2014	2015	2016
Company-owned	81	80	89	97	111
Franchised	55	60	64	70	73
Total	**136**	**140**	**153**	**167**	**184**

Source: PIZZA

In March 2016, the Po family (through Century Pacific Group or CPG) and global investment firm GIC (through Arran Investment) acquired control of PIZZA from its original shareholders the Prieto Family using its acquisition vehicle SAFHI through a leveraged buyout. Aside from the restaurants, it also acquired control of Bakemasters, Inc (BMI), Golden Gourmet Ltd (GGL), and Shakey's International Ltd (SIL). BMI serves as the commissary of Shakey's to provide key ingredients such as pizza dough and cheese, among others. GGL owns the Shakey's trademark and perpetual rights over the brand in the Philippines. SIL owns the right to use the trademark of the Shakey's brand in Asia (excluding Japan and Malaysia), Middle East, Oceania, and Australia.

On October 2016, SAFHI entered into several agreements with PIZZA and its shareholders (CPG, Arran and the Prieto family) to implement a corporate reorganization. As a result of the reorganization, PIZZA would now be directly owned by CPG, Arran and the Prieto family, while PIZZA would be the owner of BMI, GGL and SIL. PIZZA also formed a new subsidiary Shakey's Seacrest, Inc. (SSI) in June 2016. This new company will hold other intellectual properties that the company plans on acquiring.

Exhibit 2: Corporate Structure

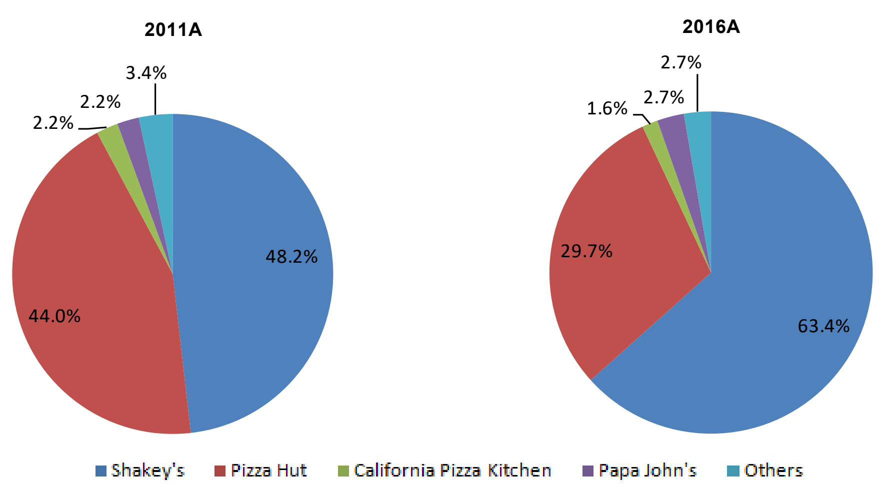


Source: PIZZA

Market leader in the chained full-service restaurant industry

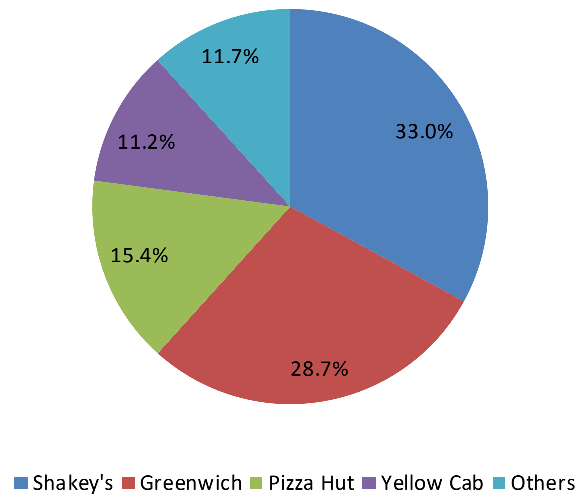
PIZZA is currently the largest chained full-service restaurant in the Philippines, both for the pizza and for the total full-service restaurant categories in terms of value. In 2016, PIZZA had a market share of 28.2% for the Php31.6 Bil chained full-service restaurant industry and a dominant 63.4% market share of the Php14.8 Bil pizza full-service restaurant industry. PIZZA's market share has also grown from only 16.7% for the full-service restaurant industry and 48.2% for the pizza full-service industry in 2011, implying an annual growth of around 24.0% and showing the company's ability to succeed despite intensifying competition.

Exhibit 3: Chained full-service pizza restaurants market share



Source: Euromonitor

Exhibit 4: Pizza restaurants market share as of 2016



Source: Euromonitor

Growth of chained pizza restaurants to outperform the whole foodservice industry

The chained full-service pizza restaurants industry where PIZZA belongs to has grown quite rapidly during the past five years, outperforming the growth of both the consumer foodservice sector in general and the full-service restaurants category.

According to Euromonitor, the Philippine consumer foodservice sector, which is comprised of fast food and full-service restaurants, among others, has grown from Php393.6 Bil in 2011 to Php536.0 Bil in 2016 at a compounded annual growth rate (CAGR) of 6.4%. Among the fastest growing category in the foodservice sector is the chained full-service restaurant category which expanded at a CAGR of 12.1% from 2011 to 2016. Leading the growth was the chained full-service pizza restaurants sub category which increased at an even faster pace of 17.9% during the same period.

According to Euromonitor, the chained full-service restaurant category was able to outgrow the whole consumer foodservice sector in general as it benefited from consumers trading up due to growing average family income, continuous urbanization, the young population, and increasing OFW remittances. Meanwhile, pizza restaurants' more significant outperformance was due to several factors including the versatility of pizza as food which can be consumed as a main meal or as a snack.

Going forward, the outperformance of the chained full-service pizza restaurants sub category is expected to continue. According to Euromonitor, the chained full-service pizza restaurant category is projected to expand at a CAGR of 4.6% from 2016 to 2021 to reach Php18.4 Bil, already accounting for 12.8% of the estimated Php138.1 Bil total full-service restaurant market.

In contrast, the consumer foodservice sector is projected to grow by a CAGR of 4.1% while the chained full-service restaurant category is projected to grow by a CAGR of 4.5% during the same period.

Exhibit 5: Food service industry CAGR

	2011A - 2016A	2016A - 2021E
Consumer food service sector	3.6%	4.1%
Chained full-service restaurants	12.1%	4.5%
Chained full-service pizza	**17.9%**	**4.6%**

Source: Euromonitor

As discussed earlier, PIZZA has already proven its ability to capitalize on the favorable growth outlook of the chained full-service pizza restaurant category as it was able to increase its market share in the full-service pizza restaurant industry from 48.2% in 2011 to 63.4% in 2016. The company achieved this through store expansion and healthy same store sales growth. In fact, from 2013 to 2016, PIZZA expanded its store count from 140 to 184, while at the same time, generating an average annual same store sales growth (SSSG) of around 3.9% to 7.6%. Going forward, PIZZA plans to capitalize on the industry's attractive growth prospects by further expanding its store network and boosting its same store sales growth through improved sales channels, introduction of new products and implementation of better marketing initiatives. For example, PIZZA showed strong SSSG of 8.1% y/y in 1H17 as in-store head count and average check size increased, largely due to the success of its recent promotion called the "2017 Meal Deal" and new menu entries.

In a "sweet spot" among restaurants

We believe that PIZZA is in a sweet spot among restaurants in the country. As discussed earlier, the market size of the chained full-service pizza industry increased by a CAGR of 17.9%, significantly outpacing the 6.4% CAGR of the consumer foodservice sector, driven by consumers trading up due to growing average family income, continuous urbanization, the young population, and increasing OFW remittances. We believe that this trend will continue given the favourable outlook of Filipinos' wealth. Note that the potential passage of the tax reform program later this year could potentially lead to a ~20% increase in disposable income for 93% of the 5.6 Mil tax payers in the Philippines. Moreover, the government is implementing numerous initiatives with the end goal of increasing the country's GNI per capita from $3,555 currently to $4,900 by 2022. Finally, Euromonitor forecasts the chained pizza full-service restaurant category to expand by a CAGR of 4.6% from 2016 to 2021, faster than the 4.1% CAGR of the food service sector during the same period.

We think that PIZZA is also a good candidate for a trade-up in consumer preferences. It is easier for Filipinos frequenting fast food restaurants such as Jollibee or McDonald's, among others, to trade up to restaurants such as Shakey's given 1) its strong brand equity and 2) attractive pricing position. At an increase of only Php100 to Php150 for each meal, consumers can enjoy better service and dining atmosphere, among others. Meanwhile, although other higher priced restaurants such as TGI Friday's is also a great candidate for consumers' trade up, we think that the steep jump in price from around Php150 to Php200 average spending for meals to Php500 to Php600 will be more challenging for consumers in the near term.

Exhibit 6: Average check per person

	Estimated check/person
Jolllibee/McDonald's/KFC	Php 100 to Php 150
Shakey's	Php 250 to Php 350
T.G.I. Friday's	Php 500 to Php 600

Source: COL Estimates

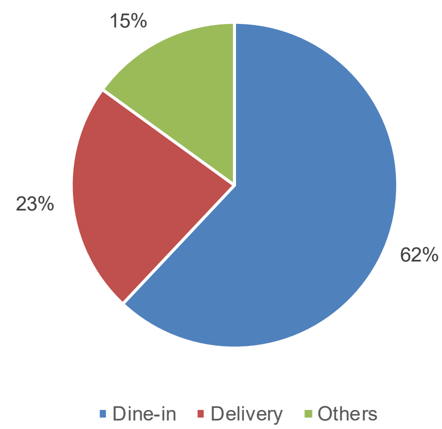
Another major advantage of the chained food service restaurants compared to fast food restaurants is their ability to increase prices given that its customers are less price-sensitive. This puts PIZZA in a better position to pass on higher costs brought about by rising raw material prices. In fact, in the second half of 2016, PIZZA managed to increase its prices by around 6% to prepare itself for higher input costs.

Three-pronged growth strategy

The company remains optimistic about its growth prospects, especially this 2017, as it expects to maintain its market leadership position and continue its double-digit top line growth. It plans to achieve this by expanding its stores, growing its delivery business, and increasing its efforts in finding local and international franchisees that fit the company's vision and goals.

The expansion of PIZZA's delivery business is a low-hanging fruit that the company could benefit from. As of 1H17, deliveries accounted for only 23% of its sales, still significantly lower compared to its dine-in contribution of around 62% of total sales. Note that according to Euromonitor, deliveries and takeaways account for close to 70% of total revenues of pizza restaurants in the US. We think that PIZZA still has ample room for improvement in its delivery business as the company admitted that delivery times can still be volatile under some circumstances such as a high volume of dine-in customers, leaving little resources for deliveries. On the bright side, management is taking steps in the right direction as it continues to open delivery outlets. These outlets serve the purpose of increasing delivery time reliability (an important key performance indicator for food/pizza deliveries) and extending its delivery reach to far-flung areas. Moving forward, it will be exciting to see the development of PIZZA's delivery business as we believe this is another huge potential for growth.

Exhibit 7: Sales channel mix breakdown as of 1H17



Source: PIZZA

Exhibit 8: US pizza restaurants delivery share

Company name	Ticker	% Delivery/ Takeaway of sales
Domino's Pizza	DPZ US	67%
Little Caesar's Pizza	-	66%
Papa John's Pizza	PZZA US	65%

Source: COL Estimates, Euromonitor, Company data

PIZZA is also looking to expand outside NCR in the medium-term given the robust growth of average family expenditures outside NCR and PIZZA's lack of store presence in these areas. Note that during the past seven years, areas such as Central Luzon and Central Visayas grew at a faster pace than NCR. Meanwhile, out of PIZZA's 195 stores nationwide as of end-1H17, the NCR already accounts for around 90 or 46% of total stores. Greenwich, which has a larger store network than PIZZA, has a more balanced mix of store locations in the country.

The company said it is currently more active in looking for franchisees that are passionate enough to grow the business in the Visayas and Mindanao areas, and even in other countries through SIL. In fact, PIZZA plans to open an international store through a franchisee by this year. Future international store additions will largely depend on the success of this store. If it doesn't find a suitable franchisee, PIZZA said it is open to the possibility of opening a company owned store assuming an attractive opportunity is available.

Exhibit 9: Regional real GDP per capita growth rates (%)

Region	2010	2011	2012	2013	2014	2015	2016	2009 - 2016 CAGR
NATIONAL CAPITAL REGION	5.6	0.9	5.0	7.3	4.0	7.9	6.3	5.3%
CORDILLERA ADMINISTRATIVE REGION	4.9	-0.8	-4.5	3.7	1.6	1.5	0.3	0.9%
ILOCOS	5.6	0.7	5.9	5.8	5.3	2.9	7.1	4.7%
CAGAYAN VALLEY	-2.1	3.8	5.6	5.2	5.8	2.1	1.9	3.1%
CENTRAL LUZON	7.9	4.3	5.3	2.5	7.3	4.9	7.9	5.7%
CALABARZON	8.8	-1.8	4.3	3.8	2.3	6.4	2.9	3.8%
MIMAROPA REGION	-1.9	0.8	2.6	-0.3	6.7	-2.8	0.6	0.8%
BICOL	2.1	-0.1	7.3	6.7	2.9	4.3	3.7	3.8%
WESTERN VISAYAS	3.2	4.3	5.5	2.1	3.9	6.3	4.6	4.3%
CENTRAL VISAYAS	11.1	4.5	7.4	5.6	6.0	3.4	7.0	6.4%
EASTERN VISAYAS	1.8	0.2	-8.0	3.4	-3.5	0.0	10.3	0.5%
ZAMBOANGA PENINSULA	-0.3	-2.2	10.7	2.5	5.0	5.0	2.9	3.3%
NORTHERN MINDANAO	4.5	3.2	4.6	3.6	5.3	4.7	5.9	4.5%
DAVAO REGION	3.8	1.3	5.2	4.9	7.5	5.3	7.3	5.0%
SOCCSKSARGEN	0.0	2.3	5.0	6.1	4.0	1.6	3.0	3.1%
CARAGA	9.2	6.4	9.9	6.7	7.9	-0.3	0.5	5.7%
AUTONOMOUS REGION IN MUSLIM MINDANAO	5.2	-2.2	-1.5	2.4	1.6	-6.6	-2.1	(0.5)%

Source: PSA

Exhibit 10: Geographical breakdown of stores as of 1H17

	% breakdown of stores	Est. # of stores
National Capital Region (NCR)	46%	90
Luzon, ex-NCR	41%	80
Visayas	9%	18
Mindanao	4%	8
	100%	**195**

Source: PIZZA, COL Estimates

Exhibit 11: Local peer store breakdown as of 1H17

		Geographical store network share			
	# of stores	**Metro Manila**	**Luzon ex-MM**	**Visayas**	**Mindanao**
Greenwich*	257	40%	35%	13%	12%
Shakey's	**195**	**46%**	**41%**	**9%**	**4%**
Pizza Hut**	165	68%	24%	7%	4%
Yellow Cab*	162	53%	30%	5%	4%

**Parent geographical store network share*

***estimate*

Source: PIZZA, JFC, MAXS, COL Estimates

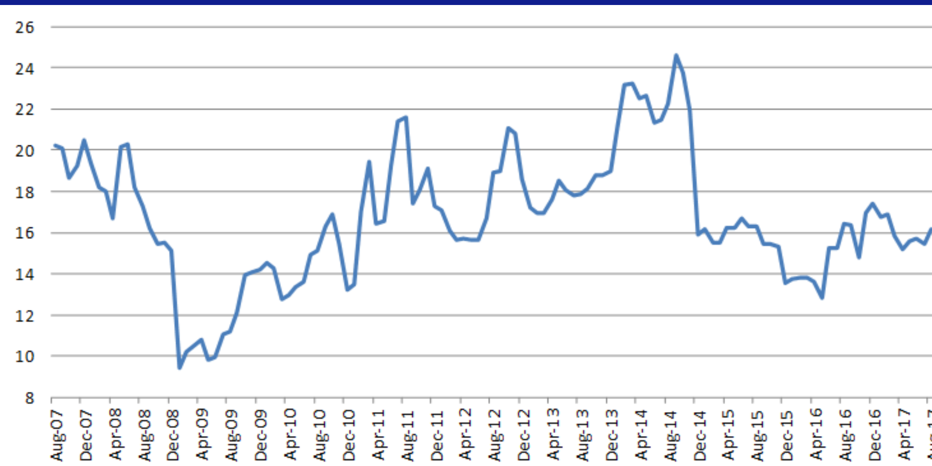
Financial Analysis

Double digit revenue growth driven by store expansion and sustained SSSG. We forecast revenues to increase by a three-year CAGR of 14.4% from 2016 (Php5.9 Bil) to 2019E (Php8.9 Bil) largely driven by store expansions of PIZZA. We assumed 25 new stores for this year since management is on track to beat its initial store guidance of 20 new stores. However, we are assuming 16 store additions in 2018 since management might cut back on its expansion given the large jump in store additions this 2017. From here on, we expect store additions to pick up (21 new stores in 2019).

We also forecast a 4.0% SSSG for this 2017, lower than 1H17's SSSG of 8.1%. We believe SSSG may come down a little towards the second half of the year given the significant selling price increase of around 6% last 3Q16. Still, our 4.0% SSSG forecast is higher than PIZZA's average SSSG of around 3.0% to 3.5% due to 1) success of "2017 Meal Deal" promo in 1Q17 and 2) "BER Bundle" promo which started September 1, allowing PIZZA to potentially grow its SSSG in 3Q17 despite the high base effect of 3Q16's price increases. For 2018 and 2019, we are forecasting an SSSG of 3.5%, in line with PIZZA's historical average.

Assuming a slight drop in margins after steep jump in 2016. From an average of around 22% the past few years, PIZZA's GPM jumped to 30.1% in 2016. According to the company, part of the increase was due to PIZZA's synergies with its new parent CPG, which enabled it to buy raw materials at a lower cost. However, we do not expect further synergies with its parent since we think that PIZZA already realized most of the said benefits through the bulk buying of raw materials. Moreover, although PIZZA's GPM reached 30.1% in 1H17, we assumed that its full-year GPM would only reach 29.9%. We think that the continuous increase in raw material prices (ex. cheese), the weak peso, and the recent promo of PIZZA called the "BER Bundle" could dilute its GPM slightly. Our full year GPM forecast is in line with PIZZA's 1Q17's GPM of 29.9% which had the "2017 Meal Deal" promo. Moving forwards, we reduced our GPM assumption to 29.4% for 2018 and 29.0% for 2019 which are more sustainable levels in our opinion.

Exhibit 12: Milk futures price in US$/CWT



Source: Bloomberg

Still, we maintained our 12.3% operating expense CAGR forecast from 2017E (Php852 Mil) to 2019E (Php1.1 Bil), slightly slower than our 13.0% revenue CAGR forecast in the same period. We think that PIZZA is in a better position to manage its margins given its position in the restaurant industry and to be able to benefit from its larger scale as a result of its store expansions and synergies with CPG.

Exhibit 13: Key assumptions

	2017	2018	2019
SSSG	4.0%	3.5%	3.5%
Store additions	25	15	21
GPM	29.9%	29.4%	29.0%
OPM	17.7%	17.2%	16.9%

Source: COL Estimates

Debt levels remain high

Debt levels of PIZZA remain high at around Php3.9 Bil (following the Php1.0 Bil repayment at the start of 2017). We estimate that this will bring debt-to-equity (D/E) ratio of PIZZA this 2017 to around 1.0X. Although management said that they are comfortable with this level of debt since they managed to lock in an attractive rate (around 4.5%), we are still assuming a debt payment of Php1.0 Bil in 2019 and in 2021 given PIZZA's strong operating cash inflows and rising cash levels. Note that the readjustment of PIZZA's loan rate will be on 2021 with a 4.5% (floor rate) or 5-Year PDST-R2 plus 75 bps, whichever is higher. We believe that the additional risk of having to pay a higher rate and the significantly better profitability following the decrease in its interest expense will cause management to pay down its debt. We see interest expense for this 2017 of Php177 Mil to go down to around Php129 Mil in 2020.

Company restructuring, IPO, and new debt to pull down 2017 EPS; growth to normalize going forward

Despite the 17.2% increase in revenues and the 53.4% jump in operating profits in 2017, we forecast net income to remain flat at Php759 Mil (compared to 2016's Php759 Mil) and EPS to drop by 43.7% to Php0.50. The reason for this is the restructuring of PIZZA pre-IPO (acquisition of various companies including the commissary which lead to share swaps) and the issuance of 104 Mil primary shares from its IPO which both caused its weighted average outstanding shares to jump from 862 Mil in 2016 to 1.5 Bil in 2017. Nevertheless, starting 2018, we forecast EPS growth to normalize closer to revenue growth as we do not anticipate any other earnings dilutive capital raising exercises for the company.

Valuations

Valuation methodology. We reached our fair value estimate of Php16.30/sh based on a discounted cash flow (DCF) method. We assumed a WACC of 8.0% given a cost of equity of 9.5%, pre-tax cost of debt of 5.0% and a debt-to-capital ratio of 25%. We also used a terminal growth rate assumption of 4.0% to account for population growth and inflation, as well as our positive outlook on PIZZA.

Attractive valuations. At its current price of Php13.30/sh, PIZZA is trading at 23.7X 18E P/E, a discount to the historical average P/E of domestic and global peers of around 27.0X to 29.0X. At our fair value estimate of Php16.30/sh, implied 2018E P/E is at 29.1X, at par with its peers' historical average P/E. We think that PIZZA deserves to trade at least in line with its domestic and global peers given its similarly attractive outlook. Note that we forecast a 13.2% EPS growth in 2018, broadly in line with its peers' median EPS growth of 15.1%.

Exhibit 14: Relative valuation

		P/E		EPS Growth	
Company name	**Ticker**	**2017E**	**2018E**	**2017E**	**2018E**
Domino's Pizza Inc.	DPZ US	34.7	29.3	32.4%	18.5%
Yum! Brands Inc.	YUM US	27.2	24.0	14.6%	13.2%
Jollibee Foods Corporation	JFC PM	39.8	33.2	8.3%	20.1%
Max's Group, Inc.	MAXS PM	21.9	19.6	14.8%	11.8%
Papa John's Intl Inc.	PZZA US	25.5	22.1	12.1%	15.1%
Average ex-PIZZA		29.8	25.6	16.4%	15.7%
Median ex-PIZZA		27.2	24.0	14.6%	15.1%
Shakey's Pizza Asia Ventures, Inc.	**PIZZA PM**	**26.8**	**23.7**	**-43.7%***	**13.2%**

** IPO and company restructuring last 2016*

*** as of September 20, 2017*

Source: COL Estimates, Bloomberg

Risks

Weak peso, rising raw material costs. Potential rising of soft commodity prices such as chicken, dairy (cheese), and potatoes, among others, could result to margin pressures for PIZZA. We estimate that the said commodities account for around 10% to 15% of the company's total costs. Meanwhile, we estimate that around 10% of raw materials are imported. This means that the weaker peso would lead to higher costs.

Nevertheless, PIZZA has a relatively stronger pricing power given its higher income target market, putting it in a better position to pass on higher costs through price increases.

Competition and changing consumer preferences. Intensifying competition and changing consumer preferences are always inherent in the restaurant industry and may pose risks to PIZZA's sales and profitability. In fact, because of the attractive growth prospect of pizza restaurants and PIZZA's very high margins, new competition could enter into the sector.

On the positive side, PIZZA has shown its ability to perform well despite competition. Recall that from 2011 to 2016, it was able to increase its market share from 48.2% to 63.4%.

Execution risk. Execution risks pertaining to PIZZA's new stores such as the stores not performing as expected and expansion not materializing as fast as expected could hamper earnings growth and lead to disappointment.

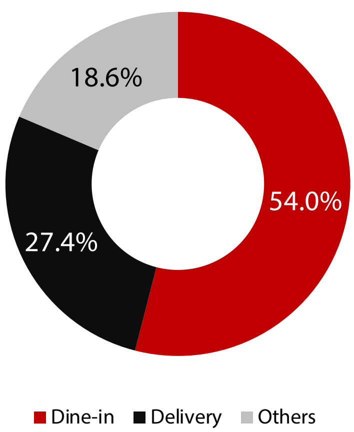
Higher costs due to excise taxes on sugary drinks. The government bared plans to impose excise taxes on sugary drinks at Php5-10/Liter. This could potentially lead to higher costs for PIZZA and potentially hurt margins. However, drinks only account for a small share of revenues and costs at less than 10%.

Shakeys Pizza Asia Ventures, Inc. (PIZZA)

COMPANY BACKGROUND

Shakey's Pizza Asia Ventures Inc. (PIZZA) is currently the largest chained pizza brand in the Philippines, outperforming several large brands such as Greenwich and Pizza Hut in terms of sales value, garnering a dominant market share of 32.2% in 2015. After first opening its doors in the Philippines in 1975, Shakey's as of 2016 has a total of 184 restaurants nationwide, 74 of which are franchised stores.

SALES CHANNEL MIX



INCOME STATEMENT (IN PHPMIL)

	FY14	FY15	FY16	FY17E	FY18E	FY19E
Revenues	4,697	5,244	5,946	6,971	7,958	8,903
% Growth	-	11.7%	13.4%	17.2%	14.2%	11.9%
Gross Profit	1,058	1,196	1,787	2,082	2,338	2,583
% Growth	-	13.0%	49.4%	16.5%	12.3%	10.5%
EBITDA	695	864	1,197	1,407	1,575	1,745
% Growth	-	24.4%	38.5%	17.6%	11.9%	10.8%
Operating Profit	531	613	802	1,231	1,369	1,509
% Growth	0.0%	15.6%	30.8%	53.4%	11.2%	10.2%
Interest Expense	-	-	(128.5)	(177.0)	(175.9)	(174.7)
Other Income/Expense	50	46	262	-	-	-
Pretax Income	581	659	936	1,054	1,193	1,334
Tax Expense	152	179	177	295	334	373
Net Income	429	480	759	759	859	960
% Growth	0.0%	11.7%	58.3%	-0.1%	13.2%	11.8%
EPS (Php)	1.16	0.62	0.88	0.50	0.56	0.63
% Growth	-	-46.6%	41.9%	-43.7%	13.2%	11.8%

BALANCE SHEET (IN PHPMIL)

	FY14	FY15	FY16	FY17E	FY18E	FY19E
Cash & Equivalents	406	389	329	330	783	1,317
Trade Receivables	400	543	421	553	632	707
Inventories	255	239	256	268	308	346
Other Current Assets	82	70	1,138	13	13	13
PPE	440	577	999	1,560	1,785	2,006
Other Non-Current Assets	839	846	6,241	6,241	6,241	6,241
Total Assets	**2,423**	**2,664**	**9,384**	**8,967**	**9,762**	**10,631**
Accounts Payable	1,038	908	864	911	1,047	1,177
Other Current Liabilities	50	58	1,113	89	89	1,089
LT Debts	-	-	3,933	3,908	3,883	2,858
Other Non-Current Liabilities	70	120	115	115	115	115
Total Liabilities	1,158	1,086	6,025	5,023	5,135	5,240
Total Equity	**1,265**	**1,578**	**3,359**	**3,943**	**4,628**	**5,390**
Total Liabilities & Equity	**2,423**	**2,664**	**9,384**	**8,967**	**9,762**	**10,631**
BVPS	**3.4**	**2.1**	**3.9**	**2.6**	**3.0**	**3.5**

CASHFLOW STATEMENT (IN PHPMIL)

	FY14	FY15	FY16	FY17E	FY18E	FY19E
Income (loss) before income tax	581	659	936	1,054	1,193	1,334
Depreciation & Amortization	164	210	138	177	206	236
Other Non-Cash Exp (Gains)	(16)	(14)	(79)	177	176	175
Interest income	3	4	3	-	-	-
Increase (decrease) in Working Cap	(73)	(225)	114	(98)	18	17
Income tax expense	(156)	(172)	(178)	(295)	(334)	(373)
Operating Cash Flow	**504**	**462**	**934**	**1,014**	**1,259**	**1,389**
Capex	(295)	(350)	(418)	(738)	(431)	(458)
Other Investments	(331)	20	(6,451)	1,125	-	-
Investing Cash Flow	**(626)**	**(329)**	**(6,869)**	**388**	**(431)**	**(458)**
Proceeds (Payment) Debts	-	-	4,975	(1,048)	(25)	(25)
Payment of Cash Dividends	(134)	(150)	(1,102)	(175)	(174)	(198)
Others	-	-	2,001	(177)	(176)	(175)
Financing Cash Flow	**(134)**	**(150)**	**5,874**	**(1,400)**	**(375)**	**(397)**
Effect of forex rates on cash	0	0	0	-	-	-
Change in Cash	**(256)**	**(17)**	**(60)**	**2**	**453**	**533**

INVESTMENT THESIS:

Three-pronged growth strategy
PIZZA remains optimistic about its growth prospects, especially this 2017, as it expects to maintain its market leadership position and continue its double-digit topline growth. The company plans to achieve this by expanding its stores, growing its delivery business, and increasing its efforts in finding local and international franchisees that fit the company's vision and goals. This 2017, PIZZA is expecting topline growth in the mid-teens and earnings growth in the low-teens.

Exciting industry growth prospects
The Philippine consumer foodservice sector continued to reap the benefits of growing average family income, continuous urbanization, young population, and increasing OFW remittances. Still, outperforming the whole industry is the chained full-service pizza restaurant category which expanded at a CAGR of 21.7% in the past five years, outpacing the 4.0% CAGR of the whole full-service restaurant market in the same period. Pizza restaurants' outperformance was due to several factors including the versatility of pizza as food which can be consumed as a main meal or as a snack. In the next five years, the chained pizza full-service restaurant category is projected to expand at a CAGR of 14.0%. By 2020, the chained full-service pizza market is estimated to reach Php27.1Bil, already accounting for 18.7% of the estimated Php144.9Bil total full service restaurant market.

In a "sweet spot" among restaurants
We believe that PIZZA is in a sweet spot among restaurants in the country. From 2011 to 2015, the market size of the chained full service pizza industry increased by a CAGR of 21.7%, largely outpacing the 10.6% CAGR of the overall fast food market. We believe that this trend will continue given growing average family income, among other things. Note that the potential passage of the tax reform program later this year could potentially lead to ~20% increase in disposable income for 93% of the 5.6Mil tax payers in the Philippines. This could also potentially translate to a trade up amongst consumers from fast food restaurants to Shakey's. Moreover, the chained food service market is that consumers are less price-sensitive given their higher level of affluence. This puts Shakeys' in a better position to pass on higher costs brought about by higher raw material prices.

KEY RATIOS

	FY14	FY15	FY16	FY17E	FY18E	FY19E
GPM (%)	22.5%	22.8%	30.1%	29.9%	29.4%	29.0%
EBITDA Margin (%)	14.8%	16.5%	20.1%	20.2%	19.8%	19.6%
OPM (%)	11.3%	11.7%	13.5%	17.7%	17.2%	16.9%
NPM (%)	9.1%	9.1%	12.8%	10.9%	10.8%	10.8%
Times Interest Earned (X)	-	-	6.2	7.0	7.8	8.6
Current Ratio (X)	1.05	1.28	1.08	1.16	1.53	1.05
Net D/E Ratio (X)	(0.32)	(0.25)	1.40	0.91	0.67	0.29
Days Receivable	28.3	33.9	30.7	30.0	30.0	30.0
Days Inventory	18.6	22.3	21.7	20.0	20.0	20.0
Days Payable	95.1	87.7	77.8	68.0	68.0	68.0
Asset T/O (%)	193.9%	196.8%	63.4%	77.7%	81.5%	83.8%
ROAE (%)	30.2%	19.4%	20.8%	17.7%	17.1%	16.5%

MAJOR CORPORATE DEVELOPMENTS (5-YEARS)

Went public with primary shares of around 104 Mil at Php11.26/sh	2H16
Century Pacific Group (CPG) and Arran Investments (GIC) acquired control from Prieto family.	1H16
Acquired Shakey's trademark for Middle East, Asia (ex. Japan and Malaysia), Australia, and Oceania.	2014

Valuation Methodology

RELATIVE VALUATION

	P/E		EPS Growth	
	2017E	**2018E**	**2017E**	**2018E**
Domino's Pizza Inc.	34.7	29.3	32.4%	18.5%
Yum! Brands Inc.	27.2	24.0	14.6%	13.2%
Jollibee Foods Corporation	39.8	33.2	8.3%	20.1%
Max's Group, Inc.	21.9	19.6	14.8%	11.8%
Papa John's Intl Inc.	25.5	22.1	12.1%	15.1%
Average ex-PIZZA	29.8	25.6	16.4%	15.7%
Median ex-PIZZA	27.2	24.0	14.6%	15.1%
Shakey's Pizza Asia Ventures, Inc.	**26.85**	**23.71**	**-43.7%***	**13.2%**

**IPO was last just 2016*

As of July 19, 2017

VALUATION ASSUMPTIONS

For DCF	
Risk Premium	5.0%
Risk Free Rate	5.0%
Beta	0.90
Cost of Equity	9.5%
Cost of Debt	5.0%
Tax Rate	28.0%
WACC	8.0%
Terminal Growth Rate	4.0%
PV (2018E-2022E)	4,066
PV of Terminal Value	24,014
Enterprise value	28,080
Less: Net Debt	3,125
Equity Value	24,955
O/S	1,531
FV Estimate	**16.30**

IMPORTANT RATING DEFINITIONS

BUY

Stocks that have a BUY rating have attractive fundamentals and valuations based on our analysis. We expect the share price to outperform the market in the next six to 12 months.

HOLD

Stocks that have a HOLD rating have either 1) attractive fundamentals but expensive valuations 2) attractive valuations but near-term earnings outlook might be poor or vulnerable to numerous risks. Given the said factors, the share price of the stock may perform merely in line or underperform in the market in the next six to twelve months.

SELL

We dislike both the valuations and fundamentals of stocks with a SELL rating. We expect the share price to underperform in the next six to12 months.

IMPORTANT DISCLAIMER

COL RESEARCH TEAM

APRIL LYNN TAN, CFA
VP & HEAD OF RESEARCH
april.tan@colfinancial.com

CHARLES WILLIAM ANG, CFA
DEPUTY HEAD OF RESEARCH
charles.ang@colfinancial.com

GEORGE CHING
SENIOR RESEARCH MANAGER
george.ching@colfinancial.com

RICHARD LAÑEDA, CFA
SENIOR RESEARCH MANAGER
richard.laneda@colfinancial.com

FRANCES ROLFA NICOLAS
RESEARCH ANALYST
rolfa.nicolas@colfinancial.com

ANDY DELA CRUZ
RESEARCH ANALYST
andy.delacruz@colfinancial.com

JUSTIN RICHMOND CHENG
RESEARCH ANALYST
justin.cheng@colfinancial.com

KYLE JEMMRIC VELASCO
RESEARCH ANALYST
kyle.velasco@colfinancial.com

JOHN MARTIN LUCIANO
RESEARCH ANALYST
john.luciano@colfinancial.com

ADRIAN ALEXANDER YU
RESEARCH ANALYST
adria.yu@colfinancial.com

COL FINANCIAL GROUP, INC.
2402-D EAST TOWER, PHILIPPINE STOCK EXCHANGE CENTRE,
EXCHANGE ROAD, ORTIGAS CENTER, PASIG CITY
PHILIPPINES 1605
TEL NO. +632 636-5411
FAX NO. +632 635-4632
WEBSITE: **www.colfinancial.com**