

# JOLLIBEE FOODS CORP (JFC): THE CHAMP OF FAST FOOD

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Market Data					
Price	247	Change	↑ 3.20 (1.31%)	Primary Exchange	XPHS

## Executive Summary

As a group, we are issuing a **BUY recommendation** based on the analysis of financial statements, information on quick –service market, well-known stock analysts forecasts, and significant events for the period 2006 to 2016 (up to 30 September 2016). In particular, the group made the a buy recommendation for the following reasons:

### *JFC's Quality of Earnings*

As we know, in making decisions on whether to buy or sell stock, it is best to look at the company's quality of its of earnings. For JFC, it is very clear: revenues are increasing, margins are stable, but more importantly, JFC is awash with cash.

### *JFC's Competent Management*

The performance of JFC has been highly attributed to their Management. While there may have been changes, they seem to be insignificant, thus continuity of strategies (proven to be successful) is expected from a stable company such as JFC.

### *Market Valuation of JFC from 2006-2015*

Market has over-valued the stock – this is very clear from the figures. But this does not mean that the over-valuation is without basis. It simply means that the market has high expectations with respect to JFC's performance.

### *Competition in the Quick Service Restaurant Industry*

JFC is in a market that has so many players. In the past, JFC's strategy was to buy-out its competitors. This strategy may still work now with new entrants to the quick service restaurant industry.

### *JFC's Stock Performance from 2006-2015*

A critical indicator for stock performance is returns. On the average, it is still growing, but at a slower pace -- an indicator that JFC as a company has matured and stabilized.

## Business Description

**Jollibee Foods Corporation (JFC)** is a Philippines-based company engaged in the development, operation and franchising of quick-service restaurants (QSR) under the trade name Jollibee. The Company has a number of subsidiaries, which include FRESH N' FAMOUS FOODS, INC., which develops, operates and franchises quick-service restaurants under the trade names Chowking and Greenwich; RED RIBBON BAKESHOP, INC. (through RRB HOLDINGS, INC.), which develops, operates and franchises restaurants under the Red Ribbon trade name; MANG INASAL PHILS., INC., which develops, operates and franchises restaurants under the Mang Inasal trade name, and PERF RESTAURANTS INC., which franchises restaurants under the Burger King trademark in the Philippines. It also has subsidiaries and affiliates,

which develop and operate its international brands, Yonghe King, Hong Zhuang Yuan, San Pin Wang, brands under the SuperFoods Group (including Highlands Coffee and Pho 24), 12 Hotpot and Dunkin' Donuts.

## Company Strategies

JFC focuses on these strategies:

1. **Global Expansion & Brand Acquisition** – JFC continues to expand its brand portfolio to cater to different market segments and establish business presence across globe through organic growth and acquisitions to boost growth and profitability. JFC has increased by 205 stores worldwide compared to a year ago.
2. **Increasing Number of Stores** – 2015 was a record-breaking year for JFC with a total of 306 stores opened: 249 in the Philippines, 39 in China, 1 in the US, 17 in Southeast Asia and the Middle East. 67 Jollibee stores were also opened during the year, the highest in Jollibee history.
3. **Strong Domestic Business** – Jollibee, Chowking, Greenwich, Red Ribbon and Burger King stores in the Philippines all showed strong performance and exceeded target sales and return on investments with some brands posting double-digit growth in system-wide sales. In particular, Burger King continues this trend with 12 consecutive months of double-digit sales growth in 2015.

## Key Performance Indicators

JFC has Top Five (5) Key Performance Indicators:

1. **System Wide Sales** – A measure of all sales to consumers both from company-owned and franchised stores.
2. **Revenues** – Total of 1) all sales made by the JFC owned stores, 2) commissary sales to franchised stores, 3) rental revenues from Jollibee Group's property division, and 4) services rendered by in-house construction and service groups.
3. **Net Income Margin** – A measure of JFC's return for every peso of revenue earned after deducting cost of sales, operating expenses, interests and taxes.
4. **Basic Earnings per Share** – An indicator of JFC's profitability which allocates the company's profit to each outstanding share of common stock.
5. **Return on Equity** – A measure of return for every peso of invested equity. JFC uses ROE to compare profitability of other firms in the same industry.

## Shareholder Structure

Three major shareholder groups own JFC. As of December 2015, Hyper Dynamic Corporation owns 25.54% while Honeysea Corporation owns 11.94%, and Winall Holding Corporation with 5.06%. It is important to note that 28.58% is owned by PCD Nominee Corp. (Non-Filipino) and PCD Nominee Corp. (Filipino) with 9.34%. Total issued and outstanding shares as of December 2015 are 1,069,669,555 shares. Tony Tan Caktiong holds 0.79% while William Tan Untiong and Ernesto Tanmantiong hold 0.72% and 0.49%, respectively.

## Corporate Management

In July 2014, the board of JFC approved the appointment of Chief Operating Officer Ernesto Tanmantiong as the company's next Chief Executive Officer and President replacing his brother Tony Tan Caktiong, who founded Jollibee in 1978 and steered it into one of Asia's largest food service companies. This was part of JFC's Succession Planning. "We have been preparing Ernesto for assuming greater responsibilities. His performance has clearly demonstrated that he is ready to lead the Jollibee Group as its new CEO," Tan

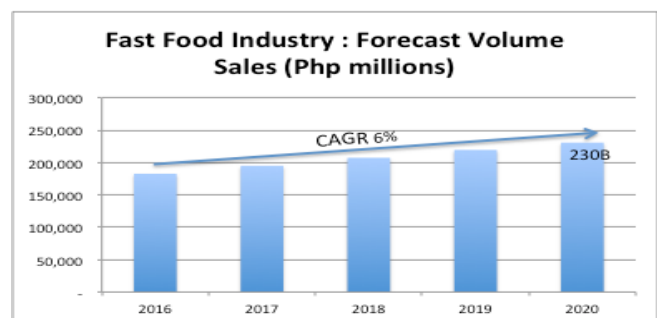
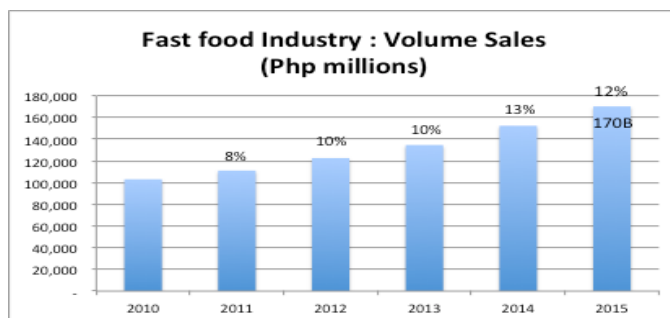
Caktiong said, describing the move as it builds a stronger and larger business in the future. Tan Caktiong remained as the Chairman of the JFC Board and continues to play a significant role in pursuing new ventures and partnerships as well as product research and development for the Jollibee Group.

## Industry Overview and Competitive Positioning

### Fast food Industry in the Philippines

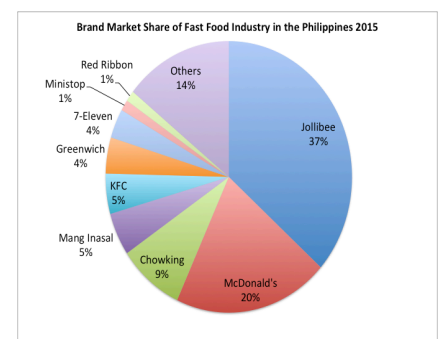
#### Industry Value

Due to a growing economy, the fast food industry in the Philippines is currently valued at Php 170B in 2015 (sales in fast food category: foodservice value) with a total number of 7,629 stores across the country. This 12% growth from the previous year is a marginal slowdown from the 13% value growth in 2014 due to stiffening competition and maturity of the industry. However, fast food is poised to record a value CAGR of 6% from 2016-2020, forecasting to hit Php 231B in 2020. Also, the number of stores is expected to increase by a CAGR of 6% to 10,622 stores in 2020. According to Euromonitor, fast food remains the fastest growing consumer food service channel in the country in 2015.



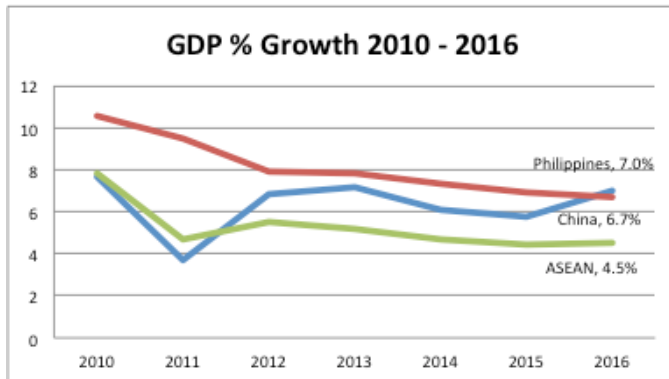
#### Competitive Landscape

In 2015, JFC maintains its dominance in the fast food segment with a company market share of 55.9%. This is characterized by its wide range of brand portfolio consisting of popular local brands such as Jollibee, Mang Inasal, Greenwich, Chowking, Red Ribbon and Burger King. These brands are also the leaders in their respective fast food categories. Its nearest competitor, McDonald's Corp., holds a 20.3% market share, while in third place is Yum! Brands Inc., which operates KFC. In the fast food brand category, Jollibee leads the way with 37.5% market share followed by McDonald's with 20.8%. Chowking and Mang Inasal, both brands under Jollibee Foods Corp., trail with 8.8% and 5.2% market share respectively. KFC has 5.0% share of the industry.



### Robust Philippine Economic Performance

No longer the sick man of Southeast Asia, the Philippines has been showing a stellar economic performance since 2012 with a GDP growth of 6.8% driven by the influx of foreign remittances from OFWs and the robust growth of the BPO industry resulting to an increase in household consumption. The midterm



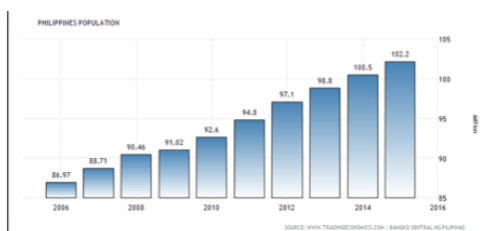
elections of 2013 and Presidential elections in 2016 have contributed greatly to the GDP growth above 7%. In 2016, for the first time ever, the Philippines

surpassed China's growth of 6.7%. The continued strong economic performance, surpassing the ASEAN region, earned the country an investment grade rating due its strong economic fundamentals.

In addition to its GDP growth, the GDP per capita also has been increasing, which translates to an increase in household consumption expenditure. This means that the purchasing power of Filipinos has increased to include more than the basic necessities. Filipinos have more disposable income and the fast food industry would benefit greatly since Filipinos can dine more and shop more. The GDP per capita in 2015 reached USD 2,529 or Php 123,000.



## Growing Philippine Population

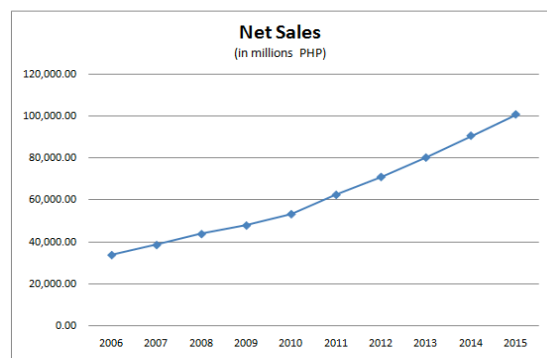


The population of the Philippines reached 100M in 2014 and the trend is expected to continue as it hit 102M in 2015. The increasing population is beneficial to the fast food industry as more people translate to more customers and sales. Growing communities in provincial areas are quickly turning municipalities into cities and the foray of JFC into expanding to these previously underserved areas will result to untapped growth opportunities for the company.

## Financial Analysis

RATIOS	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
PROFITABILITY										
Gross Profit Margin	17.41%	18.33%	18.36%	17.44%	17.49%	18.62%	19.42%	18.12%	20.40%	20.00%
Operating Profit Margin	6.80%	7.76%	8.11%	7.20%	7.43%	8.21%	8.08%	7.56%	8.25%	8.87%
Net Profit Margin	4.89%	5.91%	5.82%	5.25%	5.17%	5.99%	5.56%	5.28%	6.17%	6.36%
Return on Assets	8.75%	11.12%	11.09%	9.85%	9.88%	11.01%	10.22%	10.09%	12.29%	12.51%
Return on Equity	17.05%	21.56%	21.46%	18.33%	17.62%	19.13%	17.50%	17.30%	20.21%	20.91%
LIQUIDITY										
Current Ratio	1.29	1.26	1.18	0.94	1.10	0.99	1.45	1.45	1.38	1.29
Quick Ratio	0.85	0.80	0.83	0.70	0.75	0.79	1.18	0.98	1.00	0.94
ACTIVITY										
Receivable Turnover	15.44	16.94	27.53	27.66	24.70	21.10	22.18	22.61	21.68	20.97
Inventory Turnover	13.94	14.87	20.18	20.39	17.26	21.46	16.41	15.70	20.18	19.31
Payables Turnover	16.12	18.14	18.78	19.03	11.82	11.32	10.11	11.87	12.65	11.50
Total Asset Turnover	1.59	1.70	1.77	1.73	1.65	1.67	1.66	1.66	1.83	1.84
LEVERAGE										
Long-term debt to Equity	28.71	16.29	18.02	4.04	20.18	0.30	14.96	17.55	0.81	0.43
Debt to Equity	32.66	25.78	22.92	25.65	28.77	24.71	17.16	20.70	2.38	2.08
SHAREHOLDER RATIOS										
Earnings per Share	4.62	5.07	4.45	3.58	3.14	3.12	2.61	2.27	2.36	2.16
Dividend Payout Ratio	56.96%	32.32%	15.95%	35.49%	34.10%	32.07%	-	37.04%	33.84%	31.47%

## Growth of Jollibee from 2006 to 2015



### Growth in Sales

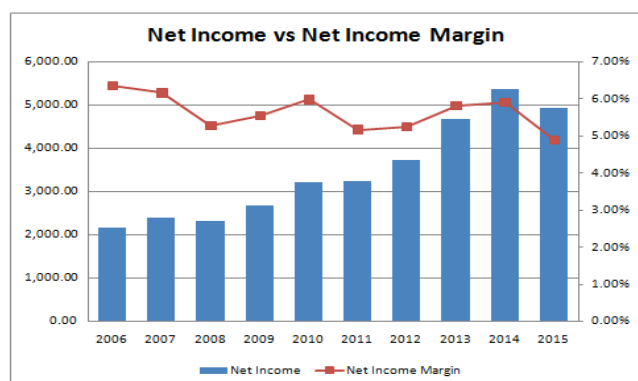
In terms of sales, Jollibee has grown positively from 2006 to 2015. It has an average annual growth rate of 13.27% for the past 10 years. Net sales increased from almost PhP 34 billion in 2006 to PhP 100 billion at the end of 2015. Sales were driven by local and global expansion through the years as stated previously. JFC has presence in Southeast Asia, China, Middle East and United States. Additionally, Jollibee has continued to acquire several quick service restaurants in the Philippines and abroad.

JFC's merger and acquisitions from 2006-2015 are shown below:

BK Titans Inc	Acquisition	September 30, 2011
Mang Inasal Philippines Inc	Acquisition	November 22, 2010
Beijing Hongzhuangyuan Catering Trade Management Co Ltd	Merger	October 1, 2008
Belmont Enterprises Ventures Ltd	Acquisition	June 18, 2007
Baker Fresh Foods Philippines Inc	Acquisition	September 29, 2006
Greenwich Pizza Corp	Acquisition	January 17, 2006

### Growth in Net Income

Net income figures have shown a relatively increasing trend since 2006. Average annual growth rate is at 11.99% while average net income margin is 5.64%.

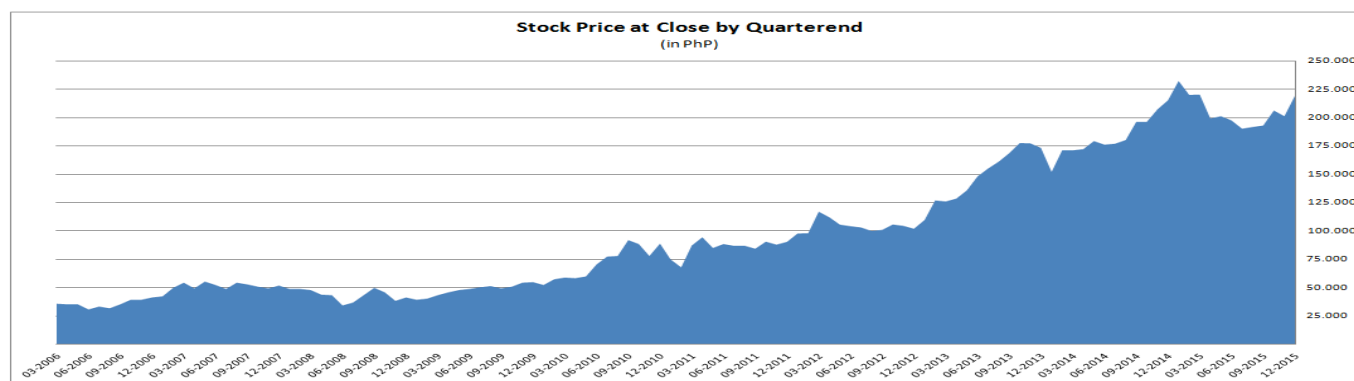


However, there is an inconsistency between actual net income figures and the net income margins. As shown in the graph, actual net income may show an increase as compared to the previous year but net income margin may show otherwise as compared to the previous performance.

Growth in actual net income can be attributed to the general reduction in Cost of Goods Sold, and Selling, General and Administrative Expenses values. Cost of Goods Sold values moved in the same increasing manner as revenues, with an annual average of

77.53% of sales since 2006. On the other hand, Selling, General and Administrative Expenses trended inversely with sales at an annual average of 10.81%. Nonetheless, as to Net Profit Margin, the trend shows that it is downwards.

### Growth in Stock Price and Market Capitalization



JFC's stock price trended positively through the years. From the period 2006 to 2015, JFC recorded the lowest quarterly closing price of PhP 31.00 on June 2006, while the highest price of PhP 232.00 was in January 2015. With this trend, JFC's market capitalization sky-rocketed to an annual average growth of 22.06%. Table presents market capitalization, its yearly growth rate and volume. Graphically, market

capitalization is shown below. With high market capitalization, JFC may experience slow growth, which is consistent with the net profit margin but assumes low risk.



Note: Market capitalization and volume figures are expressed in millions.

Year	Market Capitalization (in million PHP)	Volume (in million shares)	% Change vs. Last Year
2006	42,060.86	1,001.45	4.45%
2007	52,907.25	1,017.45	25.79%
2008	42,477.66	1,023.56	-19.71%
2009	56,925.59	1,035.01	34.01%
2010	92,188.54	1,036.99	61.95%
2011	93,932.86	1,038.37	1.89%
2012	106,688.90	1,046.68	13.58%
2013	182,002.67	1,051.43	70.59%
2014	228,730.42	1,063.86	25.67%
2015	234,104.76	1,068.97	2.35%

## Performance for Current Year 2016

Second Quarter Net Income is up by 17.5% vs. last year

### Financial Highlights

	Quarter 2 2016	% Change vs Last Year	YTD June 2016	% Change vs Last Year
System Wide Sales	37,101	15.1	71,446	14.9
Revenues	28,323	14.0	54,425	13.7
Net Operating Income	1,785	21.5	3,523	20.7
Net Income	1,632	11.3	3,064	13.4
Net Income Attributable to Equity Holders of the Parent	1,656	17.2	3,054	17.5
Earnings Per Share - Basic	1.545	16.6	2.852	16.9
Earnings Per Share - Diluted	1.515	16.8	2.795	16.9

Note: Amounts in Php Millions except for Per Share Data

Second quarter 2016 earnings of JFC shows double-digit growth compared to the same period in 2015, with an increase of 17.5%. This is attributed to a strong core business of the company propelled by new product offerings introduced this 2016.

## Significant Events that affected JFC

Reviewing the financial information of JFC, it may be remiss not to look as well at certain important internal and external events that may have affected Jollibee. As there are many significant internal and events that may have affected Jollibee, this report will focus on one external and one internal event that occurred within the period of study, particularly from 2006 to 2015. The study will focus particularly on: (i) the 2007-2008 World Financial Crisis; and (ii) the retirement of Tony Tan Caktiong as CEO and President in 2014.

### 2007-2008 Global Slump: How Jollibee Management Reacted

*The global financial crisis (GFC) or global economic crisis is commonly believed to have begun in July 2007 with the credit crunch, when a loss of confidence by US investors in the value of sub-prime mortgages caused a liquidity crisis. This, in turn, resulted in the US Federal Bank injecting a large amount of capital into financial markets. By September 2008, the crisis had worsened as stock markets around the globe crashed and became highly volatile. Consumer confidence hit rock bottom as everyone tightened their belts in fear of what could lie ahead.<sup>1</sup>*

The description of the Global Financial Crisis above is very accurate as it affected stock markets globally. The effects of the GFC, however, were not as harsh in the Philippines as the consumer-driven economy of the Philippines proved to be more resilient than many in the world, including some of its Asian neighbors.

As for JFC stock prices, while it started to decline and reached a negative growth for the first time in the 10-year period of study sometime April of 2008, it suddenly surged and continued to grow. In fact, it upended Ayala Land, Inc. during the global crisis, proving that “[i]n the Philippines, consumer-related companies rule the roost in good times and bad.”<sup>1</sup>

In fact, the GFC might have been an opportunity for JFC, as consumers were driven to find cheaper alternatives for their food choices. In one article, James Hookway noted that:

*Ordinary consumers say the same thing. "I used to go to Starbucks for coffee and maybe a pastry for breakfast," says Raymond Gomez, a clerical worker in Manila's financial district. "But now most days, I pop into Jollibee where I can eat breakfast for half the price or less."*<sup>1</sup>

In fact, this is not new for JFC, in 1983, with the Philippines in political turmoil, JFC took advantage and provided what the Filipinos wanted – a cheap alternative to international fast food restaurants which were coming into the Philippine Market at around this time. JFC was confident with their product and this sentiment reflected on JFC's stock prices. A snapshot of JFC stock prices compared to the PSEi was taken from the website of the Wall Street Journal and is presented in the graph.

Source: The Wall Street Journal website



## The Change in Leadership

Effective July 1, 2014, Ernesto Tanmantiong took over the Chief Executive Officer position at JFC, replacing Tony Tan Caktiong, the erstwhile founder of JFC. Mr. Tan Caktiong was at the helm of JFC for almost 40 years and was hailed to have “transformed Jollibee from an ice cream parlor into one of Asia’s largest food service companies”<sup>1</sup>, a JFC whose growth is unsurpassed in its industry. While there were many unconfirmed reports as to the reason behind the replacement, one thing is clear, JFC as a corporation was unmoved.

Based on the report on the website of the Wall Street Journal, stock prices of JFC remain on a steady rise as stock traders were unmoved by these news. Despite the resignation of their founding CEO, the sound financial fundamentals of JFC, as seen above, allowed JFC to hurdle this negative news. As may be seen from the graph, three months before the announcement, JFC's stock prices continue to perform better than the market, and continued even after Mr. Tanmantiong takeover in June 2014, or almost a year after the announcement.

Source: The Wall Street Journal website

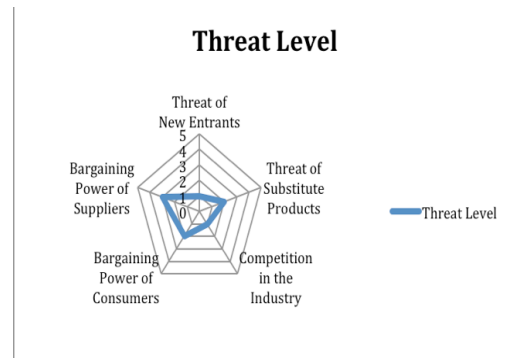


## JFC and Porter's Five Forces Analysis

To analyze JFC further, Porter's Five Forces Analysis was utilized, in particular, looking at the critical five threats to JFC:

1. Competitive rivalry or competition (weak)
2. Bargaining power of buyers or customers (moderate)
3. Bargaining power of suppliers (strong)
4. Threat of substitutes or substitution (moderate)
5. Threat of new entrants or new entry (weak)

Based on the group's analysis, it is clear that there may be a new trend for JFC in the future.



### Threat from Competitors

As may have been seen from the previous discussion, JFC has 55% of the market share of the local quick service restaurant market, severely overshadowing JFC's closest rival, McDonald's, with a market share of 20%. The other 25% is distributed amongst more than 30 other quick-service chains. JFC has far reaches from Aparri to Jolo, with almost 2500 stores. JFC has increased market share not only by expanding its Jollibee Stores, but buying out existing fast food chains such as: (i) Greenwich, (ii) Chowking, (iii) Red Ribbon, (iv) Mang Inasal, (v) Burger King, (vi) Yonghe King, (vii) Hong Zhuan Yuan, (viii) San Ping Wang, (xi) SuperFoods, (x) 12 Hotpot, (xi) Jinja – and soon Smashburger.

### Threat from substitute products

There is a new trend coming worldwide, a trend to Health and Wellness. In the Philippines, alone, there is an emergence of a new healthy lifestyle outlook.

This is a serious threat to JFC's growth as customers now are looking for healthy alternatives and consider fast food, JFC included, as junk food. In the Philippines, there are now fast food restaurants like Juju Eats and Salad to Go providing healthy fast food alternatives. Presently, however, these restaurants are limited to the Metro areas of the Philippines (e.g. Metro Cebu, Metro Davao and Metro Manila). This healthy trend is more obvious internationally as Government Health Institutions are now showing concerns on the ill effects of fast food restaurants.

Considering the market strategy of JFC, it may choose not to include healthy alternatives in their menu. However, it may not be farfetched to conceive JFC acquiring a health-oriented quick service restaurant in the near future.

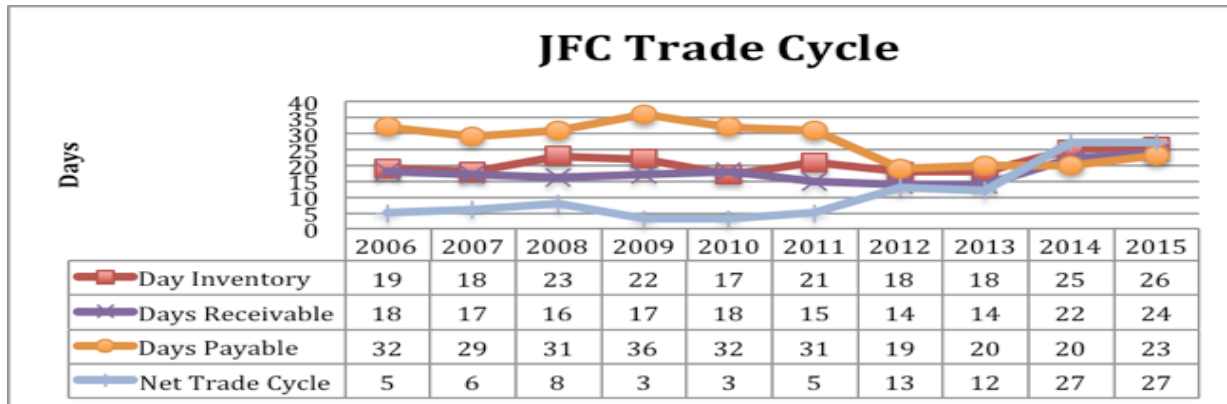
### Threat from New Entrants

Locally, there may be new entrants that could prove to be a threat to JFC, but their impact may not be felt in the near future. The latest significant entrant to the fast-food market was Chic-Boy in 2011. There were talks that JFC was attempting to buy Chic-Boy but the talks fizzled, along with Chic-Boy. This is what JFC does to entrants --- buy them or stomp them out.

Any new entrant to the Philippine Market, whether local or international franchise, will have a difficult time as JFC, the market leader, an almost insurmountable advantage over them. New entrants, therefore, should stay clear from JFC's niche.

## Bargaining Power of Suppliers

JFC's control over its suppliers is waning. In the ten-year study period, JFC's Net Trade Cycle or Cash Conversion Cycle had increased from 5 days in 2006 to 27 days in 2015. This is a serious threat to JFC as this will have big impact on its future margins and revenues.



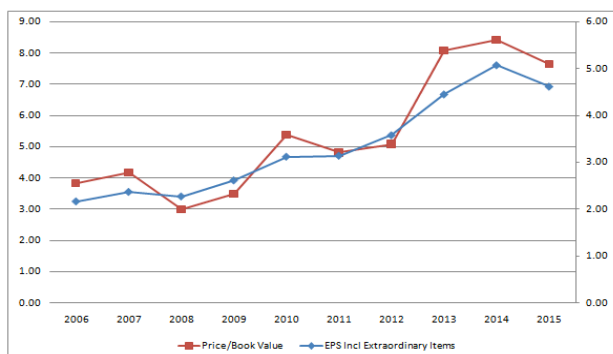
## Bargaining Power of Customers

For JFC, customers are no. 1. Its operations adapt to customers wants. As shown earlier, JFC maintains a small to reasonable Net Profit Margin, ensuring that prices are cheap without compromising quality. JFC has also shown that its flavors adapt to what the customers demand. JFC creates new items that would suit the customers' taste. Thus, it is not uncommon to see the JFC menu differ from one region to another.

## Conclusion

The decision to buy Jollibee was supposed to be a no-brainer decision. However, as may have been seen from the financial analysis above, the decision has become more difficult as result of the following factors:

## Market Analysis



### Market is Continuing to Overvalue JFC

JFC's price to book ratio has steadily increased from 3.84 in 2006 to 7.64 in 2015. This steady increase is attributed to the continued increase in share prices but slow decline in its EPS Ratio. Obviously, the market is overvaluing JFC share prices based simply on JFC's continued projected growth.

In fact, CapitalCube's (the Wall Street Journal website data provider) analysts' position is that the median implied price of JFC is 187.14 while the range is between 171.81 to 202.46. Simply put, the market is overpricing JFC by almost 25%.

### JFC and the Quick Service Restaurant Industry

JFC is heavily invested in the quick service restaurant industry, a very profitable business – in gross revenue. However, because quick service restaurants cater to the low-income to the middle-income bracket of the population, pricing strategies are critical. In fact, because of these pricing strategies, quick service restaurants are expected to have very small margins and median returns only.

Considering, JFC has not diversified and continued to invest mostly on related industries, net profit margins continue to be low even while its revenues rapidly increase.

### JFCs Stock Performance

A critical indicator for stock performance is returns. Based on data discussed above, JFC returns have started to decline in 2014.

### **JFC: a Mature Company**

On the other hand, while growth of JFC is probably in the decline, its fundamentals are stable.

### Quality of Earnings

JFC's fundamentals are intact.

First, revenues continue to rise for JFC. From 2006 to 2015, JFC's revenue rose by 197%. As can be seen in figures above, JFC's growth is, on the average, around 12%.

Second, JFC's Operating Cash flow for 2015 is at Php13.3B, an increase of more than 4 times its Cash Flow in 2014. JFC is certainly awash with cash. In fact, JFC's Cash and Cash Equivalents in 2015 amounted to more than Php11.5B, an increase of 51% from 2014, which was at P7.5B.

Obviously, JFC can finance its operations and investments without the need for borrowing funds. JFC, however, continues to borrow, long-term, as may be seen from above data, where Long-Term Debt to Total Stockholder's Equity continues to increase. Not surprisingly, JFC's Cash and Cash Equivalents is more than its Total Long Term Debt from 2006-2015.

Third, JFC's core income continues to increase from 2006 to 2015.

### Management

JFC's management has proven their mettle in times of crisis. In fact, as presented earlier, two major events have tested JFC and its performance. As discussed, JFC and its Management survived the 2007-2008 Global Financial Crisis and the Change in Leadership in 2013 with flying colors, as JFC continued its revenue growth and market leadership.

## **A Buy Recommendation**

In fine, while JFC stocks continue to be over-valued by the Market, this over valuation is not without bases. The market is continues to be confident of JFC's performance in the future with its very sound financial fundamentals.

Thus, the group, while having some reservations, recommends a BUY of JFC shares, but with a caveat that small to moderate returns should only be expected.