

## SHAKEY'S PIZZA VENTURES, INC:

**Dominant leader of the local pizza market**

**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 32.2% in 2015. After first opening its doors in the Philippines in 1975, Shakey's now has a total of 177 restaurants nationwide, 71 of which are franchised stores.

**IPO details.** PIZZA plans to raise a total of Php1.1Bil (net of fees) through its ongoing initial public offer or IPO. PIZZA plans to use bulk of the proceeds to pay down its Php5.0Bil outstanding long term debt, and to fund the expansion of its commissary (which is already operating at full capacity) and the relocation of its corporate headquarters. PIZZA will sell a total of 351.9Mil shares at Php11.26/sh, broken down into 104Mil primary shares and 202Mil secondary shares, with an over-allotment option of up to 45.9Mil secondary shares. Following the IPO, the Po family through CPG will remain the biggest shareholder in PIZZA with a 52.0% stake, followed by Arran Investment with a 18.5% stake. Meanwhile, the public will own 23.0% of the company.

**Exciting industry growth prospects.** As the chained full-service pizza restaurant industry grew the fastest and is expected to continue its momentum in the next five years, PIZZA plans to capitalize on this by expanding its store network and boosting its same store sales growth (SSSG) by improving its sales channels, introducing new products and implementing better marketing initiatives. For example, PIZZA is looking to expand outside NCR in the medium term due to the lack of presence of its stores in these areas, as well as the robust growth of average family expenditures outside NCR.

**Strong track record.** From 2013 to 2015, PIZZA's profits have increased by a CAGR of 14.3%. This was driven by the 12.4% CAGR of revenues as the company expanded its store network from 140 in 2013 to 167 in 2015, and as it consistently generated positive same store sales growth. It also boosted sales through its loyalty rewards program (the Shakey's Supercard) and by using other sales channels (delivery through its hotline or online platform, take-aways). Margins have likewise improved. From 22.0% in 2013, gross margin has increased to 22.8% in 2015, while operating margin has improved from 10.9% in 2013 to 11.7% in 2015.

**Priced at a premium compared to its peers.** At its IPO price of Php11.26/sh, PIZZA will be trading at 27.2X 16E P/E based on an annualized 2016 core profits (two times the actual 1H16 profits minus the Php252.8Mil one-time gain and accounting for the interest expense to be incurred this year). This is at premium compared to the 24.9X median 16E P/E of the consumer sector.

**FORECAST SUMMARY:**

in PhpMil	2013	2014	2015
<b>Revenues</b>	<b>4,154.3</b>	<b>4,696.5</b>	<b>5,244.3</b>
% change y/y	-	13.1	11.7
<b>Gross Profit</b>	<b>913.5</b>	<b>1,058.0</b>	<b>1,196.0</b>
% change y/y	-	15.8	13.0
Gross Margin (%)	22.0	22.5	22.8
<b>Operating Income</b>	<b>452.7</b>	<b>530.5</b>	<b>613.4</b>
% change y/y	-	17.2	15.6
Operating Margin (%)	10.9	11.3	11.7
<b>Net Income</b>	<b>367.2</b>	<b>429.2</b>	<b>479.6</b>
% change y/y	-	16.9	11.7
Net Margin (%)	8.8	9.1	9.1
<b>EPS</b>	<b>0.24</b>	<b>0.28</b>	<b>0.31</b>
% change y/y	-	16.9	11.7
<b>RELATIVE VALUE</b>			
<b>P/E(X)</b>	<b>47.0</b>	<b>40.2</b>	<b>36.0</b>
<b>P/BV(X)</b>	<b>18.0</b>	<b>13.6</b>	<b>10.9</b>
<b>ROE(%)</b>	<b>38.3</b>	<b>33.9</b>	<b>30.4</b>

source: PIZZA



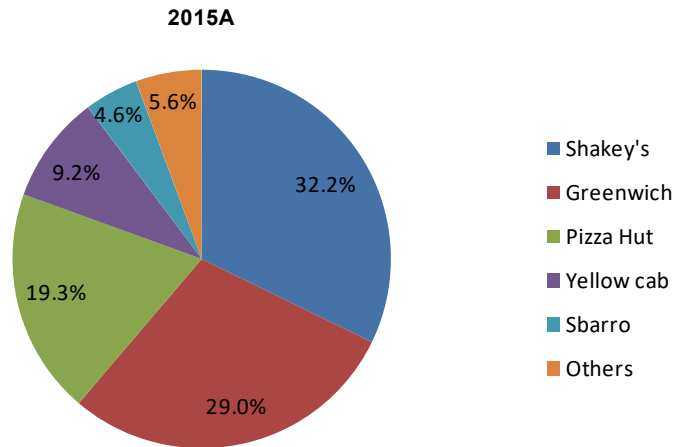
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**Company Description:**

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**Exhibit 1: Chained pizza restaurants market share**



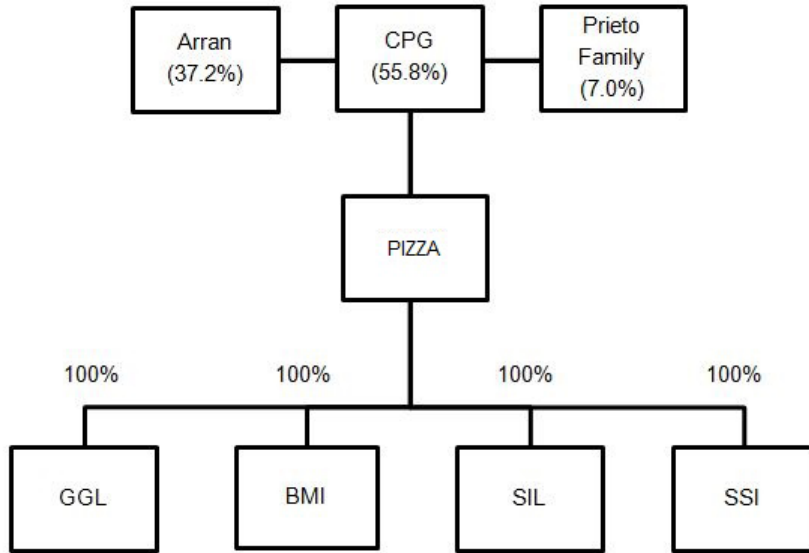
Source: Euromonitor

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, New Zealand, 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.

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PIZZA's current ownership structure is as follows:



Source: PIZZA

IPO details: PIZZA plans to raise a total of Php1.1Bil (net of fees) through its ongoing initial public offer or IPO. PIZZA plans to use bulk of the proceeds to pay down its Php5.0Bil outstanding long term debt, and to fund the expansion of its commissary (which is already operating at full capacity) and the relocation of its corporate headquarters. PIZZA will sell a total of 351.9Mil shares at Php11.26/sh, broken down into 104Mil primary shares and 202Mil secondary shares, with an over-allotment option of up to 45.9Mil secondary shares. Following the IPO, the Po family through CPG will remain the biggest shareholder in PIZZA with a 52.0% stake, followed by Arran Investment with a 18.5% stake. Meanwhile, the public will own 23.0% of the company.

The public offering will last from December 2 (9:00 am) to December 8 (12:00 pm), while SPAVI is scheduled to list at the Philippine Stock Exchange on December 15 with the ticker PIZZA.

**Exhibit 2: IPO details**

Stock Symbol	PIZZA
Offer Price	Php11.26/sh
Total share on offer (in Mil)	351.9
Primary	104.0
Secondary	202.0
Over-allotment	45.9
Gross proceeds to be raised (in Mil)	Php1,171.0
Issued and outstanding shares after offer (in Mil)	1,531.3
Market capitalization after offering (in Mil)	Php17,242.7
Estimated public float post-IPO	23.0%
Offer date	2-Dec-16 to 8-Dec-16
Tentative listing date	15-Dec-16

Source: PIZZA

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**Exhibit 3: Ownership structure**

in Mil	Pre-IPO		Post-IPO	
	Number of Shares	% of Outstanding	Number of Shares	% of Outstanding
CPG	796.4	55.8%	796.4	52.0%
Arran	531.0	37.2%	283.1	18.5%
Prieto	99.9	7.0%	99.9	6.5%
Public	-	-	351.9	23.0%
<b>Total</b>	<b>1,427.3</b>	<b>100.0%</b>	<b>1,531.3</b>	<b>100.0%</b>

Source: PIZZA

**Exhibit 4: Use of proceeds**

in PhpMil		% of total	Estimated Timing
Debt repayment	940.3	87.3%	
Capex for commissary expansion and relocation of corporate headquarters	137.0	12.7%	2017
<b>Estimated net proceeds</b>	<b>1,077.3</b>	<b>100%</b>	

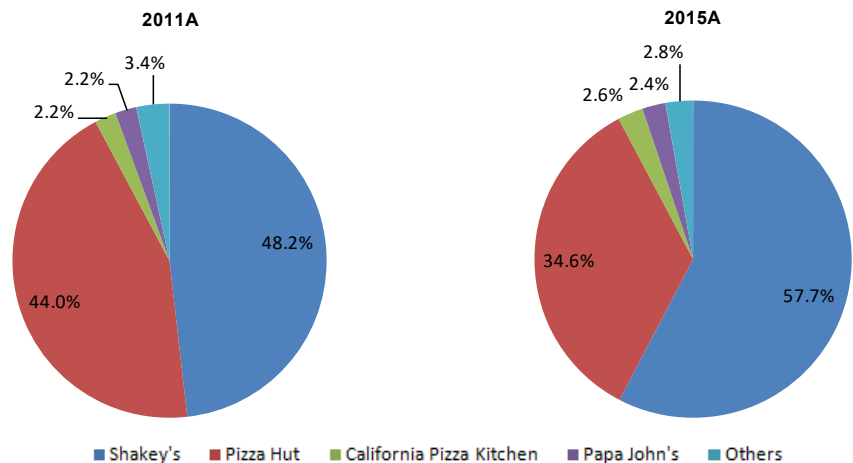
Source: PIZZA

**Key Investment Highlight**

**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 2015, Shakey's had a market share of 26.7% for the Php30.4Bil chained full-service restaurant industry and a dominant 57.7% market share of the Php14.1Bil pizza full-service restaurant industry according to Euromonitor. Shakey'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, showing the company's ability to succeed despite intensifying competition.

**Exhibit 5: Chained Full-service pizza restaurants market share**



Source: Euromonitor

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### Exciting industry growth prospects

According to Euromonitor, the Philippine consumer foodservice sector, which is comprised of fast food and full-service restaurants among others, has grown from Php393.6Bil to Php502.2Bil at a compounded annual growth rate (CAGR) of 6.3% from 2011 to 2015. Going forward, it is expected to grow at a CAGR of 7.8% to Php732.7Bil from 2015 to 2020E. Among the fastest growing category in the foodservice sector is the chained full-service restaurant category which grew at a CAGR of 14.3% from 2011 to 2015. This industry continued to reap the benefits of growing average family income, continuous urbanization, young population, and increasing OFW remittances. The chained full-service restaurant category is expected to maintain its momentum, expanding at a CAGR of 13.5% from 2015 to 2020 to Php57.2Bil by 2020E.

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.

#### Exhibit 6: Industry CAGR

	2010A - 2015A	2015A - 2020E
Overall full-service restaurants	4.0%	3.6%
<b>Chained full-service pizza</b>	<b>21.7%</b>	<b>14.0%</b>
Independent full-service pizza	4.3%	1.8%

Source: Euromonitor

#### Exhibit 7: Industry market share

in PhpMil	2015A		2020E	
	Value	% of total	Value	% of total
Overall full-service restaurants	121,116.8	-	144,872.9	-
<b>Chained full-service pizza</b>	<b>14,087.3</b>	<b>11.6</b>	<b>27,117.5</b>	<b>18.7</b>
Independent full-service pizza	719.6	0.6	785.2	0.5

Source: Euromonitor

PIZZA plans to capitalize on the industry's attractive growth prospects by expanding its store network and boosting its same store sales growth (SSSG) by improving its sales channels, introducing new products and implementing better marketing initiatives.

For example, PIZZA is looking to expand outside NCR in the medium term due to the lack of presence of its stores in these areas, as well as the robust growth of average family expenditures outside NCR. As of end June 2016, 48.6% (86 stores) of its system-wide stores were located in the NCR, 37.9% (67 stores) were located in Luzon excluding NCR, while only 9.0% (16 stores) were located in Visayas and 4.5% (8 stores) were located in Mindanao. The company is targeting to add another 3 stores for the rest of 2016 and 24 stores for the whole of 2017 so that it will have a total of 204 system-wide stores by the end of 2017.

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Expansion outside the Philippines remains a possibility in the medium to long term as PIZZA through one of its subsidiaries owns the right to use the trademark of the Shakey's brand in Asia (excluding Japan and Malaysia), Middle East, New Zealand, and Australia.

### Strong track record

From 2013 to 2015, PIZZA's profits have increased by a CAGR of 14.3%. This was driven by the 12.4% CAGR of revenues as the company expanded its store network from 140 in 2013 to 167 in 2015, and as it consistently generated positive same store sales growth. It also boosted sales through its loyalty rewards program (the Shakey's Supercard) and by using other sales channels (delivery through its hotline or online platform, take-aways). According to Shakey's, 40.1% of sales were generated outside of the dine-in channel. Margins have likewise improved. From 22.0% in 2013, gross margin has increased to 22.8% in 2015, while operating margin has improved from 10.9% in 2013 to 11.7% in 2015.

#### Exhibit 8: 2013A-2015A results summary

in PhpMil	2013A	2014A	% change	2015A	% change
<b>Revenues</b>	4,154.3	4,696.5	13.1	5,244.3	11.7
<b>Gross profit</b>	913.5	1,058.0	15.8	1,196.0	13.0
Gross margin (%)	22.0	22.5	-	22.8	-
<b>Operating income</b>	452.7	530.5	17.2	613.4	15.6
Operating margin (%)	10.9	11.3	-	11.7	-
<b>EBITDA</b>	640.0	739.1	15.5	863.7	16.9
EBITDA margin	15.4	15.7	-	16.5	-
<b>Net income</b>	367.2	429.2	16.9	479.6	11.7
Net margin (%)	8.8	9.1	-	9.1	-
<b>SSSG (%)</b>	7.6	7.6	-	3.9	-
<b>Store network</b>	140	153	-	167	-

Source: PIZZA

#### Exhibit 9: 1H16 sales channel mix

in PhpMil	1H16 Net Sales	% of total
Dine-in	1,623.2	59.9%
Delivery	696.4	25.7%
Others (take-out, etc.)	390.2	14.4%
<b>Total</b>	<b>2,709.9</b>	<b>100.0%</b>

Source: PIZZA

First half 2016 results were also strong as revenues grew 14.1% y/y to Php2.8Bil while recurring profits as measured by EBITDA jumped by 46.6% to Php565.7Mil. EBITDA increased significantly relative to revenues as PIZZA benefited from lower prices of raw materials. Net profits increased by a much faster pace of 71.8% to Php365.2 Mil as PIZZA lengthened the useful life of its assets, reducing depreciation expenses by Php66.4Mil.

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**Exhibit 10: 1H15, 1H16 results summary**

in PhpMil	1H15	1H16	% change
<b>Revenues</b>	2,456.5	2,783.7	13.3
<b>Gross profit</b>	589.2	806.6	36.9
Gross margin (%)	24.0	29.0	-
<b>Operating income</b>	255.3	447.2	75.2
Operating margin (%)	10.4	16.1	-
<b>EBITDA</b>	385.8	565.7	46.6
EBITDA margin	15.7	20.3	-
<b>Net income</b>	212.6	365.2	71.8
Net margin (%)	8.7	13.1	-
<b>SSSG (%)</b>	3.9	3.9	-
<b>Store network</b>	159	177	-

Source: PIZZA

PIZZA also has a strong operating cash flow. Cash flow from operations reached Php624.3Mil, Php519.8Mil and Php457.5Mil in 2013, 2014 and 2015, respectively, allowing the company to fund its historical capex using internally generated cash and without having to rely on debts.

**Consolidation of subsidiaries to pull down profits**

PIZZA provided a pro-forma income statement for 2015 and 1H16 showing how the consolidation of BMI, GGL and SIL into PIZZA affected profitability. For both 2015 and 1H16, revenues grew by only 0.7% as commissary BMI allocates 90% of its sales to Shakey's. On the other hand, consolidated net income fell by 13.5% in 2015 largely due to the consolidation of GGL and SIL which resulted to an additional Php78.5Mil of amortization costs from intangible assets.

Although the consolidation of BMI, GGL and SIL into PIZZA resulted to a significant increase in pro-forma profits during 1H16, this was largely due to the booking of Php252.5 Mil worth of non-recurring income from the write off of advances from previous stockholders. Excluding the said amount, 1H16 pro-forma profits were lower by 4.0% y/y.

**Exhibit 11: Pre-consolidation and post-consolidation financials**

in PhpMil	2015A			1H16		
	Pre-conso	Post-conso	% change	Pre-conso	Post-conso	% change
<b>Revenues</b>	5,244.3	5,282.3	0.7	2,783.7	2,804.3	0.7
<b>Gross profit</b>	1,196.0	1,187.0	-0.8	806.6	809.2	0.3
Gross margin (%)	22.8	22.5	-	29.0	28.9	-
<b>Operating income</b>	613.4	580.5	-5.4	447.2	443.5	-0.8
Operating margin (%)	11.7	11.0	-	16.1	15.8	-
<b>Net income</b>	479.6	414.7	-13.5	365.2	603.0	65.1
Net margin (%)	9.1	7.9	-	13.1	21.5	-

Source: PIZZA

**Higher debt levels to push up interest expenses**

CPG and Arran Investment employed a leverage buyout to partly finance the acquisition of PIZZA earlier this year. This is the reason why PIZZA now has Php5.0Bil worth of long term debts in its books (from none previously). The cost of the said debt is 4.5%, to be repriced on June 20, 2021 at a floor of 4.5% or 5Y PDST-R2 plus 75 bps, whichever is higher. Consequently, we estimate PIZZA to book interest expenses amounting to Php131Mil this year and Php182Mil next year, dragging earnings growth.

On the positive side, PIZZA will not be hurt by an increase in interest rates in the next five years as it was able to fix the rate of the loan until 2021. Moreover, the loan is a 10-year loan and the amortization schedule is very light, with PIZZA only required to pay-off Php25.0 Mil every six months, and the final payment of Php4.55Bil at the end of the 10th year. PIZZA also plans to immediately pay down Php940.3 Mil of its loans using the proceeds of the IPO, which should reduce its leverage position. Given PIZZA's strong operating cash flow, we believe that it is capable of slowly paying down its loans within the available time frame.

**Priced at a premium compared to its peers**

At its IPO price of Php11.26/sh, PIZZA will be trading at 27.2X 16E P/E based on an annualized 2016 core profits (two times the actual 1H16 profits minus the Php252.8Mil one-time gain and accounting for the interest expense to be incurred this year). This is at slight premium compared to the 24.9X median 16E P/E of the consumer sector.

**Exhibit 12: Relative valuation**

	<b>16E P/E (X)</b>
CNPF	21.5
DNL	30.5
EMP	16.0
JFC	36.6
PGOLD	19.9
RRHI	27.3
URC*	24.9
<b>Median ex-PIZZA</b>	<b>24.9</b>
<b>PIZZA</b>	<b>27.2</b>

\* actual results FY ending Sept. 30

Source: PIZZA, COL Estimates

**Risks**

**Rising raw material costs.** After falling significantly earlier this year, prices of soft commodities (such as cheese and beef) are now recovering. This could hurt the margins of PIZZA.

**Regulatory risks.** The Duterte administration bared plans to impose excise taxes on sugary drinks. It also bared plans to end the use of contractual labor. These developments would lead to higher costs for PIZZA and potentially hurt margins.

However, PIZZA is in a better position to pass on higher costs as it targets the A, B, and upper C market which are less sensitive to price adjustments.

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## Important Rating Definitions

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### 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 to 12 months.

## Important Disclaimer

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