OCBC Bank

Issuer Profile:
Neutral (5)

Jollibee Foods Corp ("JFC")

Ticker:
JFCPM

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Issuer Profile:	Bond Recommendation:	
Neutral (5)	JFCPM 4.125% '26	OW
	JFCPM 4.75% '30	OW
	JFCPM 3.9% PERP	OW

Fundamental Analysis Consideration
- Time-tested food service market leader in the Philippines
- Pressure on earnings from COVID-19
- Weak credit metrics partly mitigated by liquidity buffer

Technical Analysis Consideration
- Visible retail presence and household name
- Lack of credit rating
- Decent yield amidst low interest rate environment
- Headwinds from COVID-19

Summary

- **Fast food champion in the Philippines:** Better known for its flagship brand Jollibee, Jollibee Foods Corp ("JFC") is a Filipino food service and restaurant company with a market cap of PHP171bn (USD3.5bn) and 5,874 stores worldwide (3,286 stores in Philippines, 2,588 stores abroad). Through a number of acquisitions, JFC has grown to become a multinational company and owns and/or operates brands including Smashburger, Coffee Bean and Tea Leaf ("CBTL"), Chowking, Greenwich, Red Ribbon, Mang Inasal, Tim Ho Wan. JFC is a time-tested market leader in the Philippines with over 50% market share in the food service industry and commands a leading market share position in the quick service restaurant segment.
- **Sales weighed down by COVID-19:** Revenue fell 46.6% y/y to PHP23.3bn in 2Q2020 as JFC faced restaurant closures worldwide including the Philippines, China, North America and EMEAA. Despite reopening most of the stores (88% were open) by June 2020, same store sales were impacted, particularly in the Philippines, due to ongoing restrictions which dissuaded customers from visiting JFC's stores.
- **Repositioning to weather the downturn:** JFC has reduced its planned capex for 2020 to ~PHP5bn from ~PHP14bn. Separately, PHP7bn in provisions has been earmarked for its Business Transformation plan. This include pre-termination of leases from closure of unprofitable stores (203 stores have been closed in 1H2020 worldwide, more closures likely to follow especially in North America) and separation packages for affected employees.
- **Targeting to return to profitability:** JFC forecasts that reported EBITDA would turn positive by 4Q2020 and targeting revenue and profit in 2021 to recover closer to 2019 levels. We think the plan may be fluid given that events around COVID-19 are still evolving. That said, we think profitability should eventually return given the time-tested brand loyalty to JFC's core brands (e.g. Jollibee, Chowking, Greenwich, Red Ribbon, Mang Inasal) and the focus on expense reduction. In particular, JFC is targeting to turnaround Smashburger and CBTL. Increasingly, JFC is relying on franchised stores to grow. While franchisee revenues is also subject to franchisee's net sales (which is similarly impacted by COVID-19), franchising is a high margin asset light business which provides a higher certainty to deliver profitability.
- **Deterioration of credit metrics partly mitigated by liquidity buffer:** JFC entered 2020 with a weakened hand following significant capital outlays to acquire CBTL (PHP17.2bn) in 2019 and Smashburger (PHP5.7bn) resulting in net debt-to-EBITDA rising y/y to 3.6x (2018: 2.1x). In 1H2020, adjusted net gearing (accounting senior perps as debt) surged to 2.1x h/h (2019: 1.4x) given rise in net debt, driven by PHP7.6bn net cash outflows from operating and investing activities and PHP12.6bn net loss impacted by provisions from Business Transformation. We think JFC may continue to acquire, given the recent increase in stake in Tim Ho Wan. That said, USD1.2bn of bonds and perpetuals raised in 1H2020 helped topped up JFC's cash balance to PHP57.9bn. This should allow JFC to cover its debt obligations (~PHP3bn-PHP5bn debt maturing each year between) 2021 and 2024 and cashflow needs (1H2020 cash outflows from operating activities and investing activities, excluding working capital changes was PHP1.1bn).

Company Background

Listed on the Philippine Stock Exchange in 1993, JFC is a Filipino food service and restaurant company with a market capitalisation of PHP171bn (USD3.5bn) as of 19 Oct 2020. Better known for its flagship fast food brand Jollibee, JFC has through acquisitions of numerous brands and organic growth grown to become a multinational company with 5,874 owned and franchised stores globally (3,286 stores in Philippines, 2,588 stores abroad) as of 30 June 2020. JFC believes it is the largest food service and restaurant company in the Philippines and amongst the largest in Asia in terms of sales and store network.

Aside from the Jollibee brand (1,475 stores), JFC owns and/or operates brands including Smashburger (293), Coffee Bean and Tea Leaf (1,106), Burger King (106), Chowking (654), Greenwich (271), Red Ribbon (526), Mang Inasal (606), Yonghe King (344), Highlands Coffee (411), PHO24 (41), Hong Zhuang Yuan (33), Dunkin' Donuts (5), Hard Rock Café (2), Panda Express (1).

Jollibee

Called out as "the McDonald's of the Philippines" by CNBC, Jollibee is a fast food restaurant (or quick service restaurant) serving set meals including Chickenjoy, Yumburger, Jolly Hotdog, Jolly Spaghetti and other dishes. According to JFC, Jollibee (Philippines) accounted for ~40% of JFC's consolidated system-wide sales (comprising company operated and franchise stores).

While the outbreak of COVID-19 has invariably impacted sales, Jollibee (and also JFC as a whole) has stepped up on serving customers via drive-thru, delivery business channels / online channels to mitigate loss of sales from closure of stores.

Despite facing competition (e.g. McDonald's and KFC), JFC believes that Jollibee has the largest market share in the chicken and burger segment in the Philippines. We think a differentiating factor is Jollibee's offering which is angled towards the local Filipino consumer. Customer loyalty is evidenced by strong support from migrant Filipinos abroad with large turnouts for Jollibee's overseas store openings.

As of 31 Mar 2020, there were 1,200 Jollibee stores in the Philippines, of which 510 were owned and operated while 690 were franchised. Jollibee had 270 stores abroad, of which 191 were owned and operated while 79 were franchised. Amongst stores abroad, we estimate about half are in Vietnam, 16% are in United States while the remainder are largely in Brunei, Hong Kong, Singapore, Saudi Arabia, UAE, Canada, Qatar and Kuwait.

Jollibee was founded in 1975 (incorporated in 1978) by Mr. Tony Tan Caktiong and his family though the venture actually begun as an ice cream parlour. This was converted to fast food outlets when hot meals and sandwiches attracted more demand than ice cream, which subsequently saw Jollibee expand rapidly through Philippines. It was not until 1994 when JFC acquired its first brand, Greenwich.

Greenwich

Greenwich offers pizzas and pastas which are catered for Filipinos.

Source: Company

As of 31 Mar 2020, Greenwich had 283 stores in Philippines, of which 162 were owned and operated while the rest were franchised. As of 31 Mar 2020, Greenwich is the leader in the pizza and pasta segment in the Philippines with a store network market share of 31%. JFC first acquired 80% of Greenwich in 1994 and in 2006 bought out the remaining shares for PHP384mn (USD7.9mn).

Chowking

Chowking offers Chinese cuisine menu, such as fried rice, noodle soups, and dim sum but with a fast food service.

Source: Company

As of 31 Mar 2020, Chowking had 613 stores in the Philippines, of which 264 were owned and operated while the rest were franchised. Chowking also had 48 stores outsides of Philippines, of which 15 were owned and 33 were franchised. In the Philippines, JFC believes Chowking has 88% of the Chinese quick service restaurant market share. Chowking was wholly-acquired by JFC in 2000. In 2011, JFC took over a chain of 20 stores in the US from a master franchisee for PHP693.3mn (USD14.3mn).

Red Ribbon

Red Ribbon is a bakeshop offering cakes, pastries and bread.

Source: Company

As of 31 Mar 2020, Red Ribbon had 505 stores in the Philippines, of which 200 were owned and operated while the remainder were franchised. Red Ribbon also had 33 stores in the U.S. In the Philippines, JFC believes that Red Ribbon is the number two player with a 40% market share in the bakeshop segment. Goldilocks, competitor of Red Ribbon, claims to be the largest Filipino-owned bakeshop. Red Ribbon was wholly-acquired by JFC in 2005 for PHP1.7bn (~USD35.1mn).

Mang Inasal

Mang Inasal offers grilled food products (e.g. chicken, pork) as well as desserts.

Source: Company

As of 31 Mar 2020, Mang Inasal had 614 stores in the Philippines, of which 17 were owned and 597 were franchised. Mang Inasal is the leading grilled chicken player in the Philippines with 72% market share. JFC first acquired 70%-stake in Mang Inasal in 2010 for PHP3.0bn (~USD62.0mn) before acquiring the rest of the 30%-stake in 2016 for PHP2bn (~USD41.3mn).

Yonghe King

While Chowking is almost entirely in the Philippines, Yonghe King is entirely in China. Yonghe King is a Chinese fast food restaurant with products including tomato beef noodle soup, crispy tender chicken thigh, minced pork and soya milk.

Source: Company

As of 31 Mar 2020, Yonghe King had 344 stores in China, of which 272 were owned and operated while the remainder were franchised. JFC first acquired 85%-stake in Yonghe King for PHP1.2bn (USD24.8mn) before acquiring the remainder 15%-stake in 2007 for PHP413.7mn (USD8.6mn).

Hong Zhuang Yuan

Hong Zhuang Yuan is a full-service Chinese restaurant chain, specialising in congee and its bestsellers include eight treasures congee, century egg congee, spring onion pancake and beef pies.

As of 31 Mar 2020, Hong Zhuang Yuan, which is based in Beijing, owned and operated 42 stores in China. Hong Zhuang Yuan was acquired by JFC in 2008 for PHP2.6bn (~USD53mn).

SuperFoods Group (60%-stake)

Through SuperFoods Group, JFC operates Highlands Coffee, PHO24 and Hard Rock Café franchised stores.

Highlands Coffee offers Vietnamese coffee, other beverages and light meals in trendy coffee shops.

As of 31 Mar 2020, Highlands Coffee has 346 owned and 13 franchised cafés in Vietnam and 46 franchised cafés in Philippines. Highlands Coffee is a brand under SuperFoods Group, which is 60%-owned by JFC. PHO24 offers Vietnamese dishes, with 23 stores in Vietnam and 1 store in Philippines, which are owned and operated by SuperFoods. Hard Rock Café is a music-themed restaurant chain. SuperFoods Group owns and operates 2 Hard Rock Cafés in Vietnam.

JFC first bought 50% effective stake in SuperFoods Group in 2012 through a capital contribution of PHP1.08bn (~USD25mn), which was increased by another PHP34.1mn (USD0.7mn) in 2015. In 2017, JFC took control of SuperFoods Group after acquiring an additional 10%-stake for PHP2.7bn (~USD56mn), thereby increasing its stake to 60%. Meanwhile, Viet Thai International Joint Stock Co (the other shareholder of SuperFoods Group) pared stakes down to 40%. There were intentions to list SuperFoods though plans have been delayed.

Smashburger

Smashburger is a hamburger fast casual chain (a concept that combines fast food and casual dining), offering burgers, salads and other dishes. Smashburger angles its food as “fresh, never frozen”.

As of 31 Mar 2020, Smashburger has 298 stores globally, of which 275 were located in the USA. In the USA, 143 of the stores are franchised while the rest were owned and operated. JFC first acquired 40%-stake in Smashburger for PHP4.8bn (USD100mn) in 2015. In 2018, JFC acquired the final 60%-stake in 2018 for PHP5.7bn (~USD118mn).

The Coffee Bean & Tea Leaf (“CBTL”)

CBTL is a coffee and tea chain specialising in hand-roasted coffee beans and hand-blended teas, offering a variety of hot and cold drinks. CBTL also sells baked food, whole bean coffees, whole bean teas and flavoured powders.

As of 31 Mar 2020, CBTL has 1,165 stores worldwide in 28 countries, of which 159 were in the Philippines. JFC acquired 80%-interest in CBTL for PHP17.2bn (~USD354mn) in 2019, which is the most sizeable acquisition by JFC to date.

Directors and Management

Tony Tan Caktiong, Filipino, 67, is the Chairman of JFC. Mr Tony Tan is the founder of JFC and was its president and CEO from 1978 to 1 Jul 2014. Together with his family, Mr Tony Tan has effective control of JFC and can elect members of the Board of Directors and pass shareholder resolutions. Mr Tony Tan is a member of the Executive, Nomination and Corporate Governance Committees and Chairman of the Compensation Committee. Mr Tony Tan was awarded the Global Filipino Executive of the Year by CEO Asia Awards in 2013. Mr Tony Tan is also the co-chairman of DoubleDragon Properties Corp, which is a real estate company based in Philippines.

Ernesto Tanmantiong, Filipino 61, has been the president and CEO of JFC since 2014 and a member of JFC’s board of directors since 1987. Mr Tanmantiong is a member of the Executive and Nomination Committees. Mr Tanmantiong joined JFC as a store manager in 1978 and has been contributing to JFC through various roles including the role of COO. Mr Tanmantiong graduated with a Bachelor of Science degree in business management from Ateneo de Manila University in 1979.

William Tan Untiong, Filipino 66, has been the corporate secretary of JFC since 1994 and a board member since 1993. Mr William Tan is a member of the Executive, Nomination and Audit Committees. Mr William Tan graduated with a Bachelor of Science degree in civil engineering from Adamsom University in 1975. Mr William Tan is also a non-executive director of DoubleDragon Properties Corp.

Joseph C. Tanbuntiong, Filipino, 56, joined JFC in 1993, the board in 2013 and has been the Treasurer since 27 June 2014. Mr Tanbuntiong is a member of the Executive and Compensation Committees. Mr Tanbuntiong graduated with a Bachelor of Science degree in management engineering from Ateneo de Manila University in 1984.

Ang Cho Sit, Filipino, 69, has been on JFC's board since 1978. Mr Ang is a member of the Compensation Committee. Mr Ang graduated from Grace Christian Academy High School in 1968.

Antonio Chua Poe Eng, Filipino, 72, has been on JFC's board since 1978 and is a member of the Audit Committee. Mr Chua graduated from St Stephen High School in 1965.

Ret. Chief Justice Artemio V Panganiban, Filipino, 83, has been on JFC's board since 2012. Mr Panganiban was the Chief Justice of the Philippine Supreme Court from 2005 to 2006 and had been the Justice of the Supreme Court in 1995 to 2005. Mr Panganiban is a member of the Executive and Compensation Committees and is the Chairman of the Nomination Committee. Mr Panganiban also holds positions in a number of publicly listed companies, including as an independent director of Asian Terminals, Inc., First Philippine Holdings Corp, GMA Network Inc. Mr Panganiban graduated with an associate in Arts degree from Far Eastern University in 1956 and Bacehlor of Laws degree from Far Easter University in 1960.

Monico V Jacob, Filipino, 75, has been on JFC's board since 2000. Mr Jacob is an Independent Director and is a member of the Nomination and Corporate Governance Committees as well as the chairman of the Audit Committee. Mr Jacbo also holds positions in a number of publicly listed companies, including independent director of Lopez Holdings Corp, Phoenix Petroleum Philippines, Rockwell Land Corp. Mr Jacob graduated with Bachelor of Laws degree from Ateneo de Manila University in 1971.

Cezar P. Consing, Filipino, 60, has been an Independent Director of JFC since 2010. Mr Consing is the President and CEO of the Bank of the Philippine Islands and a Senior Managing Director of Ayala Corp. Mr Consing graduated with Masters of Arts degree in applied economics from University of Michigan, Ann Arbor in 1980.

Figure 1: Shareholding

Name / Entity	Shares	% of outstanding shares
Hyper Dynamic Corporation[1]	273,218,750	24.85
Honeysea Corporation[2]	127,743,747	11.62
Winall Holding Corporation[3]	54,140,736	4.93
Honeyworth Corporation[4]	34,409,433	3.11
Kingsworth Corporation[5]	29,168,935	2.63
Centregold Corporation[6]	27,430,964	2.48
Venice Corporation[7]	17,423,735	1.57
A-Star Holding Corporation[8]	17,160,393	1.55
Tony Tan Caktiong	9,594,565	0.88
Ernesto Tanmantiong	8,492,160	0.77
William Tan Untiong	8,603,055	0.78
Subtotal	607,386,473	55.17
Others	492,019,123	44.83
Total	**1,099,405,596**	**100.00**

Source: Bloomberg, Company

[1] Majority of shares owned or controlled by Mr Tony Tan and certain relatives

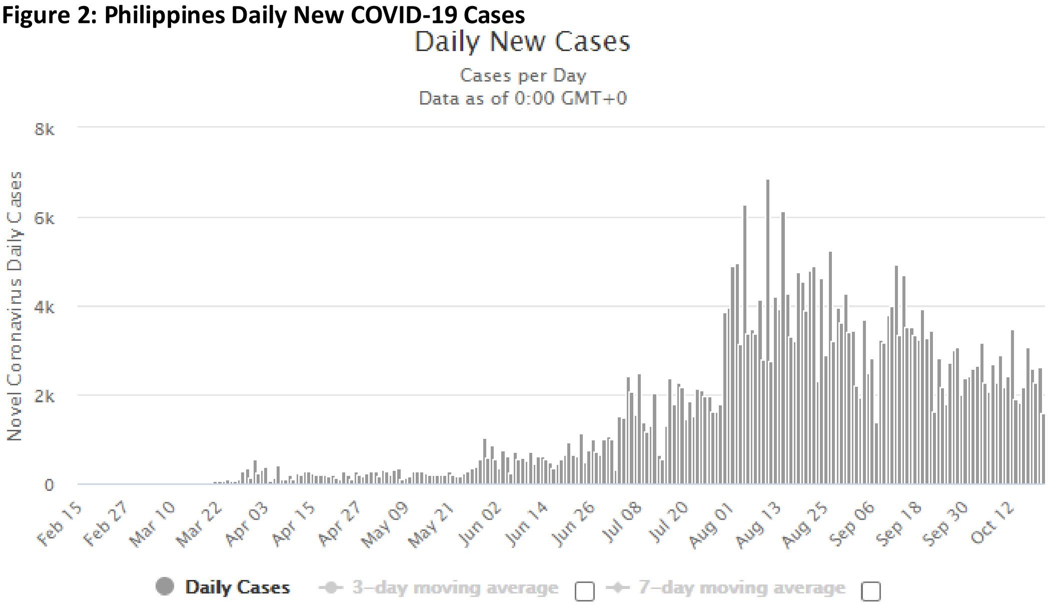
[2] Majority of shares owned or controlled by Mr Tony Tan and certain relatives

[3] Majority of shares owned or controlled by certain relatives of Mr Tony Tan
[4] Mr Chua is the chairman and president of Honeyworth Corporation
[5] Mr Tanmantiong and Mr William Tan are directors of Kingsworth Corporation
[6] Mr Tony Tan, William Tan and Tanmantiong are directors of Centregold Corporation
[7] Mr Ang is a director of Venice Corporation
8 Mr Ang is a director of A-Star Holding Corporation

Key Considerations

- **Significant impact from COVID-19 weighing on sales:** The outbreak of COVID-19 and the corresponding restrictions have dented systemwide sales[1] ("SWS"), which declined 48.4% y/y to PHP30.7bn in 2Q2020. Revenue (without consolidating franchisee's revenue) similarly declined 46.6% y/y to PHP23.3bn with a negative reported recurring EBITDA of PHP453.8mn. Store closure is one major factor dampening sales, with 50% of JFC's stores worldwide temporarily closed in April 2020. Philippines was particularly hard-hit with 70% of stores closed temporarily in Mar 2020. By June 2020, 88% of JFC's stores worldwide had reopened. However, same store sales remain impacted; June's figures were down 39% y/y, with Philippines impacted more (-48% y/y) than other regions including China (-25% y/y), North America (-9% y/y) and EMEAA (-22% y/y). JFC cited factors impacting the recovery of the domestic business which significantly impacted revenue from dine-in customers, including ongoing restrictions, such as the ongoing general community quarantines and re-imposition of the modified enhanced community quarantine in the national capital region. In addition, JFC finds that the lack of public transportation may have dissuaded customers from visiting JFC's stores. There was little to mitigate the free fall in economic activity due to the lack of safety nets (stimulus package, unemployment pay), as opposed to certain JFC's stores in North America which recorded positive same store sales growth since mid-Apr 2020, fuelled by stimulus package and unemployment pay. In 2Q2020, Philippines GDP shrank by 16.5% y/y and the Asian Development Bank expects Philippines GDP in 2020 to contract by 7.3% y/y. While daily new cases of COVID-19 infection have trended down from the peak in early August 2020, the timeline for the removal of restrictions remains to be seen given continued daily reports of new cases.

Figure 2: Philippines Daily New COVID-19 Cases



Source: worldometer

- **Steps undertaken to mitigate impact from COVID-19:** In 2Q2020, JFC sank into net loss of PHP10.2bn (2Q2019: net profit of PHP1.04bn) with operating loss of PHP5.3bn (2Q2019: operating profit of PHP1.5bn). Aside from the decline in sales, JFC was driven into further losses

[1] Including franchisee revenue

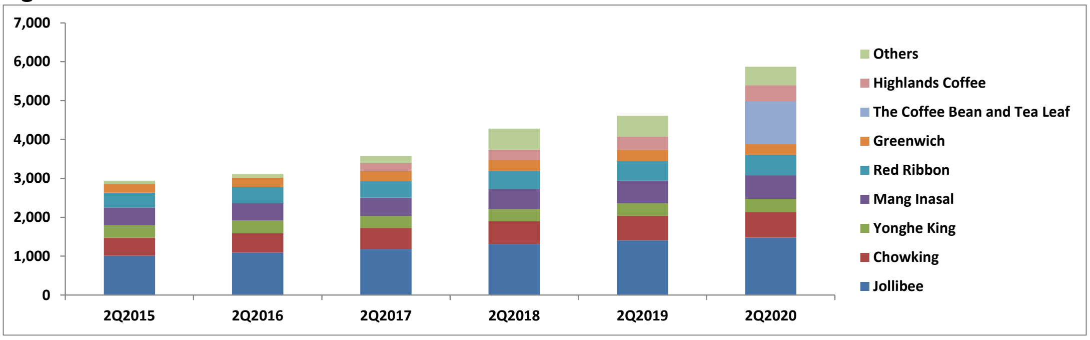
by booking PHP7.0bn in costs due to Business Transformation announced in May 2020 (without this, 2Q2020 net losses would have been narrower at PHP3.2bn). As of 30 June 2020, the remaining balance for the provision amounts to PHP6.24bn. According to JFC, a significant part of the Business Transformation cost is slated for used for pre-termination of leases of stores and separation packages for affected employees. As of 30 June 2020, JFC has closed 101 stores in North America (66 of these are due to CBTL, which has 1,106 stores worldwide remaining as of 30 June 2020). JFC is looking to close 50-60 Smashburger stores (293 remaining as of 30 June 2020) going forward, with JFC noting that a number of Smashburger stores are in poor locations. JFC has also intensified the focus on online delivery through arrangements with third-party platforms and delivery aggregators such as Deliveroo, Foodpanda, GrabFood, DoorDash, Uber Eats, GrubHub, Postmates, Lalafood, Meituan etc. This has partly mitigated the decline in sales, with JFC's online delivery business growing in most geographies including Philippines (+157%), the PRC (+16%), North America (+600%, with respect to JFC's owned Smashburger stores), Vietnam (+181%, with respect to Jollibee), Hong Kong (+105%) and Singapore (+588%) in Apr 2020. Singapore's online sales growth was large enough which resulted in the total same store sales to grow by 4%. While losses look likely to be narrowed, we think the timeline to return to profitability is less clear with uncertainties on the spread of COVID-19.

- **Would profitability return?:** JFC is forecasting that its financial performance in 3Q2020 and 4Q2020 will be stronger and estimate that reported EBITDA will turn positive by 4Q2020, though this is contingent on government restrictions not being re-imposed. JFC is also planning to open 338 stores worldwide (despite closures elsewhere), targeting revenue and profit in 2021 to recover closer to 2019 levels and grow 15% by 2022. In our view, the target on the timeline to return to profitability currently looks somewhat challenging given the depth of the net losses and potential resurgence of COVID-19. However, profitability should improve given the focus on expense reduction. Under plans for Business Transformation, 255 company-owned stores will be closed and 95 stores will see a transfer in ownership from company to franchisees. These have a target cash payback of 2 years. JFC cited systemwide sales improvements for stores in China and North America though recovery in Philippines may take longer given the re-imposition of the modified enhanced community quarantine. In particular, JFC is targeting to turn Smashburger and CBTL profitable by 2021. We note that both entities have been loss-making, which was the primary driver in driving 2019's profitability lower by 15.9% y/y to PHP6.4bn. While the magnitude of losses of Smashburger is not given, net loss incurred by CBTL in 2019 was PHP153.5mn (net loss would be PHP1.6bn were CBTL acquired at the start of 2019). JFC is looking to cut general and administrative expenses though the plan to sell underperforming CBTL stores to franchisees is hampered due to COVID-19 while CBTL stores that do not turn profitable will be closed. For Smashburger, delivery sales have more than tripled to contribute more than 30% of total sales – ironically, the poor store locations gave Smashburger a more even playing field for online delivery. That said, aside from cutting of costs, it remains to be seen if revenues at CBTL and Smashburger could be restored to pre-COVID-19 levels. However, we believe that profitability of JFC should return when COVID-19 blows over given the dominance of several brands such as Jollibee, which is time-tested.

- **Time-tested market leader in Philippines with strong brand identity amongst Filipinos:** JFC's brands command market leading position in the Philippines with over 50% market share in the food service industry. JFC's largest brands include Jollibee (30% market share in the quick service restaurant segment or 51% in the chicken-burger segment), Chowking (88% in the Chinese quick service restaurant segment), Greenwich (31% in the pizza and pasta segment), Red Ribbon (40% in the bakeshop segment), Mang Inasal (72% in the grilled chicken segment), with market share data according to JFC. In particular, Jollibee is JFC's flagship brand which has been growing in the past ~40 years. Despite facing competition, Jollibee stays ahead of rivals, including McDonald's (which entered Philippines in 1980s) through "the taste of its food products and value for money product offerings", according to JFC. Jollibee's products are relatively sweeter and cater towards the household and family. Well-regarded in the Philippines, Jollibee's following amongst Filipinos is strong, evidenced by large turnouts by Filipinos when new stores open abroad.

- **Beyond Jollibee:** With the addition of CBTL (2Q2020: 1,106 stores) in 2H2019, this has boosted JFC's total stores to 5,874 outlets generating systemwide sales ("SWS") which includes franchise revenue of PHP30.7bn and revenue of PHP23.3bn. While Jollibee (1,475 stores) is still a very important contributor, its proportion of contribution to SWS as of 2019 is ~40% while Chowking (654 stores), Yonghe King (344 stores) and Hong Zhuang Yuan (33 stores) collectively account for ~20% systemwide sales. Except FY2020, continuous same store sales growth has been recorded in recent years in 2016 (7.1%), 2017 (6.1%), 2018 (6.2%) and 2019 (2.8%).

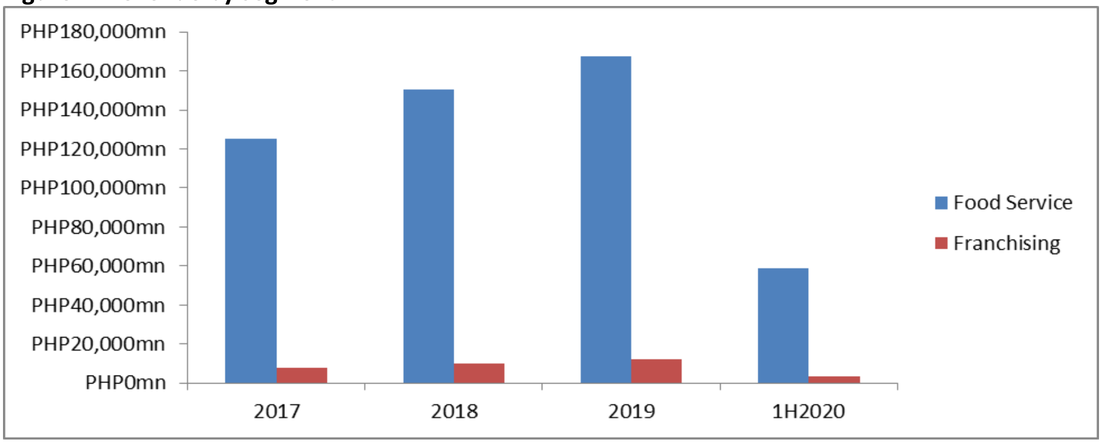
Figure 3: Store count



Source: Company

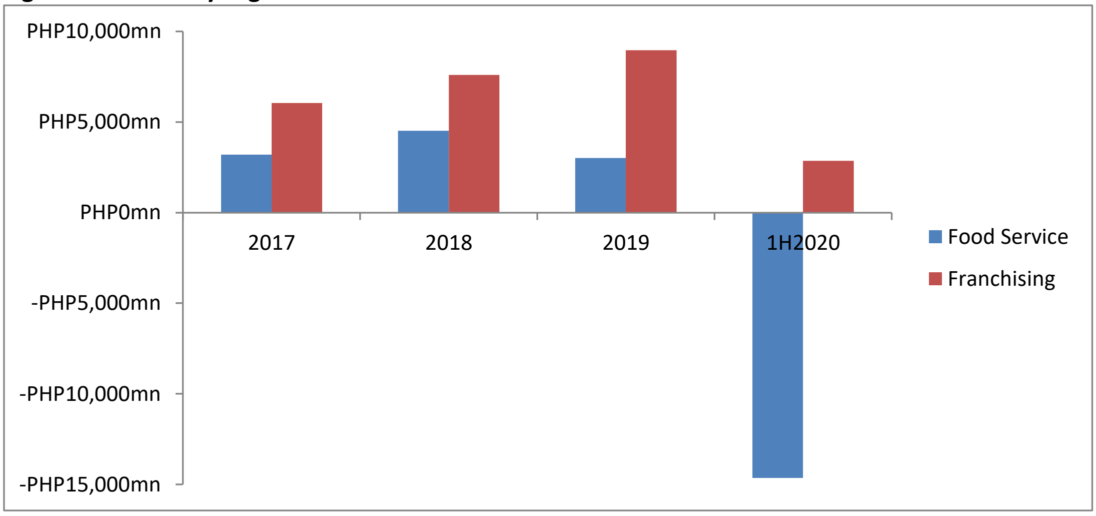
- **Move to grow through franchised stores which reduces business risks:** Increasingly, JFC is relying on franchised stores to grow, with the proportion of franchised stores increasing to 55% of the group's total as of 31 Dec 2019 (31 Dec 2017: 47%) and JFC is looking to convert a number of company-owned stores to franchised stores under the Business Transformation. Franchising revenue is largely made of up royalty fees (1H2020: PHP2.76bn), which is a monthly fee proportional to franchisee's net sales. Franchisee revenue also includes system-wide advertising fees (PHP719.8mn) and set-up fees (PHP91.1mn). While franchising revenues of PHP3.57bn represents just 5.7% of the total revenues as of 1H2020, it accounts for most of the profitability with segment results at PHP2.85bn while food service segment (which includes company-owned stores) results was a negative PHP14.6bn. Even if we examine 1H2019's results which is not impacted by COVID-19, segment results of PHP4.18bn from franchising still far outstrips segment results of PHP69.2mn from the food service segment. We think the increasing focus on franchised stores is a credit positive move as it is a high margin business resulting in higher certainty to deliver profitability. Having a franchisee model also helps to keep JFC lighter in assets; we note that JFC does not incur capex for its franchising business while PHP2.82bn of capex was undertaken for its self-owned stores as of 1H2020 (1H2019: PHP4.16bn).

Figure 4: Revenue by segment



Source: Company

Figure 5: Results by segment



Source: Company

- **Reducing outlays:** Aside from PHP7bn provision earmarked for Business Transformation, JFC is looking to reduce outlays given the steep declines in revenue. Planned capex for 2020 has been reduced to ~PHP5bn from ~PHP14bn through postponement of capex. As of 1H2020, PHP2.8bn in capex has been undertaken, of which PHP956.1mn is in the Philippines while PHP1.86bn was from abroad. JFC's relatively low degree of operating leverage lends some cushion against revenue decline. With 50.6% of its direct costs as well as general and administrative expense ("operating costs") driven by cost of inventories as of 1H2019, JFC has been able to cut operating costs by 13.8% y/y with cost of inventories falling by 25.3% y/y, which outpaces the decline in net sales of 24.6% y/y in 1H2020. According to JFC, chicken is the largest cost of inventory which accounts for 20-25% of its cost of raw materials. Thus far, JFC claims that it has been able to increase product selling prices in line with inflation rate, though it remains to be seen if prices can be increased given the weak economic outlook. Excluding CBTL which was consolidated in 1H2020's figures but not 1H2019's figures, direct costs would have decreased by 24.6% y/y in 1H2020 with net sales declining by 31.8% y/y. In addition, JFC tends to avoid real estate purchases. We believe the focus in the short-term will likely remain on cost controls. That said, it remains to be seen if JFC will turn aggressive in acquisitions, something which the company has pursued in recent years, when COVID-19 blows over.

- **Credit metrics deterioration due to acquisitions, expansion and impact from COVID-19:** In 2019, net debt surged 63.3% y/y to PHP71.2bn with net gearing rising to 1.36x (2018: 0.89x), mainly due to cash outflows to finance the acquisition of 80%-interest in CBTL for PHP17.2bn, which is the most sizeable acquisition by JFC to date. In Oct 2020, JFC announced that it will purchase another 25%-interest for SGD36.3mn (PHP1.3bn) in the holding entity of Tim Ho Wan, which will boost its stake to 85%. Previously, JFC had committed to investing SGD120mn out of SGD200mn in Titan Dining LP, which is a fund which holds the master franchise of Tim Ho Wan and owns and operates Tim Ho Wan stores in Singapore. In addition, capital expenditure amounted to PHP10.0bn in 2019 (2018: PHP9.6bn). In total, new stores and newly acquired businesses contribute 13.1% growth y/y to systemwide sales as of 2019 (2018: 15.2%). While JFC had largely operated on a negative working capital basis with trade payables and other current liabilities and contract liabilities of PHP34.7bn exceeding receivables and inventories of PHP15.9bn, the onset of COVID-19 appears to have impacted working capital with PHP6.5bn cash outflow from working capital – mainly driven by decreases in trade payables. This was the main driver resulting in adjusted net debt (including USD600mn senior perpetuals) rising 12.4% h/h to PHP80.0bn. With PHP12.6bn net loss in 1H2020, adjusted equity (less USD600mn senior perps) fell h/h to PHP39.3bn in 1H2020 (2019: PHP:52.3bn). As a result, adjusted net gearing surged to 2.1x h/h (2019: 1.4x).

- **Decent cash buffers to tide through current downturn:** After raising several issuances in 2020 including USD600mn JFCPM 3.9% PERP, USD300mn JFCPM 4.125% '26s and USD300mn JFCPM 4.75% '30s, these issuances (~PHP60bn in total) significantly buffered near-term liquidity with cash of PHP57.9bn as of 1H2020 well-covering PHP22.2bn in short-term debt. As of 31 Dec 2019, JFC has a well-staggered debt maturity of ~PHP3bn-5bn debt maturing each year between 2021 and 2024. We believe that cash on hand should be able to cover both the debt maturities and cashflow needs (1H2020 net cash used in operating and investing activities: PHP7.6bn), which should provide sufficient buffers in the downside scenario if COVID-19 drags on for the coming few years. That said, ongoing cashburn is unlikely to continue indefinitely even if the pace of recovery is slow. As covered previously, working capital outflows constitutes PHP6.5bn (out of PHP7.6bn) of the cash outflows as of 1H2020 and such outflows from working capital may decline over time if the business volume continues to be slow. Without working capital changes, 1H2020 cashflows from operating activities would be positive PHP1.4bn (1H2019: PHP9.9bn).

Technical Considerations

Positives

- Visible retail presence and household name
- Good track record
- Decent yield still amidst low interest rate environment

Negatives

- Significant near-term headwinds due to COVID-19
- Lack of credit rating
- Few close comparables

Figure 6: Relative Value

Bond	Outstanding Amount	Maturity date	YTW	Spread
JFCPM 4.125% '26	USD300mn	24 Jan 2026	3.60%	324bps
JFCPM 4.75% '30	USD300mn	24 Jun 2030	4.66%	388bps
JFCPM 3.9% PERP	USD600mn	23 Jan 2025 (1st call)	5.88%	559bps
YUM 3.625% '31	USD1050mn	15 Mar 2031	3.57%	274bps
MCD 3.6% '30	USD1000mn	01 Jul 2030	1.68%	90bps
MEGPM 4.125% '27s	USD350mn	30 Jul 2027	3.59%	306bps
SMCPM 5.5% PERP	USD500mn	29 Jul 2025	5.48%	514bps
FNNSP 3.8% '27	SGD100mn	21 Apr 2027	3.19% (SGD)	254bps

Indicative prices as at 21 Oct 2020 Source: Bloomberg

We acknowledge that JFC does not have close comparables as it is one of a kind Asiadollar issuer that has significant exposure to the Philippines catering to F&B. That said, we find that it offers wider spreads against global peers in the F&B sector such as YUM 3.625% '31s (Yum! Brands' brands include KFC, Pizza Hut, Taco Bell) and MCD 3.6% '30s, though we note that McDonald's credit profile is significantly stronger.

Relative to selected Philippines corporates such as MEGPM 4.125% '27s and SMCPM 5.5% PERP, the JFC curve trades at a slightly wider spread. JFCPM also trades wider than FNNSP 3.7% '27s (SGD).

While JFCPM 3.9% PERP's 250bps step-up upon reset is not severely punitive were JFC choose not to exercise the call, we believe the business of JFC should have bounced back from current levels by the first call date in 2025. As such, we think that it is likely for JFC to exercise the call come the call date.

Conclusion & Recommendation

Having entered 2020 with a weakened hand from large-sized acquisitions including CBTL and Smashburger, JFC's credit profile is further impacted by COVID-19 leading to significant net loss. While the near-term outlook remains uncertain, we believe that JFC should bounce back given sufficient liquidity to tide through the downturn and its strong brand identity within Philippines and amongst Filipinos. As such, **we Overweight the JFC curve and rate JFC at a Neutral (5) Issuer Profile**.

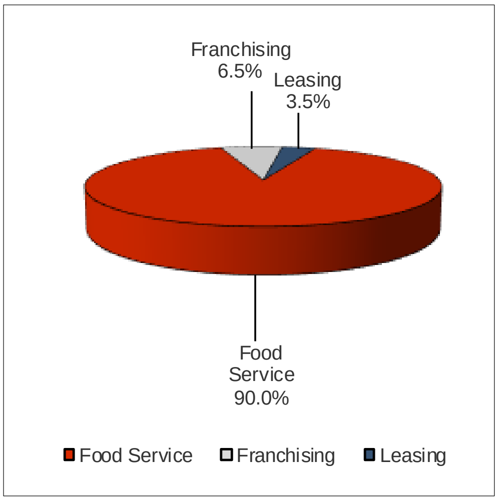
Jollibee Foods Corporation

Table 1: Summary Financials

Year End 31st Dec	FY2018	FY2019	1H2020
Income Statement (PHP'mn)			
Revenue	161,167.8	179,626.2	62,764.2
EBITDA	21,144.7	19,974.4	677.6
EBIT	9,259.0	6,501.1	-6,599.0
Gross interest expense	2,617.5	3,187.3	1,619.5
Profit Before Tax	10,321.7	9,483.6	-13,172.9
Net profit	7,070.6	6,413.4	-12,570.5
Balance Sheet (PHP'mn)			
Cash and bank deposits	23,285.9	20,892.0	57,914.0
Total assets	150,512.9	187,276.0	219,505.9
Short term debt	0.0	22,180.3	12,175.5
Gross debt	66,895.1	92,083.4	107,503.4
Net debt	43,609.2	71,191.4	49,589.5
Shareholders' equity	48,996.1	52,281.9	69,728.9
Cash Flow (PHP'mn)			
CFO	20,111.3	19,525.6	-5,295.8
Capex	9,520.7	10,041.9	2,781.5
Acquisitions	5,209.0	19,116.3	89.7
Disposals	932.3	1,802.5	164.4
Dividend	2,667.1	2,807.8	684.9
Interest paid	-731.7	-1,434.9	-462.8
Free Cash Flow (FCF)	10,590.6	9,483.7	-8,077.4
Key Ratios			
EBITDA margin (%)	13.1	11.1	1.1
Net margin (%)	4.4	3.6	-20.0
Gross debt to EBITDA (x)	3.16	4.61	79.33
Net debt to EBITDA (x)	2.06	3.56	36.59
Gross Debt to Equity (x)	1.37	1.76	1.54
Net Debt to Equity (x)	0.89	1.36	0.71
Gross debt/total assets (x)	0.44	0.49	0.49
Net debt/total assets (x)	0.29	0.38	0.23
Cash/current borrowings (x)	2.19	0.64	2.60
EBITDA/Total Interest (x)	8.1	6.3	0.4

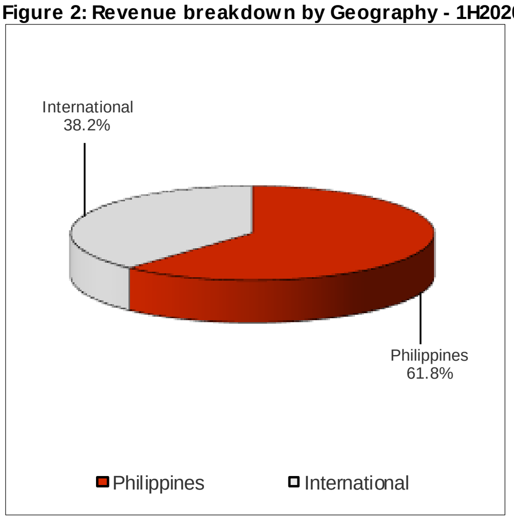
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Segment - 1H2020



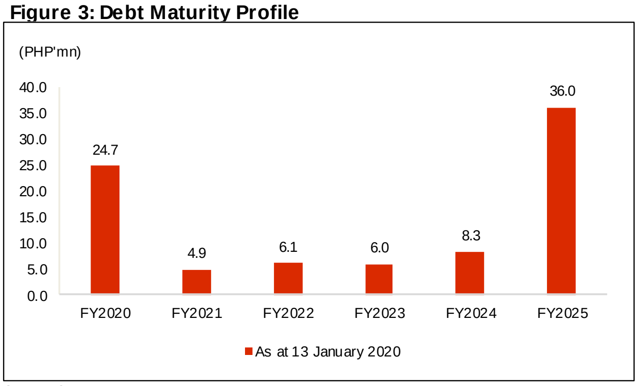
Source: Company

Figure 2: Revenue breakdown by Geography - 1H2020



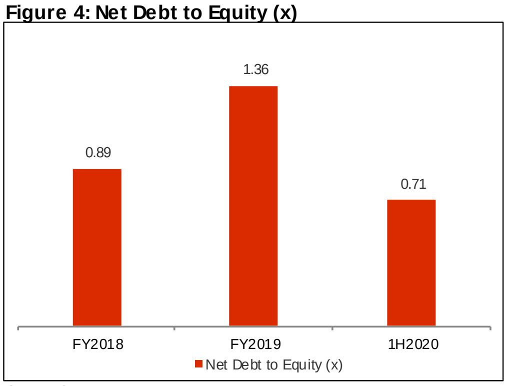
Source: Company, OCBC estimates

Figure 3: Debt Maturity Profile



Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company

Explanation of Issuer Profile Rating / Issuer Profile Score

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings into a 7 point Issuer Profile Score scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

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