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Healthy economy and tax reform underpins more positive sector outlook

Consumer companies are in for a better year this 2018 as we forecast a faster median EPS growth of 11.6% versus 7.8% in 2017. This will be driven by resilient revenue growth, capacity expansion and better margins as numerous companies overcome company specific challenges. In fact, profit growth could surprise positively as higher disposable income resulting from the reduction in personal income taxes due to the TRAIN could lead to stronger domestic consumption and revenue growth.

Favorable outlook for household consumption

Household consumption has remained strong in the first nine months of 2017, growing by 8.5% y/y and slightly faster than the 8.4% y/y growth in the same period in 2016. We expect growth in household consumption to remain strong in 2018 driven by the passage of the tax reform program, expectations that the BPO industry will resume its growth, and the resilient OFW remittances.

On December 19, 2017, President Duterte signed into law Republic Act 10963 or the Tax Reform for Acceleration and Inclusion (TRAIN) bill. One of the main provisions of the bill is the reduction of personal income taxes, benefiting tax payers earning above minimum wage (or 77% of 7.5 Mil tax payers) as they enjoy an increase in disposable income of up to 16% due to lower taxes. Higher disposable income should lead to higher household consumption.

As for the BPO sector, we think that it will continue to be a contributing factor to growth of the Philippine economy. Although there was an 8.4% y/y drop in new investment pledges to Php14.4Bil during the first ten months of 2017, the drop was much slower than the 30.9% y/y decline seen in the first half of the year. The IT and Business Process Association of the Philippines (IBPAP) also targets BPO revenues to reach US$38.9Bil by 2022, up by a CAGR of 9%. Leechiu Property Consultants, Inc. likewise believes that a recovery in demand for the BPO sector is imminent, and this will be driven by improving relationship between the Philippines and the US, the resumption in the awarding of PEZA accredited spaces, and the IT-BPM friendly tax reform program.

Meanwhile, remittances from overseas Filipino workers remained elevated during the first ten months of 2017, rising 4.2% to US$23.1Bil due to the sustained demand for skilled Filipino workers. The pace of increase is slightly faster than the recorded 4.0% y/y growth in the same period in 2016. Expectations that global economic growth will remain elevated in 2018 should continue to increase demand for overseas workers, allowing remittances to remain strong.

CENTURY PACIFIC FOOD, INC.
HOLD
PHP17.50

D&L INDUSTRIES, INC.
BUY
PHP12.70

EMPERADOR, INC.
BUY
PHP8.18

JOLLIBEE FOODS CORPORATION
HOLD
PHP257.00

PUREGOLD PRICE CLUB, INC.
BUY
PHP58.00

ROBINSONS RETAIL HOLDINGS, INC.
BUY
PHP103.00

SHAKEY'S PIZZA ASIA VENTURES
BUY
PHP16.30

UNIVERSAL ROBINA CORPORATION
HOLD
PHP142.00

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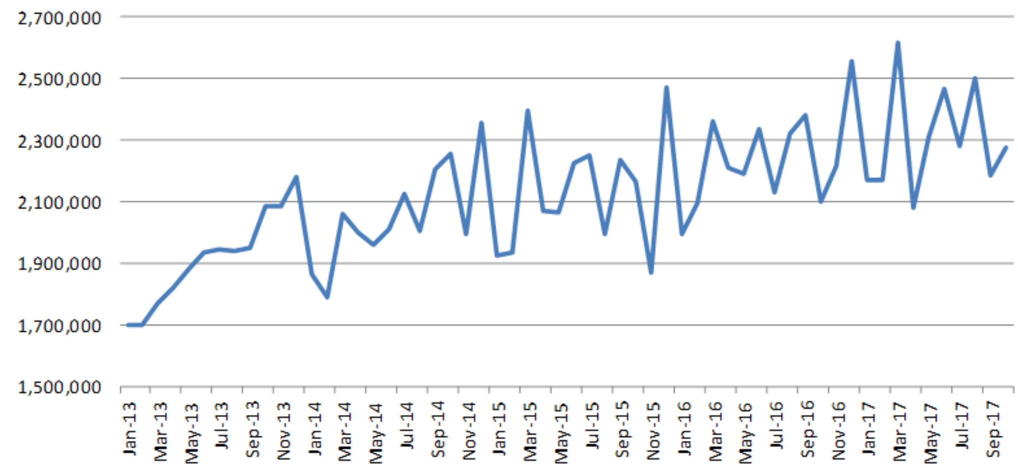
Exhibit 1: OFW Remittances in US$'000



Source: BSP

Well positioned to capitalize on growing demand

Consumer companies, specifically restaurants and retailers are well positioned to capitalize on the strong growth in domestic consumption as both groups continue to expand their foot print. PIZZA plans to open 20 new stores in 2018 after opening 24 stores in 2017, which is more aggressive than its historical average of 10 to 15 store openings annually. Meanwhile, JFC continues its global expansion with a vision of reaching a 50-50 contribution from local and international revenues in the next five years. MAXS also aims to aggressively expand its store network as it targets to reach 1,000 stores by 2020 from 660 as of end September. PGOLD is still targeting to open 25 Puregold stores and 2 S&R stores this year. Similarly, RRHI looks to continue expanding at the same pace as in 2017 opening around 150 new stores.

Beverage manufacturers to be hurt by higher excise taxes

However, not all companies will benefit from stronger demand. To fund foregone revenues as a result of the reduction in personal income taxes, the government increased excise taxes on numerous consumer goods, including sugary beverages. Under the tax reform program, the new excise tax on drinks sweetened with sugar is Php6/L while excise taxes on drinks sweetened with high fructose corn syrup is double at Php12/L. Coffee and milk drinks would be exempt from paying taxes. The resulting increase in prices of sugary drinks could hurt sales volume.

Overcoming company specific challenges leading to higher margins, faster EPS growth. In 2017, profits of numerous companies were pulled down by company specific challenges, namely:

- CNPF – rising tuna prices
- DNL – intense competition in commodity business pulling down margins
- EMP – intense competition in brandy segment
- RRHI – store renovations and road repairs affecting some supermarket and department stores

However, the outlook for most of the companies mentioned above has improved as company specific challenges have either been resolved or the impact is expected to fade. For example, CNPF's margins and profits should improve this year as the price of tuna has already peaked. EMP on the other hand should see slight improvements from the intense competition in its brandy segment. For RRHI, the company said that most of the stores impacted by temporary issues are now back to normal operations. Consequently, although we forecast median revenue growth to slow down to 10.8% this year from 13.3% in 2017, we forecast EPS growth to accelerate to 11.6% in 2018 from 7.8% in 2017.

Exhibit 2: Consumer sector revenue growth forecast

	Revenue Growth (%)		
	2017E	**2018E**	**2019E**
CIC	13.6%	15.7%	13.0%
CNPF	17.6%	11.3%	9.3%
DNL	16.4%	8.1%	9.6%
EMP	4.0%	5.2%	4.4%
JFC	14.3%	12.3%	9.6%
PGOLD	11.4%	12.0%	11.4%
PIZZA	17.2%	14.2%	11.9%
RRHI	10.6%	10.3%	9.8%
URC	12.7%	4.1%	4.9%
Median	13.3%	10.8%	9.6%

source: COL Estimates

Exhibit 3: Consumer sector EPS growth forecast

	2017E	**2018E**	**2019E**
CIC	8.3%	16.3%	14.6%
CNPF	0.7%	6.2%	15.2%
DNL	7.8%	17.0%	17.8%
EMP	-8.5%	4.3%	3.5%
JFC	11.5%	13.4%	13.9%
PGOLD	9.1%	11.6%	11.8%
PIZZA	-1.3%	13.6%	12.2%
RRHI	7.8%	10.1%	10.3%
URC	-12.5%	-0.3%	8.2%
Median	7.8%	11.6%	12.2%

source: COL Estimates

Food manufacturers: Mixed outlook

Some food manufacturers will see a better year this year given the favorable outlook for demand, lower price of raw materials and the low base in 2017. However, other companies such as beverage manufacturers may suffer from weaker sales volume as their products are slapped with higher excise taxes.

Restaurants: Attractive outlook

Outlook for restaurants such as JFC and PIZZA will remain attractive this 2018, especially with the rise in disposable income for middle income consumers brought about by the income tax reform. Restaurants' plan to expand their store network should also help drive profit growth. Although restaurants are expected to suffer from higher raw material costs due to higher excise taxes on certain products such as sugary drinks, they can manage the impact through new product and menu innovations.

Retailers: Steady growth

We expect PGOLD and RRHI to maintain steady growth in 2018. This will be on the back of strong consumer demand, continued store expansion as well as steady margins. We are forecasting an 8% and 7% increase in gross floor area for both PGOLD and RRHI, respectively, as these two companies show no sign of slowing down in their expansion plans.

Top picks: DNL, PIZZA

Our top picks among consumer stocks for this year are DNL and PIZZA. Both companies have more attractive earnings growth potential compared to peers in its sector and are still reasonably valued. Recall that DNL's stock price reached a peak of Php13.64/sh last year only to drop to a low of Php9.98/sh after releasing disappointing second quarter earnings result. Nevertheless, we believe that DNL is poised to regain its growth momentum this 2018 as initiatives to grow its export business is starting to bear fruit. Aside from this, the margin of its commodity business is showing signs of bottoming at around 3.8%. We forecast DNL's profits to grow by 17.0% this year to Php3.3Bil. At DNL's current price of Php11.66/sh, it is trading at 25.3X 2018E P/E.

PIZZA's outlook this 2018 remains attractive as we expect earnings to grow by 13.6% y/y to Php851 Mil. We expect PIZZA to be one of the main beneficiaries of the tax reform program as consumers with higher disposable income trade-up to full-service restaurants. Moreover, PIZZA's plan to grow its domestic and international store footprint will allow it to take advantage of the strong growth of consumer spending. Valuations are also reasonable, with the stock trading at 25.1X 18E P/E.

Exhibit 4: Consumer sector valuations

	Current Price	2018E P/E	FV Estimate	Upside %	Rating
CIC	62.00	21.9	52.40	-15.5%	SELL
CNPF	15.50	19.4	17.50	12.9%	HOLD
DNL	11.66	25.3	12.70	8.9%	BUY
EMP	7.87	17.1	8.18	3.9%	BUY
JFC	255.00	34.8	257.00	0.8%	HOLD
PGOLD	53.50	22.0	58.00	8.4%	BUY
PIZZA	14.06	25.1	16.30	15.9%	BUY
RRHI	100.00	24.2	103.00	3.0%	BUY
URC	163.00	32.0	142.00	-12.9%	HOLD
Industry Average P/E		**24.6**			

Source: COL Estimates

Major risk: Higher inflation

As discussed earlier, the government increased excise taxes on numerous consumer goods to fund foregone revenues as a result of the reduction in personal income taxes. Aside from sugary beverages, the government increased excise taxes on oil products and this is expected to push up inflation. Higher inflation could dampen consumer spending, especially for those earning minimum wage or less as they will not benefit from any reduction in personal income taxes.

Nevertheless, for middle income families, we think that the favorable impact of higher disposable income resulting from the reduction in personal income taxes will more than offset the impact of higher prices of basic goods. Moreover, to minimize the impact of higher prices to low income consumers, the government plans to use 30% of the additional revenues from the tax reform program to increase the number of beneficiaries of its conditional cash transfer program from 4 Million families to 10 Million families. Each family will be given Php200/month in the next three years, increasing to Php300/month in the following two years. The government also plans to provide these families discounts on medicine, transportation, rice and vocational training.

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

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