JG Summit Holdings, Inc: The Complete Package

- **Initiating coverage on JGS with a BUY rating with a FV estimate of Php48.00.** We are initiating coverage on JGS with a BUY rating and a FV estimate of Php48.00/sh based on the SOTP method. JGS is the holding company for the Gokongwei family's various investments covering consumer foods, agro-industrial and commodity food products, property development and hotel management, air transportation, petrochemicals, financial services, telecommunications and power. We expect the Philippine economy to remain resilient and JGS is well positioned to capitalize on the favourable growth outlook given the market leadership position of its operating subsidiaries, the parent company's strong balance sheet and the excellent track record of its management team. Based on our FV estimate of Php48.00/sh, potential upside from its current price of Php38.50 is 24.7%.

- **Poised to benefit from favorable growth outlook of the local economy.** The Philippine economy has been very resilient growing by 6% during the past three years. Consumer spending which accounts for more than 72% of GDP has also been resilient, increasing by a CAGR of 4.5% during the past three years. We expect this trend to continue given resilient OFW remittances and the continuous growth of the BPO sector. The continuous growth of OFW remittances and the BPO sector should help fuel an increase in the disposable income of households, leading to greater affluence. JGS is well positioned to benefit from the strength of the Philippine economy given its market leadership position in the various business sectors that are sensitive to the growth of the consumer sector. Note that URC is the largest producer of branded consumer foods in the country, while RLC is second largest mall operator in the country. Meanwhile, CEB is the largest domestic low cost carrier in the country. There is also evidence that there is a resurgence of the country's manufacturing sector. This should bode well for JGS' expansion into power distribution and the petrochemical sector as demand for industrial materials increase.

- **Balance sheet strength and management track record to ensure future growth.** Going forward, JGS is positioned to grow either organically or through acquisitions owing to its strong balance sheet. JGS' net debt/equity ratio remains to be below industry average at only 0.22X. Its interest coverage ratio is also very healthy at 16.7X and in-line with that of other holding companies. We are also positive on JGS planned expansion into government's PPP given management's excellent track record in successfully expanding businesses while maintaining a high level of profitability.

Forecast Summary (PhpMil)

Year to Dec. 31	2010	2011	2012	2013E	2014E	2015E
Revenues	**121,740**	**123,057**	**135,253**	**154,547**	**207,036**	**228,098**
% change y/y	*17.2*	*1.1*	*9.9*	*14.3*	*34.0*	*10.2*
EBIT	**21,562**	**15,387**	**20,568**	**25,109**	**36,607**	**34,452**
% change y/y	*76.9*	*-28.6*	*33.7*	*22.1*	*45.8*	*-5.9*
EBIT Margin (%)	*17.7*	*12.5*	*15.2*	*16.2*	*17.7*	*15.1*
EBITDA	**35,306**	**23,709**	**29,316**	**33,524**	**45,772**	**44,299**
% change y/y	*47.1*	*-32.8*	*23.6*	*14.4*	*36.5*	*-3.2*
EBITDA Margin (%)	*29.0*	*19.3*	*21.7*	*21.7*	*22.1*	*19.4*
Net Profits	**15,575**	**8,477**	**13,533**	**10,197**	**18,581**	**17,840**
% change y/y	*82.3*	*-45.6*	*59.6*	*-24.7*	*82.2*	*-4.0*
NPM (%)	*12.8*	*6.9*	*10.0*	*6.6*	*9.0*	*7.8*
EPS (cents)	**2.31**	**1.26**	**1.99**	**1.45**	**2.65**	**2.54**
% change y/y	*83.4*	*-45.6*	*58.3*	*-27.0*	*82.2*	*-4.0*
RELATIVE VALUE						
P/E(X)	16.9	31.0	19.6	26.8	14.7	15.3
P/BV(X)	*1.9*	*1.9*	*1.9*	*1.8*	*1.7*	*1.5*
ROE(%)	*11.0*	*6.0*	*9.6*	*6.6*	*11.3*	*9.8*
Dividend yield(%)	*0.1*	*0.2*	*0.4*	*0.4*	*0.4*	*0.4*

**Source: COL estimates*

SHARE DATA

Rating	**BUY**
Ticker	JGS
Fair Value (Php)	48.00
Current Price	39.00
Upside (%)	23.08

SHARE PRICE MOVEMENT

ABSOLUTE PERFORMANCE

	1M	3M	YTD
JGS	1.30	-10.45	1.17
PSEi	0.98	-8.74	1.66

MARKET DATA

Market Cap	273,670.47Mil
Outstanding Shares	6,797.19Mil
52 Wk Range	34.00 - 50.00
3Mo Ave Daily T/O	241.09Mil

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Initiating coverage on JGS with a BUY rating with a FV estimate of Php48.00

We are initiating coverage on JGS with a BUY rating and a FV estimate of Php48.00/sh based on the SOTP method. JGS is the holding company for the Gokongwei family's various investments covering consumer foods, agro-industrial and commodity food products (through URC), property development and hotel management (through RLC), air transportation (through CEB), petrochemicals, financial services, telecommunications (TEL) and power (MER). We expect the Philippine economy to remain resilient and JGS is well positioned to capitalize on the favourable growth outlook given the market leadership position of its operating subsidiaries, the parent company's strong balance sheet and the excellent track record of its management team. Based on our FV estimate of Php48.00/sh, potential upside from its current price of Php38.50 is 24.7%.

Company Background: The holding company of the Gokongwei family's investments

JG Summit Holdings Inc. (JGS) is the holding company of the Gokongwei Family's various investments. The company is one of the biggest conglomerates in the country with a market capitalization of Php268Bil (ranked 8th largest amongst the PSEi constituents) and total assets of Php388Bil (ranked 9th largest in the PSEi). It owns a diversified business portfolio consisting of branded consumer foods, agro-industrial and commodity food products (through URC), property development and hotel management (through RLC), air transportation (through CEB), petrochemicals, telecommunications (through its 8% stake in PLDT) and financial services. It recently gained a foothold in the country's power industry through its investment in Meralco. Note that JGS' subsidiaries are among the major players in the industries where they belong. URC is the largest producer of branded consumer foods in the country, while RLC is second largest mall operator in the country. Meanwhile, CEB is the largest domestic low cost carrier in the country.

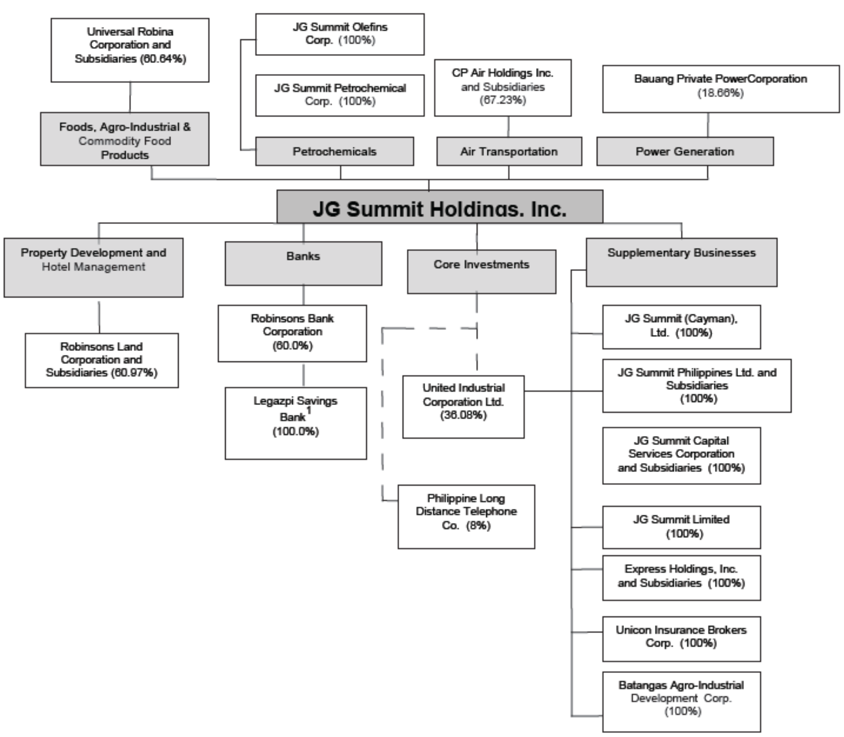
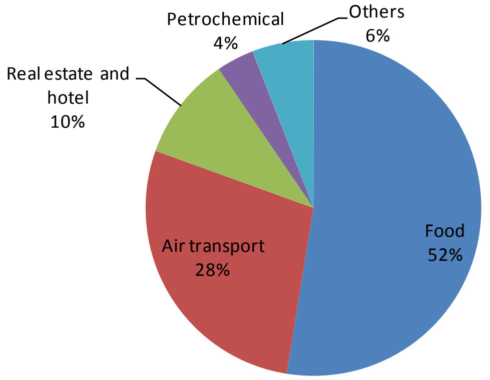
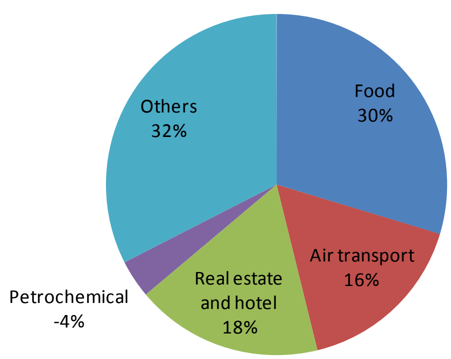


Exhibit 1: Revenue contribution of subsidiaries (as of December 2012)



***Source: JGS**

Exhibit 2: Earnings contribution of subsidiaries (as of December 2012)

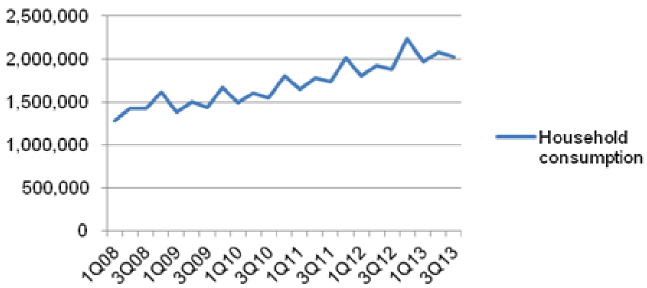


***Source: JGS**

Poised to benefit from favorable growth outlook of the local economy

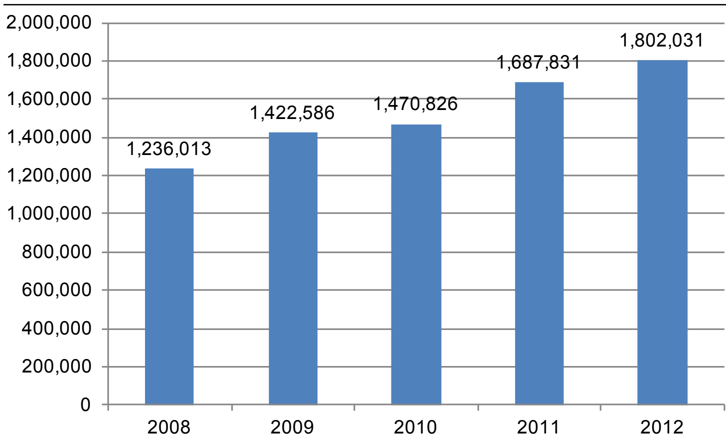
The Philippine economy has been very resilient growing by 6% during the past three years. Consumer spending which accounts for more than 72% of GDP has also been resilient, increasing by a CAGR of 4.5% during the past three years. We expect this trend to continue given resilient OFW remittances and the continuous growth of the BPO sector. From 2008 to 2012, OFW deployment grew at a relatively steady pace, increasing at a CAGR of 9.9% from 1.2 Mil to 1.8 Mil. Meanwhile, OFW remittances increased at a CAGR of 6.8%, from US$16.43 Bil to US$21.4 Bil during the said period. The BPO sector is also expected to grow significantly in the foreseeable future. After increasing by 20% to US$13.4 Bil in 2012, revenues of the BPO industry are projected to reach US$25 Bil by 2016, implying a CAGR of 16.9%. The continuous growth of OFW remittances and the BPO sector should help fuel an increase in the disposable income of households, leading to greater affluence.

Exhibit 3: National domestic consumption (in PhpMil)



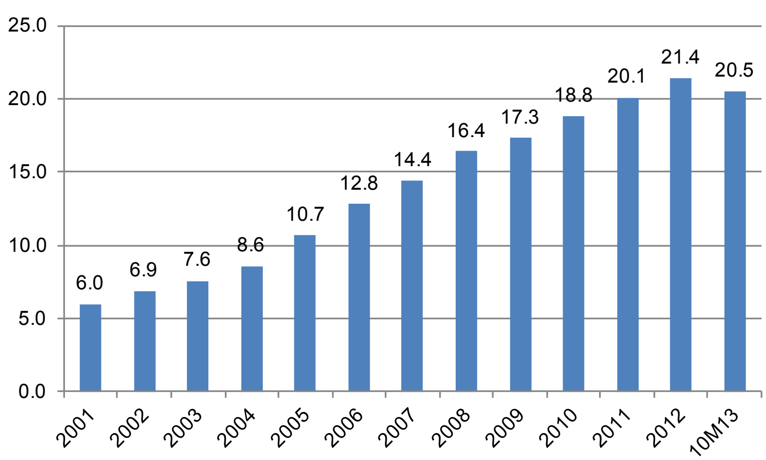
***Source: NSCB**

Exhibit 4: Annual OFW deployment



***Source: NSCB**

Exhibit 5: Annual OFW remittances in US$Bil



***Source: NSCB**

JGS is well positioned to benefit from the strength of the Philippine economy given its market leadership position in the various business sectors that are sensitive to the growth of the consumer sector. Note that URC is the largest producer of branded consumer foods in the country, while RLC is second largest mall operator in the country. Meanwhile, CEB is the largest domestic low cost carrier in the country. The continuous rise in disposable income and consumption will clearly benefit URC's consumer food business and RLC's mall and property development businesses, while the expansion of the BPO sector bodes well for RLC's office leasing business. The rising affluence of households will also indirectly boost demand for services such as air-travel, which will benefit Cebu Pacific.

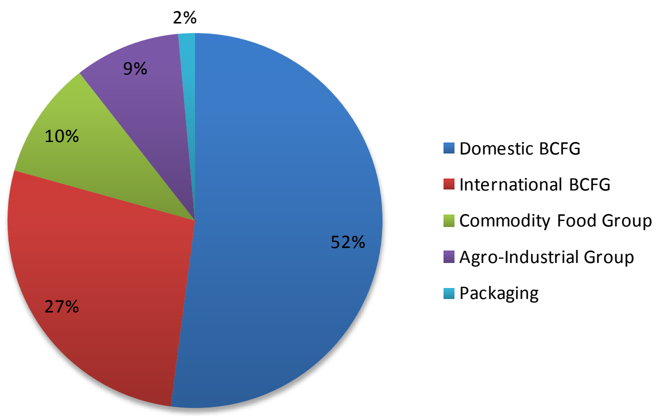
There is also evidence that there is a resurgence of the country's manufacturing sector. Power consumption by the industrial sector is on the rise. Based on MER data from 2009 to 2012, power consumption by the industrial sector grew at a CAGR of 10.2%, faster than the growth registered by the commercial and residential segment of 5.3% and 3.2%, respectively. We think that growth in the manufacturing sector is sustainable as labor cost in China and other ASEAN neighbors is on the rise, making the manufacturing sector in the Philippines more competitive. This should bode well for JGS' expansion into power distribution and the petrochemical sector as demand for industrial materials increase.

URC: Main beneficiary of rising domestic consumption

Universal Robina Corporation (URC) is one of the largest manufacturers of branded consumer food products in the Philippines with a presence in other Asian countries including Vietnam, Thailand, Malaysia, Singapore, China, Hong Kong, Indonesia and Myanmar. The company is a significant player in a wide array of products, including ready-to-drink (RTD) tea, coffee, snack food, and cup noodles. Aside from branded consumer foods, URC is involved in hog and poultry farming and manufacturing animal feeds and animal health products through its agro-industrial division. Meanwhile, the company's commodity foods division is engaged in sugar milling and refining, flour milling and pasta manufacturing.

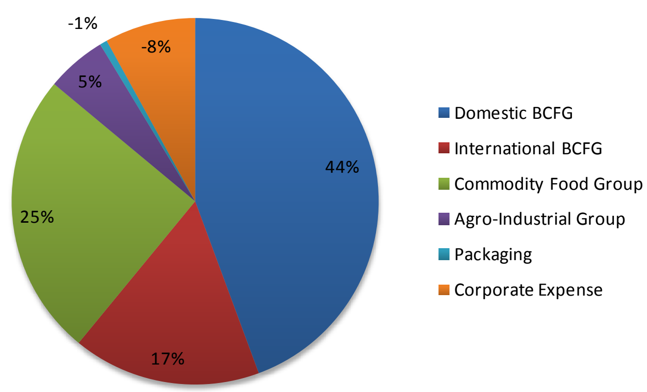
URC showed a strong performance in 2013. Strong domestic demand drove revenues up 13.4% to Php80.8Bil while operating income jumped 31.7% to Php10.3Bil as operating margin expanded to 12.7% from 11.0% due to falling commodity prices. URC is expected to sustain strong revenue growth moving forward, increasing by an average of 12.6% over the next two years driven by strong demand and expanding production capacity for its branded consumer foods business. Operating income is expected to remain strong, although growth should slow down to an average of 13.2% in the next two years as commodity prices bottom out.

Exhibit 6: URC FY13E revenue breakdown



*Source: COL estimates

Exhibit 7: URC FY13E EBIT breakdown

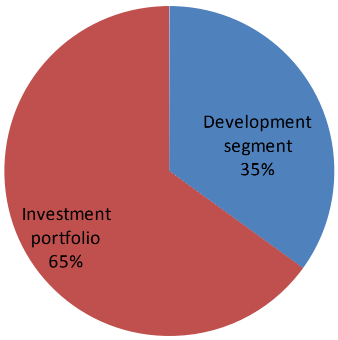


*Source: COL estimates

RLC: Growing rental property portfolio to drive earnings growth

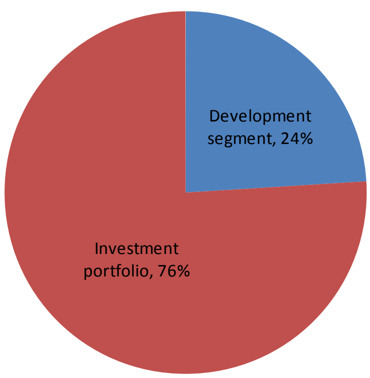
RLC is one of the largest diversified property companies in the Philippines. It has a residential development business, although bulk of profits comes from its mall leasing, office leasing, and hotel operations. RLC is the second largest mall operator in the Philippines with around over 900,000sqm of gross leasable area (GLA). RLC also has a sizable office building portfolio with 193,000sqm of GLA. Lastly, RLC has 1,500 hotel rooms under different brands that cater to different income classes. Its fastest growing brand is Go Hotels which cater to the lower-income segment of the market. RLC's residential development business is also diversified as it has four different brands that cater to varying income classes.

Exhibit 8: RLC FY13E revenue breakdown



*Source: COL estimates

Exhibit 9: RLC FY13E EBIT breakdown



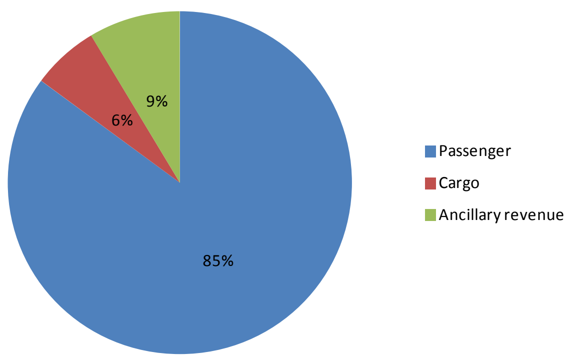
*Source: COL estimates

Growth prospects of RLC's investment portfolio are bright as expansion plans have been put in place. Mall GLA is expected to grow by 164,000sqm or 18% to 1,077,000sqm by the end of FY14. The office leasing business is also set to grow with the addition of two office buildings with a total GLA of 80,000sqm this year and the completion of its first office building with a GLA of 35,000 sqm in Bridgetowne. The said projects will lead to a 60% growth in RLC's office GLA to 308,000sqm from 193,000 sqm as of end FY13. For its hotel business, RLC hopes to add three Go Hotels per year. RLC also disclosed that it is evaluating the possibility of putting up four new Summit Hotels. The earnings contribution of RLC's residential business should also improve as a stronger sales force and increased marketing efforts led to a 50% improvement in take-up sales in FY13. This should support revenue bookings going forward.

CEB: Leading low cost carrier in the country

Cebu Pacific is the country's leading low cost carrier and offers affordable air services to passengers by having high-load and high frequency flights leading to high aircraft utilization. It currently has 47 aircrafts and 62 domestic routes. During the past five year, revenues increased by a CAGR of 20.34% as passenger volume increased by a CAGR of 19.6%. Revenue growth should remain strong as Cebu Pacific plans to increase its air fleet to 62 by 2017 and as it increases its international routes to include Japan, Saudi Arabia and Australia.

Exhibit 10: CEB FY13E revenue breakdown



*Source: COL estimates

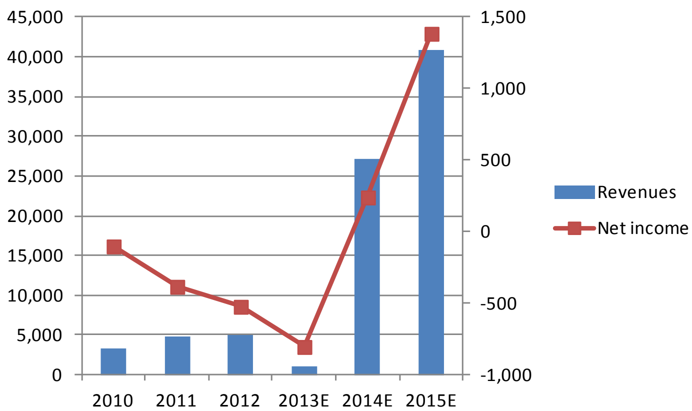
JGSPC: Petrochemical business on the verge of a turnaround

JGS manufactures and markets petrochemical products through its 100% owned subsidiary JG Summit Petrochemical Corporation (JGSPC). The two main products of JGSPC are polypropylene (PP) and polyethylene (PE). Both are used to manufacture plastics products. JGSPC has a rated capacity to produce 180,000MT of PP and 175,000 PE annually.

JGSPC has been a drag for JGS, booking operating losses during the past few years. Volatile price of imported raw materials and lack of vertical integration were responsible for the said losses. However, JGSPC is expected to turnaround soon as its US$800 Mil Naphtha Cracker is expected to begin commercial operations in 2Q14. JGS believes that the project will bring the entire petrochemical business back to profitability. The new naphtha cracker plant will make JGSPC vertically integrated as the group can now use naphtha to produce Ethylene and Propylene. The said items in turn will be used as feedstock of the PE and PP plant. Note that naphtha is less expensive compared to ethylene and propylene. Furthermore, the shipping cost for naphtha is significantly cheaper than imported gas (US$150/MT for gas vs US$15/MT for naphtha). With the lower cost to produce PP and PE, JGSPC will be competitive against larger regional producers.

Management expects revenues for a full year operations of the naphtha plant to amount to US$1Bil while it expects an 8-10% EBITDA margin and a 3-4% net margin. Given the said assumptions, we estimate that JGSPC will contribute Php27Bil and Php41Bil in revenues for JGS in 2014E and 2015E respectively, and generate earnings of Php240Mil and Php1.4Bil, representing 1.3% and 7.8% of JGS' net income for the two years.

Exhibit 11: JGSPC operating performance and forecast (in Php Mil)



*Source: JGS and COL estimates

Other businesses provide steady income stream for JGS

JGS' other major investments include its 8% stake in TEL and 27% in MER. Although TEL's net income is expected to only grow by 2% in 2014E, we believe that it is still a very good investment as it will provide Php3.1Bil in dividend income for JGS, representing 16.6% of its 2014E earnings. Meanwhile, JGS' recently acquired 27% stake in MER will also provide an attractive level of dividend income of Php3.5Bil in 2014E, representing 18.8% of JGS' net income for the said year. However, dividend for MER is expected to decline to Php2.5Bil in 2015E as we expect regulatory tariff to be slashed in MER's next regulatory period.

Balance sheet strength and management track record to ensure future growth

Going forward, JGS is positioned to grow either organically or through acquisitions owing to its strong balance sheet. JGS' net debt/equity ratio remains to be below industry average at only 0.22X. Its interest coverage ratio is also very healthy at 16.7X and in-line with that of other holding companies. We are also positive on JGS planned expansion into government's PPP given management's excellent track record in successfully expanding businesses while maintaining a high level of profitability. A good example would be URC wherein the company's revenues expanded to Php80.7Bil 2013 from only Php45.5Bil in 2008, increasing at a 5-yr CAGR of 12.2%. URC's profitability improved at an even faster pace with EBIT expanding to Php10.3Bil in 2013 from only Php3.7Bil in 2008, representing a 5-yr CAGR of 22.7%. Similarly, through the aggressive growth of its mall and office leasing portfolio, RLC has grown its net income from Php1.724 Bil in FY08 to Php4.45 Bil in FY13, implying a 5-year CAGR of 20.8%. During the economic downturn of 2009 and 2010, RLC was still able to grow its net income by 3.6% and 10% respectively.

Exhibit 12: Liquidity and solvency ratios of conglomerates

As of September 2013

	Net debt/equity	CA/CL	Net interest expense /EBITDA
AC	0.46	1.62	0.15
SM	0.33	1.17	0.12
FPH	0.75	2.36	0.19
AGI	-0.14	3.69	-0.20
DMC	0.14	2.97	0.04
Average	0.31	2.36	0.06
JGS	0.22	1.39	0.06

*Source: Company data

2014E to be a banner year on steady earnings growth of operating subsidiaries, MER investment

For 2013E, we expect earnings to decline by 24.7% despite the steady earnings growth of its operating subsidiaries, mainly due to the booking of Php4Bil in forex losses resulting from the depreciation of the peso. Nevertheless, we expect 2014E to be a banner year for JGS and its earnings is expected to rise 82.2% to Php18.6Bil due to the continuous increase in the net income of core operating subsidiaries such as URC, RLC and CEB, as well as the first full year earnings contribution from its 27% equity stake in MER. Note that MER is expected to contribute Php2.1Bil (excluding finance cost) in profits representing 11.5% of JGS' net income. For 2015, we forecast earnings to decline by 4% to Php17.8Bil, largely brought about by the 24% decline in MER's earnings as we expect regulatory tariff to be slashed in MER's next regulatory period. The drop in MER's profits will be partially offset by the positive first full year earnings contribution from JGSPC. Nevertheless, even with the drop in profits for 2015, we expect JGS' ROE to reach 9.8%, higher than the average ROE of 7.4% in the past three years.

The parent is cheaper than the parts

Buying JGS is cheaper than buying its listed subsidiaries separately. Based on our computation, the value of JGS based on the market value of its listed subsidiaries is Php51.75/sh. The said value is significantly higher than JGS' current price of Php38.50/sh.

Exhibit 13: Sum of the Parts of Valuation (Market Value)

	Share Price	Outstanding Shares	Value	JGS Stake	Effective Value	Comments
URC	119.50	2,181.50	260,689.48	55.9%	145,829.70	Based on market value
RLC	19.98	4,093.83	81,794.72	61.0%	49,870.24	Based on market value
TEL	2,710.00	216.06	585,511.14	8.0%	46,840.89	Based on market value
UIC			144,305.00	37.0%	53,392.85	Based on market value
Cebu Pacific	51.50	605.95	31,206.60	67.2%	20,980.19	Based on market value
Meralco	251.80	1,127.10	283,803.78	27.0%	76,627.02	Based on market value
Petrochem			34,800.00	100.0%	34,800.00	Based on cost
Value of Subsidiaries					428,340.90	
Parent Short-Term Debt					10,458.88	As of end 3Q13
Parent Long-Term Debt					50,793.98	As of end 3Q13
Debt for MER acquisition					71,970.97	
Total Parent Debt					133,223.84	
Conslidated Cash					76,892.68	As of end 3Q13
Less: URC Cash					12,400.00	As of end 3Q13
Less: RLC Cash					1,035.00	As of end 3Q13
Less: Cebu Pacific Cash					6,812.56	As of end 3Q13
Total Parent Cash					56,645.13	
Parent Net Cash (Debt)					(76,578.71)	
Less: Holding Company Discount					0.00	
NAV					351,762.18	
Outstanding shares					6,797.19	
NAV/sh					**51.75**	

*Source: COL estimates

Our end 2014 fair value estimate for JGS is Php48.00 based on the SOTP valuation method, which we deem suitable for a conglomerate with various business interests. We used the DCF method to capture the earnings potential of URC, CEB, MER, TEL and JGSPC while we used the NAV method in valuing RLC. For United Industrial Holdings, JGS' holding company for its property investments in Singapore, we used its current market price as the basis for our fair value estimate. Finally, we applied a 15% holding company discount to all listed operating subsidiaries of JGS to arrive at our FV estimate.

Exhibit 14: Sum of the Parts of Valuation (Fair Value)

	Share Price	Outstanding Shares	Value	JGS Stake	Effective Value	Comments
URC	117.00	2,181.50	255,235.73	55.9%	142,778.87	Based on DCF
RLC	25.30	4,093.83	103,573.90	61.0%	63,149.01	Based on NAV
TEL	3,260.00	216.06	704,341.82	8.0%	56,347.35	Based on DCF
UIC			144,305.00	37.0%	53,392.85	Based on market value
Cebu Pacific	60.00	605.95	36,357.20	67.2%	24,442.95	Based on DCF
Meralco	252.00	1,127.10	284,029.20	27.0%	76,687.88	Based on DCF
Petrochem			48,877.93	100.0%	48,877.93	Based on DCF
Value of Subsidiaries					465,676.83	
Parent Short-Term Debt					10,458.88	As of end 3Q13
Parent Long-Term Debt					50,793.98	As of end 3Q13
Debt for MER acquisition					71,970.97	
Total Parent Debt					133,223.84	
Conslidated Cash					76,892.68	As of end 3Q13
Less: URC Cash					12,400.00	As of end 3Q13
Less: RLC Cash					1,035.00	As of end 3Q13
Less: Cebu Pacific Cash					6,812.56	As of end 3Q13
Total Parent Cash					56,645.13	
Parent Net Cash (Debt)					(76,578.71)	
Less: Holding Company Discount					(62,519.83)	
NAV					326,578.28	
Outstanding shares					6,797.19	
NAV/sh					**48.05**	

*Source: COL estimates

Risks Factors

Rising commodity and fuel prices

One of the risk factors of JGS is the rise in the cost of commodity and fuel costs as the operations and profitability of some of the JGS' subsidiaries such as CEB, URC and JGSPC are extremely dependent in these inputs. Raw materials account for 76% of URC's total cost of sales, while fuel costs account for 50% of CEB's operating costs. To mitigate the impact of rising commodity prices, the company has implemented hedging strategies for fuel and uses commodity options and alternative sources of raw materials for URC's operations

Exposure to interest and forex risks

JGS is exposed to forex risks given that its revenues are predominantly denominated in the Philippne Peso, while 76% of its debt obligations are denominated in foreign currencies. Furthermore, many of the expansion projects of JGS' subsidiaries such as URC's plant expansion and CEB's fleet expansion are funded through dollar denominated debt. A weaker Philippine Peso could increase interest expense and principal payments going forward. To reduce its forex and interest rate exposures, the company utilizes interest rate swaps, currency forwards, cross currency swaps and currency options.

Investment Rating Definitions

BUY	HOLD	SELL
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 twelve months.	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 inline or underperform the market in the next six to twelve months.	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 twelve months.

Important Disclaimers