

WILCON DEPOT, INC:

Leading player in the home improvements and construction supplies industry

Company background. Wilcon Depot, Inc. (WLCON) is a leading home improvement and construction supplies (HICS) retailer that primarily caters to the middle-to-high income homeowners who are looking to build new homes or furnish, renovate, and maintain existing ones. With almost 40 years of experience in the industry, WLCON has grown to be the largest HICS retailer by net selling space contributing 6.1% of the total industry space in 2015. Additionally, it is ranked 2nd in terms of market share at 7.0% based on 2015 sales. Currently, the company has a store network of 37 stores, 33 of which are located in Luzon.

Raising Php7.0Bil from the IPO to fund expansion. Wilcon Depot, Inc will be offering 1,393.9Mil primary shares to local investors at Php5.05/sh. Assuming full subscription, the company would be able to raise Php7.0Bil gross proceeds from the offering. Bulk of the proceeds would be used for WLCON's store expansion plan. Specifically, around Php6.1Bil would be used to fund WLCON's expansion plan of adding 28 stores in five years. Meanwhile, management intends to use the balance to pay off its debt.

Sustained industry growth supported by key demand indicators. The HICS industry has grown by around 5.5% annually from 2011 to 2016 underpinned by an upward trend in the construction industry which registered a 9.3% CAGR in gross value added from 2011 to 2015, a resilient housing sector that registered a CAGR of 8.4% from 2001 to 2015, and double digit growth in imports of major home improvement products for the last 5 years.

Strong brand presence provides edge over competition. WLCON has developed a strong brand presence making its name synonymous to a one-stop shop and a preferred retailer for home improvement products. It currently offers 2,000 local and foreign brands and up to 150,000 SKUs. In addition, WLCON is able to provide core products like plumbing and sanitary and tiles and flooring in larger volumes which mall-based competitors cannot deliver due to their smaller size.

Fairly valued, upside potential rests on execution of aggressive expansion plan. At its IPO price of Php5.05/sh, WLCON will be trading at 20.7X 2017E P/E assuming its earnings grow in line with its store planned expansion for 2017. This is in line with the 20.5X 2017E median P/E of the consumer sector and is slightly above the 19.0X median P/E for its regional comparables. Nevertheless, we think further upside rests on the successful execution of the company's aggressive store expansion plan over the next five years.

FORECAST SUMMARY:

Year to December 31 (Php Mil)	2013	2014	2015
Net Sales	11,862	13,596	14,450
% change y/y	-	14.6	6.3
Gross Profit	2,561	2,520	3,610
% change y/y	-	-1.6	43.2
Gross Margin (%)	21.6	18.5	25.0
Operating Income	367	92	761
% change y/y	-	-75.0	727.4
Operating Margin (%)	3.1	0.7	5.3
Net Income	240	40	538
% change y/y	-	-83.5	1254.4
Net Profit Margin (%)	2.0	0.3	3.7
EPS	0.09	0.01	0.20
% change y/y	-	-83.5	1254.4
RELATIVE VALUE			
P/E (X)	56.9	344.0	25.4
P/BV (X)	6.6	11.8	5.5
ROE (%)	-	2.5%	29.5%

Source: WLCON



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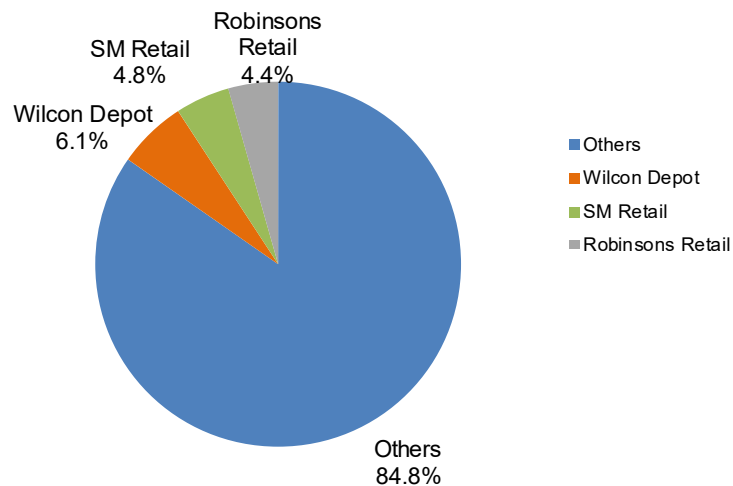
Company Background

Wilcon Depot, Inc. (WLCON) is a leading home improvement and construction supplies (HICS) retailer that primarily caters to middle-to-high income homeowners who are looking to build new homes or furnish, renovate, and maintain existing ones. WLCON currently offers local and international brands of tiles and flooring, plumbing and sanitary wares, electrical products, hardware tools, furniture, paint, and building materials, among others. Tiles and flooring, plumbing and sanitary wares are the higher margin products of WLCON. Moreover, these two product categories contribute around 60% of the company's revenues.

With almost 40 years of experience in the industry, WLCON has grown to be the largest HICS retailer by net selling space with a store network portfolio spanning 260,357 sqm or 6.1% of the total industry space in 2015. Additionally, it is ranked 2nd in terms of market share at 7.0% based on 2015 sales. As of end 2016, the company had a total of 37 stores, 17 of which are located in Metro Manila, 16 in North and South Luzon, while Visayas and Mindanao have two stores each. The 37 stores are comprised of 31 larger format stores called Wilcon Depot (usually around 9,500 sqm) and 6 Wilcon Home Essentials (about 2,500 sqm on average). Moving forward, WLCON will be focusing on expanding its depot format stores which account for majority of its revenues at 96%.

Exhibit 1: HICS Industry Net Selling Space

HICS Net Selling Space 2015: 4,296 sqm

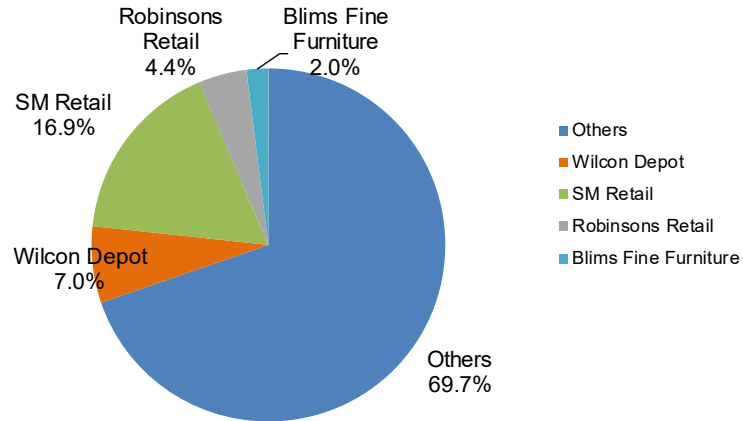


source: Euromonitor, WLCON

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Exhibit 2: HICS Industry Market Share

HICS 2015A: Php206Bil

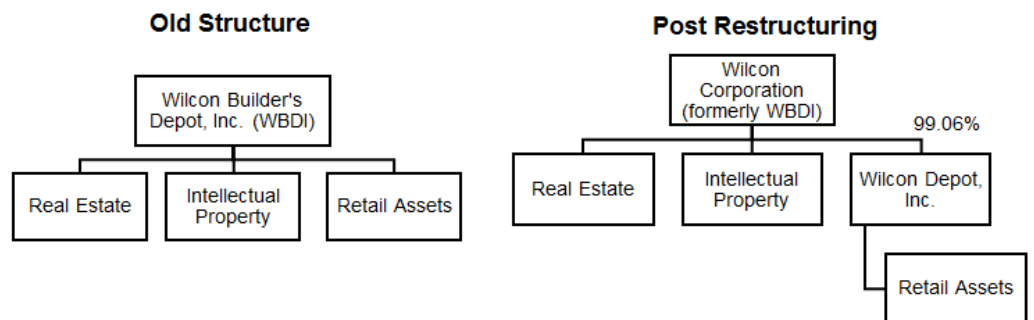


source: Euromonitor, WLCON

Corporate structure

Wilcon Depot, Inc. was incorporated in 2015 as a subsidiary of Wilcon Corporation. Wilcon Corporation, which is owned by the Belo Family, had spun-off its retail business into the newly incorporated entity. Currently, majority of the Wilcon buildings and land are being leased from the parent. However, moving forward, WLCON intends to construct the new stores while continually leasing the land from the parent company. Aside from the real estate business being under Wilcon Corporation, the intellectual property rights for the Wilcon brand remains under the parent company.

Exhibit 3: Corporate restructuring



source: WLCON

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Raising Php7.0Bil from the IPO to fund expansion

Wilcon Depot Inc, will be offering 1,393.9Mil primary shares to local investors at Php5.05/sh. Assuming full subscription, the company would be able to raise Php7.0Bil from the offering. Following the initial public offering, the existing shareholders will own 66% of WLCN while the public will own the balance of 34%. The shares will be offered from March 20-24. Wilcon Depot, Inc. will be trading under the ticker WLCN, and its market capitalization would amount to Php20.7Bil.

Exhibit 4: IPO details

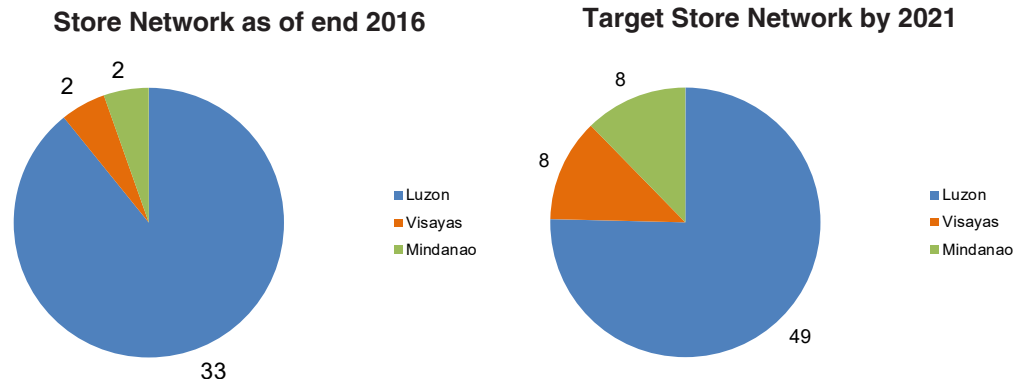
Stock symbol	WLCN
Offer Price	Php5.05/sh
Total shares on offer	
Primary shares	1,393.3Mil
Gross proceeds to be raised	Php7.04Bil
Total shares outstanding post IPO	4,099.7Mil
Public float post IPO	34%
Offer period	Mar-20 to Mar-24
Listing date	Mar-31

source: WLCN

Bulk of the proceeds from the IPO will be used to fund WLCN's rapid expansion plan of opening 28 stores by 2021. WLCN currently has 37 stores and intends to open 8 stores in 2017 followed by 5 stores annually for the succeeding year. This would bring the company's store network portfolio to 65 stores in 5 years. In addition, WLCN intends to expand its presence in Visayas and Mindanao as 12 of the 28 stores to be opened would be located in those regions.

Management intends to use the remaining balance to pay off the company's debt.

Exhibit 5: Store network breakdown



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Exhibit 6: Use of proceeds

	Amount in Bil	Percentage	Timetable for disbursement
Store network expansion	6,111.8	91%	2017-2021
Debt repayment	594.2	9%	2017-2021
Total	6,706.0	100.0%	

Source: WLCON, COL Estimates

Sustained industry growth supported by key demand indicators

The HICS industry has grown by around 5.5% annually from 2011 to 2016 underpinned by an upward trend in the construction industry which registered a 9.3% CAGR in gross value added from 2011 to 2015, a resilient housing sector that registered a CAGR of 8.4% from 2001 to 2015, and double digit growth in imports of major home improvement products for the last 5 years.

The construction sector remains healthy, growing by an average of 9.3% from 2011 to 2015, with private construction contributing 76% of the total gross value added in construction as of 2015. This was supported by a robust growth in residential construction which grew at an average of 7.6% every year.

The Philippine housing sector also shows promising prospects as additional housing units per annum recently broke the 200,000 level. The sector has been growing at an average of 8.4% per year since 2001. Furthermore, the housing backlog currently stands at 5.7Mil units in 2016 and the government's efforts to close this gap is beneficial for the home improvements industry.

In addition, a summary of the imported home improvement goods in the Philippines show that most of the major product categories registered double digit growth in 2011 – 2015. Tiles and flooring grew the fastest at an average of 30.4% followed by building materials at 26.7%, appliances at 21.1%, and plumbing and sanitary at 19.5%. Paint was the only product that grew by single digits every year at an average of 7.6%. This data shows that WLCON is strategically positioned to take advantage of the faster growing products in its industry given that 60% of its revenues come from tiles and flooring combined with plumbing and sanitary, which are among the fastest growing segments in imported HICS products.

Strong brand presence provides edge over competition

WLCON has developed a strong brand presence making its name synonymous to a one-stop shop and a preferred retailer for home improvement products. It currently offers 2,000 local and foreign brands and up to 150,000 SKUs. In addition, WLCON is able to provide core products like plumbing and sanitary and tiles and flooring in larger volumes which mall-based competitors cannot deliver due to their smaller size. Part of the company's brand proposition also includes a commitment to provide excellent customer service through experienced and knowledgeable personnel. They provide design hubs where in-house consultants can assist customers by using a 3D program to design the customer's intended floor plan. Moreover, the customer's shopping experience is further enhanced by the store's facilities which include free parking, sufficient ventilation coupled with air-conditioning, a well-lit shopping area, and an easy to navigate store layout.

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Focus on in-house and exclusive brands to drive superior profitability

Management intends to focus on improving and expanding its in-house and exclusive brands further enhancing WLCON's wide selection of product offerings as well as its profitability. The in-house brands are produced by foreign original equipment manufacturers (OEMs) with WLCON's quality control teams overseeing the whole process to make sure that the products continue to cater to their customer's needs. Currently, it has 16 of these brands across its different product categories, and this differentiates WLCON from competition while increasing brand loyalty. In addition, the in-house and exclusive products translate to higher margins and represent 42%-43% of total revenues.

Leveraging on competitive strengths and growth strategies to expand market share

WLCON intends to build on its existing position as a market leader, its extensive product portfolio, and its purchasing scale by executing an aggressive growth strategy coupled with quality control efforts to sustain its edge over competition. Amidst a rapid expansion plan of adding 28 new stores in the next 5 years, WLCON aims to sustain same-store-sales growth at 4.0% - 4.5% by continuing to appeal to its existing customers and attract new ones as well. They intend to be quick in expanding their product range and brand offerings, improving existing stores to increase visitor traffic, and improving customer service to generate brand loyalty. With this, WLCON targets to expand its market share in the fragmented HICS industry. Recall that nearly 70% of the home improvement industry is represented by small independent hardware stores.

Fairly valued, upside potential rests on execution of aggressive expansion plan

At its IPO price of Php5.05/sh, WLCON will be trading at 20.7X 2017E P/E assuming its earnings grow in line with its store planned expansion 2017. This is in line with the 20.5X 2017E median P/E of the consumer sector and is slightly above the 19.0X median P/E for its regional comparables. Nevertheless, we think further upside rests on the successful execution of the company's aggressive store expansion plan over the next five years.

Exhibit 7: Relative valuation of local peers

	2017E P/E
CIC	17.5
CNPF	18.6
DNL	28.3
EMP	13.9
JFC	33.9
PGOLD	19.6
RRHI	21.3
URC	24.1
Median	20.5

Source: COL Estimates

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Exhibit 8: Relative valuation of regional peers

	Ticker	2017E P/E
Ace Hardware Indonesida	ACES IJ	20.2
Arwana Citram Ulia Tbk Pt	ARNA IJ	17.8
Siam Global House Pcl	GLOBAL TB	33.6
Home Product Center Pcl	HM PRO TB	26.8
Pan-United Corp Ltd	PAN SP E	12.6
Viglacera Corp	VGC VN	7.9
Median		19.0

Source: Bloomberg

Risks:
Rapid expansion plan poses execution risk

With its rapid expansion plan, WLCON is facing some execution risk going forward considering it only opened an average of two to three stores in the past. These include potential concerns ranging from planning, constructing, personnel training, to operating the 8 branches it intends to open this 2017 alone and the 5 stores every succeeding year. Any delays in the rollout of the new stores would negatively affect WLCON.

Foreign exchange risk

A depreciation in the peso is also not favorable for the company as 40-45% of its net sales are imported from the US, Europe, and China. To put this into perspective, a 1% depreciation in the peso would roughly decrease WLCON's net income by around 4.0%-4.5%. This is managed by passing on the costs to the customers, however, management did note that they only raise prices by at most twice a year as customers may lessen their spending given the price adjustment.

Tax concerns

Last June 2016, WLCON's parent received a preliminary assessment notice (PAN) from the BIR for tax deficiencies in 2011 and 2012 amounting to a total of Php5.1Bil. Wilcon Corporation has responded to the PAN by submitting the necessary documents to explain their side. Currently, the BIR has not yet responded to the parent's reply; however, in the event that the BIR finds the reply to be without merit they would enforce the notice on Wilcon Corporation's assets including its retail assets if necessary.

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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 to 12 months.

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