Philequity Corner
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By Ignacio B. Gimenez

Resurgence of the Lopez Empire

"If the price is right, we will (divest our shares in Meralco). If there is a good offer, we will (sell)" – Oscar Lopez, chairman of the Lopez group. Source: *Philippine Star*, November 28, 2006

"(Buying the government's Meralco shares) is something we are looking at." – Manuel Lopez, chairman of Meralco. Source: *Philippine Star*, January 17, 2007.

Two contrasting statements from the stalwarts of the Lopez group. Within a span of less than two months, the Lopezes have become possible sellers to possible buyers of more Meralco shares. The 180-degree change in family's stance only reflects their business empire's reversal of fortune as economic and political conditions became more favorable. The key catalyst for this change was the favorable Supreme Court ruling on a Meralco power rate hike. This suddenly turned the prospects of the company from gloomy to bullish.

If there is one business group whose interests are closely intertwined with the country's economic and political fate, it is that of the Lopezes. Their businesses cover areas that are very basic to the economy: power and energy, utilities, infrastructure, media, property and healthcare. It is inevitable therefore that their fortunes rise and fall along with economic trends.

Ironically, their economic and political profile has also rendered the group vulnerable to powers-that-be who desired absolute power. In fact, the business empire became prey to political predators twice in its colorful history. It took two EDSA revolts to restore to the family what was nearly lost: affluence and influence.

1997 financial crisis: perilous times

But the biggest challenge that almost broke the conglomerate's back was the financial crisis in 1997. The group's rapid expansion and entry into new capital-intensive businesses like telecoms and water utility entailed heavy borrowing. Unfortunately, this preceded by a few months the 1997 Asian crisis which saw the peso falling steeply. This and the ensuing economic downturn resulted in heavy debt burden and sluggish business for the group – a precarious combination that spelled hardships for the conglomerate.

A confluence of factors exacerbated the group's predicament and eventually led to their downfall.

- A string of unfavorable court rulings caused a financial hemorrhage for Meralco
- Telecom arm Bayantel, while saddled with heavy debt, also suffered from heavy losses as its fixed line business was preempted by the advent of cheaper mobile telephony.
- The foray into water distribution through Maynilad ended with near bankruptcy, with the group eventually returning the franchise back to the government.
- Heavy debt burden and political troubles paralyzed broadcasting company ABS-CBN which eventually lost market leadership to the erstwhile industry runner-up GMA Network.

Even the parent company Benpres Holdings defaulted on its debt payments, prompting creditors to sell Benpres debt papers at huge discounts. The group subsequently had to engage in a comprehensive balance sheet management plan that entailed asset sales, cost reduction and suspension of capital investments, and debt reduction. The group eventually stagnated while rivals passed them by.

Reversal of fortune

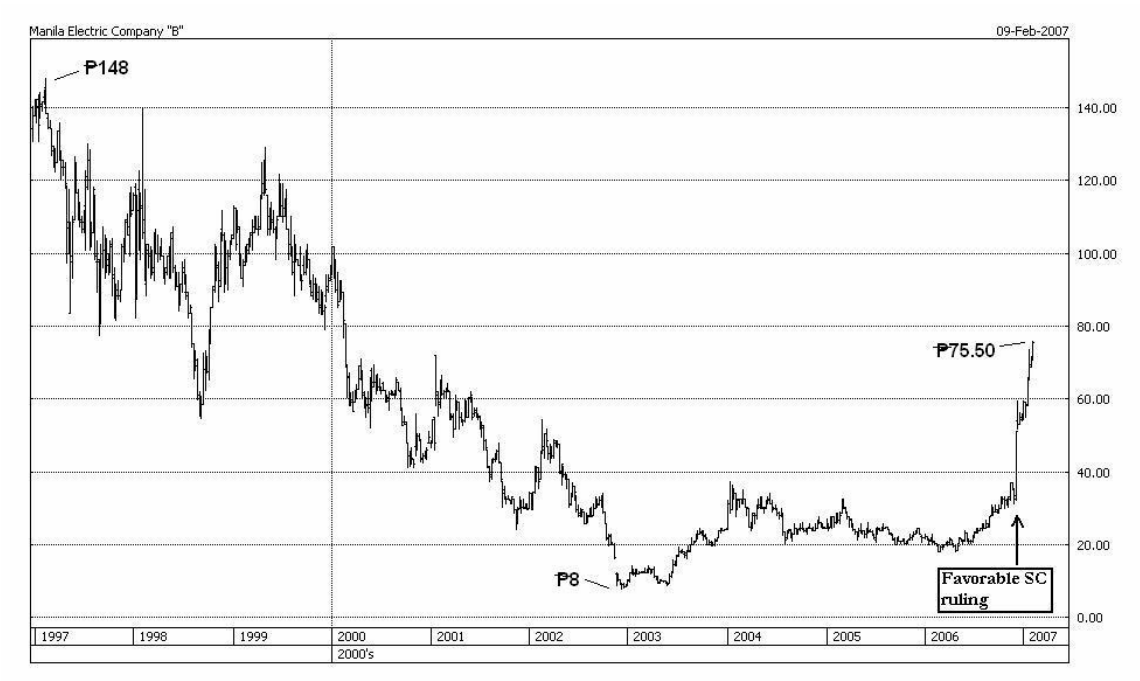
Thanks to the unwavering efforts by the government to put its fiscal position in order, the economy has picked up some pace and now offers more conducive conditions for business. The peso has recovered quite significantly, interest rates are at record lows, and investor confidence has been restored.

The stock market has also gained significant momentum and is now bound to hit record highs set in 1997. The resurgence of the stock market has enabled many companies to turn to the capital markets to raise funds for expansion and debt repayment. One of the biggest IPO last year was that of First Generation, a 66.5%-owned subsidiary of First Philippine Holdings (FPH). FPH is in turn a 45%-owned subsidiary of Benpres Holdings. The strong interest in the First Gen IPO signified the returning investor confidence in the Lopez group.

Regaining lost glory

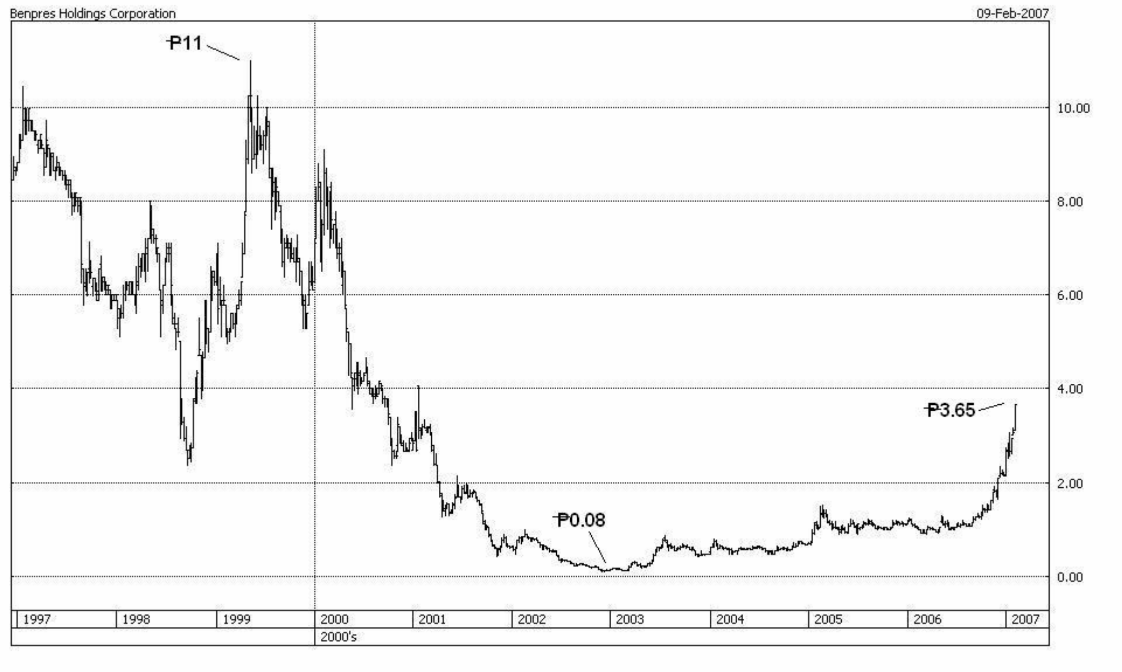
With the economic rebound, many of the Lopez companies found a second wind. The once losing Bayantel found a new gold mine in the data/internet business which is now restoring profitability to its fixed line assets. The increase in economic activities is also generating business opportunities for its power generation and infrastructure assets.

But the biggest turning point for the group was when the Supreme Court ruled in favor of Meralco's rate hike in connection with a mandatory tariff unbundling. This ended a long losing streak with the courts and the regulator. As per industry estimates, the court ruling would restore some P20 billion (gross of taxes) to Meralco's book value and would put the company back on a growth path. Also, the favorable court ruling served as a flash point that sent Meralco's share price soaring out of the doldrums (see chart below).



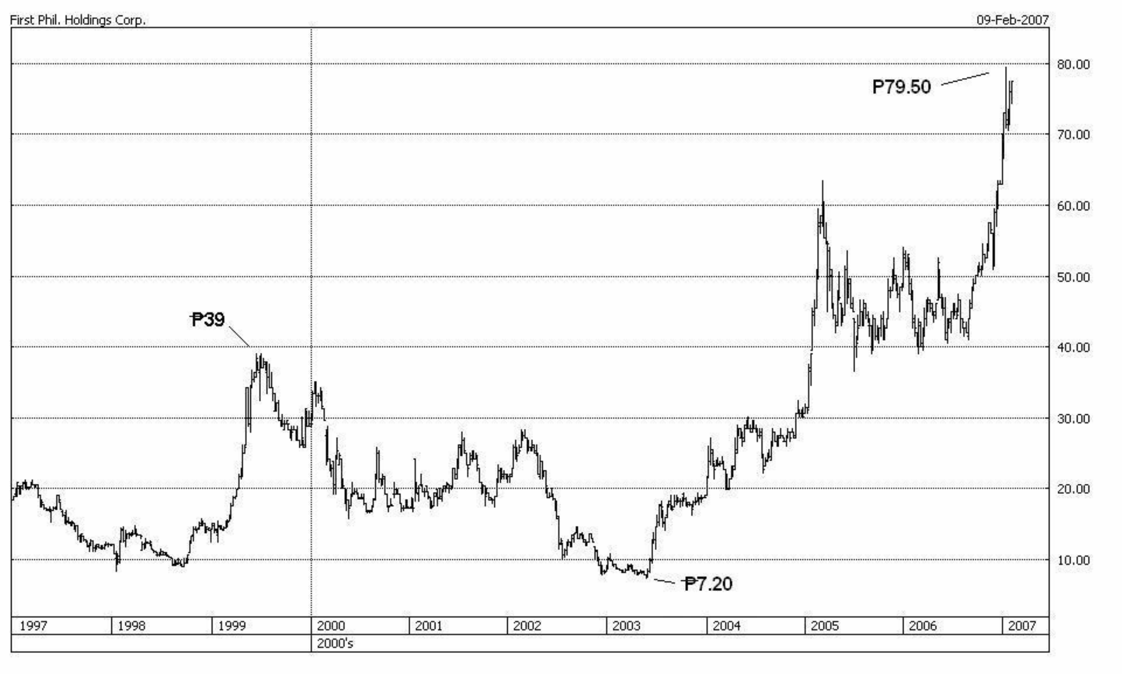
Source: Technistock

The positive sentiment on Meralco also spilled over to other listed Lopez companies such as Benpres Holdings Corp (BPC)…



Source: Technistock

...and First Philippine Holdings.



Source: Technistock

A rising tide lifts all ships

The Lopez conglomerate is now in a better and stronger financial shape to take advantage of any opportunities in a growing economy. But this reversal of fortune is not exclusive to the Lopez group. With the economy on a roll, many companies and conglomerates share the same fate of having a new lease on life. Businesses are picking up, enabling them to generate cash flows to pay off debts and resulting in more cost savings.

With the budget deficit reduced to manageable levels, the government is now in a better fiscal position to aggressively pursue pump priming programs that would create more opportunities for these companies. This should spur higher employment that will finally allow our economic gains to trickle down to all segments of society.

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Congratulations to Congressman Joey Salceda on his appointment as Presidential Chief of Staff. Mr. Salceda is credited as the key architect of the government's fiscal reforms that have brought the economy back to life. We were fortunate to have Mr. Salceda present to the Philequity board the roadmap to the Philippines economic recovery program. With him closer to the President, we are confident that the country stands a better chance at continuing its economic reform program and the long-awaited prime priming activities. In this way, we can achieve a growth pace closer to those of China, Vietnam and other high-growth countries in order to have the economic benefits felt by every Filipino.

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