Philequity Corner
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PNOC-EDC IPO: Manna from heaven

With its spectacular performance and hefty returns to investors, people have labeled the PNOC-EDC IPO as manna from heaven. We even heard a lot of investors say that Santa Claus came to town early. It has been a long while since we have seen an IPO of this size doing as great. At the close of its first trading day, PNOC-EDC's share price rose by a whopping 42% from the IPO price of P3.20/share. Even if it had corrected to P4.35 last Friday, this still represents a 36% gain.

What made PNOC-EDC tick?

We attribute the success of PNOC-EDC to a confluence of factors.
1. The government is the issuer. It has been a long time since the government offered to the public the chance to participate in any of its profitable entities. The last time that this happened was when the Philippine National Bank and Petron Corporation were privatized.

2. The IPO also came timely as investors are increasingly interested in the region (and in the Philippines in particular) which is seen to buck the trend of economic slowdown in bigger markets.

3. PNOC-EDC, by itself, also had a lot of good fundamentals to offer, has a good story to tell and was priced attractively. It was offered at around 7-8x prospective earnings or at a discount to comparable companies in the region.

4. The issue has received a virtual imprimatur from the International Finance Corporation, the private investment arm of the World Bank, which took a 5% stake in the company by investing US$50 million through the IPO. This provided an additional boost to investor confidence.

5. PNOC-EDC provides an interesting play for the growing number of investors seeking for companies engaged in the production of energy from alternative and renewable sources amid the steady increase in prices and decline in the supply of oil.

There is also an increasing interest in projects or businesses which show concern to the environment. Green is definitely in, and this is no longer an exclusive purview for environmentalists and cause-oriented groups. The amount of funds invested in environment-friendly companies or projects has grown from just $12 billion in 1995 to $179 billion in 2005. PNOC-EDC definitely fits the bill given its focus on geothermal energy which releases significantly lower levels of harmful emissions than energy generated by fossil fuels. Its credential of being the biggest geothermal energy company in the world's second biggest geothermal energy producing country is a badge of honor of sorts.

Other forms of public offering

Last week, we discussed IPO as a form of public offering. There are other capital raising activities by listed companies that one can explore for opportunities. These include the following:

1. **Follow-on offering**. We have discussed this extensively in our October 23 issue entitled "A New Kind of Public Offering." To recall, a follow-on issue is the offering of primary and

secondary shares in a public offering by already listed companies (in contrast to an IPO which is done by a private company wishing to go public for the first time). This is very much en vogue nowadays. About P50 billion in proceeds were generated by follow-on issues this year, including those conducted by Universal Robina Corporation, Robinsons Land Corporation, Megaworld Corporation, Metrobank, and Chemrez Technologies.

2. **Listing by way of introduction**. This refers to listing of securities that are already issued or will be issued upon listing in lieu of a public offering under the following conditions:
    a. a requirement by law that such shares should be listed in an exchange (some examples are the Philippine Stock Exchange, telecom and power companies)
    b. the shares are already listed in another exchange or market (as in the case of Sun Life and Manulife)
    c. the shares are distributed as a property dividend by a listed holding or parent company (like in the case of Petroenergy Resources Corporation)
    d. issuing the shares of a newly-formed holding company in exchange for the securities of a listed company. The listing of the latter is eventually withdrawn after the swap, and the new company's shares are the ones left listed in the exchange. An example of this is the newly formed Metro Pacific Investment Corporation in place of Metro Pacific Corp.

    A property dividend is one in which, instead of cash or stock, a company offers to existing shareholders shares or assets in a subsidiary. This will eventually be beneficial to shareholders of the listed parent company because the subsidiary to be listed will assume a market value instead of just being valued at cost (in the parent company's books). Depending on the subsidiary's fundamentals, the newly listed shares also offer additional potential for returns in terms of capital appreciation. In this case, it would be prudent to invest in both the listed parent company and the newly-listed subsidiary.

3. **Stock Rights**. This is another way for a company to raise capital. These instruments offer shareholders the preemptive right to buy other securities of the company at a specified (usually discounted) price and date. Investors see stock rights as a way to acquire additional shares at a cheaper cost and would tend to avail of the offer especially if they see tremendous growth potential in the company. The more recent examples of this are those conducted by Megaworld Corporation, Lepanto Consolidated and Manila Mining Corporation.

4. **Preferred shares**. Companies can also sell preferred shares to raise capital. Preferred shares often carry dividends at fixed rates and are paid prior to dividends for common shareholders. The dividend rate is usually based at a premium to other fixed income instruments such as treasury rates. However, preferred shares normally do not carry voting rights but may carry other compensating features such as convertibility to common shares after a specified time. Recent examples are the preferred share offering of Ayala Corporation and RCBC.

5. **Backdoor listing**. This is a method of going public by buying a listed but inactive company (sometimes called a shell company). As such, the price of the listed company usually rises but the extent of such appreciation is highly speculative until one can determine the value of assets to be infused into the (listed) company. An example of a backdoor listing is BPO company Paxys Holdings through Fil-Hispano.

In any of the above instances, we emphasize the need to go over the issuing company's fundamentals. We strongly advise investors to study and evaluate the underlying fundamentals, and use these as guide to determine if the investment is sound.

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