**Philequity Corner**
**By Ignacio B. Gimenez**

**An Urgent Appeal To Congress**

This week's article serves as a follow-up to our article last week titled, "It's all or nothing for the 12% VAT." We reiterate our position that failure to pass a 12% VAT with no exemptions would result in damaging implications to the economy, including:

1) ***Higher interest rates*** – This results from an increase in the country's sovereign risk as the national government fails to meet its deficit targets in 2005 and disappoints in a key measure in its fiscal reform plan.

2) ***Another round of credit downgrades*** – In this case, Moody's would be proven right in downgrading us a couple of months ago. Another round of downgrades from these credit rating agencies (which put further pressure to interest rates) would hamper the government's ability to seek foreign financing in the future.

3) ***Decline in the prices of stocks, bonds*** – Recent volatility on these financial instruments, shows that they are only tracking the developments in the VAT bill – and not so much the fundamentals anymore. In the stock market, for example, some issues are already trading at absurdly cheap levels and at valuation multiples we have not seen for quite a while.

4) ***Reversal of the peso appreciation -*** The peso is quite fortunate that regional currencies, such as the Japanese Yen, have recently been appreciating against the US dollar on news that China could be willing to loosen its peg on the dollar soon. This is why the stock market is getting the brunt of the drop as foreign investors have gotten exasperated with the long delayed VAT measure. If the dollar starts to appreciate against regional currencies, however, all the peso gains this year may quickly disappear assuming a stalemate on the fiscal reform process.

The current stalemate on the VAT bill causes deep concern. It is on this regard that we appeal to our Senators and Congressmen to heed the growing consensus calling for a 12% VAT with no exemptions. And the sooner it gets passed, the better. Among those supporting the 12% expanded VAT include the ff:

1) multilateral institutions such as the World Bank, IMF, ADB, and the U.N.;
2) business communities and associations including Philippine Chamber of Commerce and Industry, Federation of Filipino Chinese Chambers of Commerce and Industry, Financial Executives Institute of the Philippines, Makati Business Club, etc.;
3) foreign chambers of commerce (American Chamber of Commerce of the Phils., Canadian Chamber of Commerce of the Phils., European Chamber of Commerce of the Phils., Japanese Chamber of Commerce of the Phils., Korean Chamber of Commerce of the Phils., Philippine Association of Multinational Companies, etc);
4) credit rating agencies such as Moody's, Fitch, and S&P;
5) the Philippine Stock Exchange, local and foreign fund managers, the Bankers Association of the Philippines, most foreign investment banks and foreign brokerage houses;
6) economists from U.P. and the PIDS, incumbent and former chiefs of NEDA and many other leading economists.

We also cannot discount the fact that the stock market is the barometer of the macro economy. The recent slump in stock prices already reflects a loss of confidence on the fiscal reforms. Foreign funds have been net sellers in more than a month, pulling out a net of P2.7bn worth of stocks during that period. This same reaction is being experienced in the bond market where prices of ROP bonds have likewise declined.

Remember that it is also a sentiment/confidence game with regard to financial markets. Once that confidence is lost and investors (especially foreign) decide to pull out, it will take a long while for them to come back. Furthermore, if foreign funds want to get out, they sell at market prices – even if company fundamentals are intact, since most of them employ a TOP-DOWN investing approach. In the end, it will cost the Philippines more (in terms of paying higher interest rates) just to woo them back.

Already, we are experiencing damaging results in stock prices. As we have pointed out in our previous article, the Philippines went from being a darling in the region during the first two months of the year (up 19%) to being the worst performer (down 14%) since March. At current levels, the market is no longer trading on fundamentals. Despite seemingly favorable 1st quarter results for most companies, stock prices are still down with prices of some issues already cut in half despite trading at attractive P/E multiples. Even the daily turnover in the Philippine Stock Exchange was halved, from previous volume of P1bn to P2bn to current volume of P500m to P1bn.

**Worst Performing Liquid Stocks**

| | Company | 2005 High | Recent Low | % Change | P/E Ratio (2005E) |
|---|---|---|---|---|---|
| 1 | DMCI Holdings, Inc. | 6.10 | 2.44 | -60% | 3.1 |
| 2 | Metro Pacific Corporation | 0.71 | 0.33 | -54% | not rated |
| 3 | Digital Telecommunications Phils., Inc. | 2.02 | 0.98 | -51% | -5.7 |
| 4 | Manila Mining Corporation "B" | 0.04 | 0.02 | -50% | not rated |
| 5 | Holcim Philippines, Inc. | 4.90 | 2.50 | -49% | 10.6 |
| 6 | Empire East Land Holdings, Inc. | 0.63 | 0.35 | -44% | 20.0 |
| 7 | Belle Corporation | 1.86 | 1.04 | -44% | 40.0 |
| 8 | Lepanto Consolidated Mining Co. "B" | 0.57 | 0.32 | -44% | not rated |
| 9 | Philex Mining Corporation "B" | 1.80 | 1.04 | -42% | not rated |
| 10 | Benpres Holdings Corporation | 1.50 | 0.90 | -40% | 6.5 |
| 11 | Megaworld Corporation | 2.02 | 1.22 | -40% | 10.8 |
| 12 | Semirara Mining Corporation | 52.00 | 32.50 | -38% | 4.1 |
| 13 | Filinvest Land, Inc. | 2.12 | 1.34 | -37% | 15.4 |
| 14 | Fil-Hispano Holdings Corp. | 12.00 | 7.80 | -35% | 14.1 |
| 15 | Manila Electric Company "B" | 32.50 | 21.25 | -35% | 6.5 |
| 16 | First Phil. Holdings Corp. | 63.50 | 42.00 | -34% | 5.3 |
| 17 | JG Summit Holdings, Inc. | 4.25 | 2.90 | -32% | 8.5 |
| 18 | ABS-CBN Holdings Corporation Pref. | 19.00 | 13.00 | -32% | 9.6 |
| 19 | A. Soriano Corporation | 2.65 | 1.82 | -31% | 5.6 |
| 20 | Petron Corporation | 4.55 | 3.20 | -30% | 7.9 |
| 21 | Pilipino Telephone Corporation | 4.10 | 2.90 | -29% | 5.5 |
| 22 | Ayala Corporation | 8.70 | 6.30 | -28% | 16.3 |
| 23 | Metropolitan Bank and Trust Company | 40.50 | 29.50 | -27% | 14.0 |
| 24 | Ayala Land, Inc. | 10.00 | 7.30 | -27% | 21.2 |
| 25 | SM Prime Holdings, Inc. | 9.70 | 7.10 | -27% | 13.9 |
| 26 | Manila Water Company, Inc. | 7.60 | 5.80 | -24% | 5.8 |
| 27 | Int'l Container Terminal Services, Inc. | 8.70 | 6.70 | -23% | 9.1 |
| 28 | Bank of the Philippine Islands | 60.00 | 47.00 | -22% | 13.1 |
| 29 | Banco de Oro Universal Bank | 31.50 | 24.75 | -21% | 10.3 |
| 30 | Globe Telecom, Inc. | 970.00 | 810.00 | -16% | 9.1 |
| | **Average** | | | **-35%** | **10.8** |
| | **Philippine Composite Index (PHISIX)** | 2,172.76 | 1,817.01 | **-16%** | **11.1** |

Note that no one was spared in the recent slump in stock prices, be it the big institutional funds or even the small retail investor. Most institutional funds were not able to pare down their holdings as liquidity suddenly dried up. Meanwhile, most retail investors have already lost big-time since favored blue chip and 2nd line issues have declined an average of 35% - in just a short period of time. And if the performance of more illiquid issues were added, the losses reflected would have been much higher.

Anyway, the latest in the unfolding "VAT" drama is that President Arroyo will be given the power to increase the VAT from 10% to 12% herself so as to break the deadlock. While it may not be a perfect solution of an immediate 12% thru Congress, we think that the market can live with it as long as it provides the P100bn+ revenues urgently needed. If this is the way to break the long drawn affair that should have been passed months ago, then so be it and let it be done with.

Once again, we appeal to our Senators and Congressmen to resolve the current stalemate. While we recognize their noble intentions, all these delay is not helping us any. Foreign investors are already getting exasperated and have started looking for alternative investments elsewhere. There are myriad of opportunities elsewhere in the region and it is very easy now for investment capital to move. We are not the only market in the world. And once the damage has been done and investors pull out, it would be difficult for them to come back. By then, all the positive effects from key policy measures initiated since last year would have gone to waste.

Indeed, timing is of the essence and just as we say in Filipino, *"Aanhin pa ang damo kung patay na ang kabayo."*

*For comments and inquiries, you can email us at info@philequity.net or ibgimenez@gmail.com .*