Philequity Corner (08/08/2005)
By Ignacio B. Gimenez

The race goes on

Banco de Oro (BDO), together with parent SM Group, finally succeeded in getting a substantial stake in Equitable-PCI Bank (EPCI) in a bid that started way back in December 2003. The move is seen as a first of a series of moves which will eventually end in the merger of the two banks and catapult BDO to No. 3 position in the rankings race.

Ironically, it is the Go family who paved the way for BDO's entry to the EPCI board. BDO together with SM Group have agreed to purchase the Go family's 24.76% stake in EPCI for P56.50 per share or equivalent to P10.2 billion.

At the acquisition price of P56.50 per share, BDO will be paying 0.9x of reported book as of 2Q05 or 1.3x adjusted book (ex-Goodwill).

Fast-tracking growth thru M&A

It's enviable how BDO was able to aggressively build up its branch network and asset base thru reasonable acquisitions in the past few years. It merged with Dao Heng Phils. in 2001, acquired 57 branches and deposits in First E-Bank in 2002, and acquired Banco Santander Phils and Santander Investment Securities Phils. in 2003. It also recently purchased 66 branches (with P11bn in deposits) of United Overseas Bank for P600m. The EPCI acquisition, however, is the most significant and virtually vaults BDO from ranking 7th in terms of assets to 3rd place - well within range of Metrobank and BPI.

The acquisition price of 1.3x adjusted book is also cheap considering EPCI's large branch network (over 400 branches nationwide), large low-cost deposit base, strong remittance, credit card, and trust businesses and professional management. BDO will also inherit EPCI's large client base (corporate accounts of the old PCI Bank and the loyal Chinese accounts of the old Equitable Bank). We reckon that BDO paid around 1.8x to 2.0x clean book depending on how one values EPCI's non-performing loans (NPLs) and the foreclosed assets.

Not to be outdone by BDO's aggressive moves, BPI made an announcement two weeks ago (ahead of the EPCI acquisition) that it has agreed to acquire 80% of Prudential Bank. Like BDO, BPI is one of the more successful banks who implement a fast-tracked growth strategy thru M&A.

In previous years, BPI has successfully acquired and merged with a number of banks and finance companies, namely: People's Bank and Trust Co. (1974), Commercial Bank and Trust Co. (1981), Ayala Investment and Development Corp. (1982), Makati Leasing and Finance Corp. (1982), Family Bank and Trust Co. (1985), Citytrust Banking Corp. (1996), Ayala Insurance Holdings Corp. (2000), Far East Bank and Trust Co. (2000), DBS Bank Philippines (2002).

Battle for position

*"If BDO succeeds in getting its foot in EPCI …we expect to see the same M&A frenzy which characterized the industry back in 1999, (**The Hunter becomes the hunted – Philequity Corner, May 30, 2005**)."*

Back in 1999, it was Equitable Bank who first created a stir in the banking industry when it acquired 72% of PCI Bank with the help of the government pension funds, SSS & GSIS. The two banks eventually merged to form EPCI, making it then the country's 2nd largest bank in terms of asset size. This single move cascaded into a series of banking consolidations which saw Metrobank acquire and merge with several banks (Solid Bank, Global Bank, Phil. Banking Corp. and Asian Bank), and BPI merge with Far East Bank to maintain the top 2 positions.

Now, the tables have been turned and it is BDO's turn to create a stir with its EPCI acquisition. From last month's annual shareholders meeting, it was very clear that the majority of EPCI shareholders (SSS, GSIS, TMEC) were receptive of the Sy Group's entry to the board and that it was only a matter of time before an actual merger between the two banks happens. Note that if we include China Bank (also controlled by the Sy Group), then a BDO-EPCI-China Bank triple merger will put it at No. 1 ranking - far ahead of Metrobank's and BPI's sights. And speaking from history, expect Metrobank and BPI to fight back with acquisitions or mergers of their own.

Incidentally, the next bank up for grabs is PNB whose 67% stake - jointly owned by the government and the Lucio Tan Group - is up for auction on August 12. Among those seriously considering the bid is Union Bank of the Philippines. The Tan Group, however, has the right of first offer and the right to match the highest offer at the public bidding.

We further expect consolidations happening as the bigger banks continue to battle for position, and smaller banks consolidate forces (thru mergers among equals) or else be acquisition targets themselves.

Below is our short-list of key players currently involved in the banking consolidation saga :

1) **Henry Sy Group** – The Sy Group's flagship bank Banco de Oro has been the most aggressive bank in terms of M&A deals after the 1997 Asian crisis. It has just agreed to purchase the Go family's 24.76% stake in EPCI and is also eyeing SSS' 26% interest in the EPCI including the 10% stake held in EBC Investments. The Sy Group also controls China Bank making a three-way BDO-EPCI-China Bank merger a strong possibility.
2) **Ayala Group** – The Ayala Group's Bank of Phil. Islands is the No. 2 bank in terms of asset size. More than capitalized for its own need, BPI has openly expressed its interest to acquire other banks, not only in the Philippines, but even in other parts of the region. BPI recently announced that it has agreed to purchase 80% of Prudential Bank.
3) **Lucio Tan Group** – The Tan Group controls Allied Bank and owns a 45% stake in Philippine National Bank (PNB) which is up for auction on August 12. A merger between Allied Bank and PNB will always be a strong possibility.
4) **George Ty Group** – The Ty family has long held the No. 1 position in Philippine banking thru Metrobank. In 1999, Metrobank refused to let go of its top position by merging with several smaller banks after BPI merged with Far East Bank and Equitable merged with PCI Bank. Metrobank, however, has not indicated any M&A plans … yet.
5) **John Gokongwei Group** – Gokongwei has been absent in the banking scene since he sold JG Summit's stakes in Far East Bank (sold at 2.3x BV) and PCI Bank (sold at 1.8x BV) in 1999. Now that EPCI has been bought and no longer on Gokngwei's radar screen, he may be eyeing other banks now.
6) **Others** – There's also the strong possibility that well-run, profitable mid-sized banks (such as Union Bank, Security Bank, RCBC and IBank) will acquire or be merged with other banks of similar size. Union Bank recently said it will participate in the PNB auction on August 12. Other possible targets are UCPB which went into receivership last year and Export and Industry Bank which has long been rumored to be up for sale. Meanwhile, there are also talks of the Land Bank and DBP possibly merging.

Catalyst for the market

Since we wrote our first article on the banking consolidation story in May 30, two of the key players mentioned in our list above (namely, the Ayala Group and the Henry Sy Group) already made their moves. This, however, does not discount the possibility of these two players making further deals to strengthen their position.

From May 30 to date, the banking index has already gone up by 4.0%. The banks currently involved in an M&A or those perceived to be involved in the future clearly outperformed the rest. Phil. National Bank got the biggest boost in share price, increasing by 39.4% for the period mentioned. Meanwhile, Banco de Oro registered a 12.3% gain, followed by Union Bank with 10.9% increase and EPCI Bank which is up 10.1%.

Banking Sector Price Performance

	Price as of May 27	Price as of Aug 5	% Change
Phil. National Bank	33	46	39.4%
Banco de Oro	28.5	32	12.3%
Union Bank	27.5	30.5	10.9%
Equitable-PCI Bank	49.5	54.5	10.1%
Security Bank	30	32	6.7%
Bank of Phil. Islands	48	49.5	3.1%
Int'l Exchange Bank	18.75	19	1.3%
Metrobank	30.5	27.5	-9.8%
Bank & Fin Svcs Index	**549.18**	**571.27**	**4.0%**

Source: Technistock

Philequity maintains the banking sector as its top sector pick. With potential deals left and right, we believe that an M&A frenzy similar to that of 1999 is already in the works. And as we have mentioned time and again, this should be a positive catalyst for share prices going forward.

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Speaking of the banking sector, Philequity congratulates Enrique Luy – an intelligent and well-respected businessman in the copra business - who is now the Chairman of Phil. Bank of Communications (PBCom). I have personally known him since the Manila Stock Exchange days when we both served as Governors. He is also the Chairman and President of Luy's Securities, a member of the Phil. Stock Exchange.

Philequity also welcomes former Secretary of Finance Ernest Leung as the new director of the Philequity Group of Funds, replacing incumbent Secretary of Finance Gary Teves who served as Philequity director since 1999. Aside from his stint in the Department of Finance, Ernest previously held positions as President of the Philippine Deposit Insurance Corp., Chairman of the Development Bank of the Philippines, representative to the World Bank and IMF, and President of the Philippine Stock Exchange, among others. He graduated with a degree in Natural Sciences in Ateneo de Manila. He then pursued further studies in Development Economics in Williams College, Massachusettes, where Secretary Teves, incidentally, took the same economics course.

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