

Philequity Corner (August 31, 2009)

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Defense Wins Games

In the past weeks, we have written about stocks related to Manny Pangilinan and Ramon Ang as they engaged in a tug-of-war for the companies they both vie for dominance. Lopez issues flew through the roof as their stocks have been the subject of interest. These were high beta stocks that tend to out-perform the PSE index at times of rally. They also tend to do the reverse when the stock market drops. As the PSE Index gained heftily since its lows last March going up by 54.9% year-to-date, it would now be fitting to highlight stocks that exhibit defensive characteristics. A combo of aggressive and defensive stocks would be an ideal mix in one's investment portfolio.

Companies like PLDT, SM, Jollibee, and the Ayala companies are traditionally defensive. They all have proven track records, sustainability in earnings, and consistent declaration of dividends. But what we would like to highlight more are the holding companies of the Ayala family and the SM group. In our view, their diversified yet focused strategy best underscores our theme on defense. We will write about the SM group in a subsequent issue. For today's article, we will discuss the country's oldest holding company, Ayala Corporation.

Epitome of Diversification

One of the most diversified companies listed in the Philippine Stock Exchange is Ayala Corporation. Its major business interests include telecom, property, banking, and water utility services. Each of its entities is a leader in its respective sector. It has considerable market share and it benefits from economies of scale. More importantly, each of Ayala Corp.'s major unit regularly declares cash dividends that lessen the need for it to rely on borrowings.

While other holding companies also have interests that span several industries, they normally have one sector focus that renders all of its stocks vulnerable during unfavorable times. One good example is First Philippine Holdings. The holding company of the Lopez family has carved a niche in the energy sector. FPH has different types of assets in the power generation business alone – natural gas, geothermal, hydro electric, among others. And although its stake in Meralco has diminished already, it still has a sizeable stake in electricity distribution.

The stock market crash of 2008, however, aptly illustrates the differences between AC and FPH. The PSE Index fell by 48 percent. While no stock was spared by the market's nosedive, AC did not perform as badly as FPH. Its diversification and conservatism are testaments to its resiliency in times of market weakness.

Strong Strategic Partners

Large companies often have strategic partners who can help in expanding a company's business perspective. It's like having a big brother who acts as a coach and provides guidance every step of the way. In Ayala Corp.'s case, it has anchor investors in its business units that aid them in their strategic pursuits. Having respectable and recognized strategic foreign partners not only helps improve shareholder profile but also assists generate investor confidence in the company. BPI partnered with Development Bank of Singapore. Globe has Singapore Telecom. Manila Water tied up with United Utilities.

Foreign investor friendly

Given Ayala Corp's solid reputation in the investment community, it is also not uncommon for foreign brokers to invite an Ayala company to participate in investment road shows. Ayala's familiarity with foreign fund managers makes them a staple investment in every portfolio.

It is likewise not surprising to know that Ayala Corp, its subsidiaries, and management officials have garnered numerous citations from regional magazines like Finance Asia and Euromoney. From Best Company to CEO and CFO of the Year, every Ayala company is a perennial candidate.

Safe and Sound

Ayala Corporation is of one those stocks that investors can buy and then hold for many years. AC and its subsidiaries are well-run companies. They are fairly conservative in their business plans. And they execute well and according to plan. We highlight below the strengths of Ayala Corp's subsidiaries:

Attractive Dividend Yield

Telecom's main attraction to investors is their ability to generate cashflows and plough these back to shareholders. Given a 100% payout ratio, Globe's dividend yield at 9.6% is higher than PLDT at 8.7%. Yields of other Ayala companies, BPI (4%), MWC (3%) and ALI (1%), are fairly decent relative to competition.

Conservative Business Practice

Banking is a business of trust and confidence. Employing conservatism is therefore of prime importance. BPI leads its peers in every aspect with respect to conservatism. As far asset quality is concerned, BPI has the lowest NPL ratio in the industry at 1%. This is why whenever there is panic in the market, investors and even depositors put their money in BPI.

Unparalleled Service, Execution and Efficiency

Water utility is more than just a business; it is a service. By operating efficiently, better service is achieved. Manila Water tops its competitor in every efficiency metric. From its low rate of pilferage to the number of customers served per employee, MWC is the standard bearer of unparalleled service.

Ayala Land is the country's premier real estate developer. It is a distinguished developer, as Ayala Land is known for well-designed and executed projects not to mention prompt delivery to home buyers.

Defense is the best offense

In basketball, they say that defense is the best offense. This was made true during the 2008 NBA Finals when the LA Lakers met their archrival Boston Celtics. Kobe Bryant was that year's MVP and NBA's leading scorer. In the end, it was however the Celtics' stinging defense that made the difference. The year after, not only did the Lakers spread their offensive prowess, they also emphasized on their defense. And it paid off. They won the 2009 NBA Finals. As Phil Jackson, Pat Riley, Larry Brown and other best coaches say, offense wins games but defense wins championships.

Barbell Approach

In stock market investment, one should not only buy high flyers. They should diversify into defensive plays in order to protect a portfolio from taking too much risk. Though stocks themselves are risky per se, buying defensive issues like Ayala Corp, Globe Telecom, Ayala Land, and Manila Water limits downside risk.

At Philequity, we employ a barbell approach. It is a mix of both offensive and defensive strategies. We spot investment opportunities and are quick to take positions. At the same time, we hold conservative and stable companies as part of our overall strategy. Our offense has generated us with unparalleled gains, but our defense enabled us to garner Investment Company Association of the Philippines' (ICAP) top awards consistently.

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