

## Philequity Corner (August 2, 2010)

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### Size Matters

Bank stocks have been very active recently. Talks of mergers and acquisitions (M&As) abound which led to the significant share price appreciation of a number of banks. Although we have written several articles on bank M&As in the past, this column serves as an update to the countless permutations of possible bank marriages. Some banks are in the hunt to be at the top while others time and calibrate their acquisitions. Considering the vibrant prospects of the economy and the healthy stock market, it is possible that the industry is ripe for another round of M&As. To stay competitive in this league, size matters.

### Bank Ranking

	MARKET CAP	ASSETS	LOANS	DEPOSITS	CAPITAL	ROE	NPL	CAR
Banco de Oro	121,767	847,682	507,787	679,857	69,790	11.9%	4.5%	12.8%
Metrobank	114,683	833,428	338,738	602,071	75,058	13.6%	3.5%	14.3%
Bank of P.I.	153,930	695,499	317,193	557,758	67,428	16.6%	2.8%	14.7%
RCBC	20,965	282,849	154,128	201,783	31,414	13.5%	4.5%	18.2%
PNB	25,033	281,512	98,817	209,147	31,620	11.5%	4.1%	18.4%
UnionBank	29,441	236,001	84,617	186,807	32,473	10.7%	2.6%	15.1%
China Bank	44,513	228,741	106,652	187,310	31,419	14.2%	4.1%	12.8%
Security Bank	29,179	143,613	65,224	96,929	18,851	20.1%	1.5%	18.1%

### El Kapitan Draws First Blood

The PNB-Allied bank merger is set to finally push through once the US regulators approve of the sale of Allied Bank's 27.78% interest in Oceanic Holdings (BVI), a company which owns California-based Oceanic Bank. The sale is the last hurdle hindering the union of Lucio Tan's banking interests. PNB, as the surviving entity, will be a strong fourth placer in the industry with a network of more than 600 branches.

The announcement of the merger caught the eye of stock market punters and traders. From a low of 20.75 at the start of the year, PNB's share price continuously traded higher as the merger nears fruition. Talks of PNB as a possible target pushed the stock even further to P44.50, its 52-week high. Indeed, size does matter.

### PNB-Allied: Ranks 4<sup>th</sup> in the Industry

	ASSETS	LOANS	DEPOSITS	CAPITAL
Banco de Oro	847,682	507,787	679,857	69,790
Metrobank	833,428	338,738	602,071	75,058
Bank of P.I.	695,499	317,193	557,758	67,428
PNB-Allied	468,858	189,110	355,130	55,217
RCBC	282,849	154,128	201,783	31,414
UnionBank	236,001	84,617	186,807	32,473
China Bank	228,741	106,652	187,310	31,419
Security Bank	143,613	65,224	96,929	18,851

PNB management said that after its merger with Allied Bank is completed, it will still be in the hunt for smaller banks. But it is also likely that the consolidation of PNB with Allied Bank is a preparatory move for an eventual sale, as Lucio Tan will own

80% of the enlarged PNB. With the increase in asset size, a merged PNB-Allied Bank increases its attractiveness. We are reminded of our past article *The Hunter becomes the Hunted* (**The Philippine Star**, 30 May 2005) – Equitable Bank acquired a much bigger PCIBank only to be gobbled up by Banco de Oro in the end.

### **Eye Opener**

While a potential sale of the PNB-Allied Bank may be widely perceived as pure speculation, the recent move of Lucio Tan served as a precedent. The merger of Lucio Tan's Fortune Tobacco with foreign rival Philip Morris created a dominant cigarette company with a 90% share of the market. Fortune Tobacco is Lucio Tan's crown jewel. The sale of this cash cow caught the business circle by complete surprise. They are pondering the rationale of this move. After the sale of Fortune Tobacco, there are now talks that Philippine Airlines is opening its doors to foreign investors and carriers for a possible sale and/or strategic tie-up. PNB-Allied Bank may not be far behind.

### **Succession and Estate Planning**

The country's prominent business tycoons have already passed on their businesses to their children. John Gokongwei has anointed Lance as the top man. Henry Sy has relegated the SM empire to his heirs. The same is true for the Ayala and Lopez families, where the patriarchs have handed the baton to the next generation. Likewise, George Ty of Metrobank and the Gotianuns of Filinvest have passed on their respective business interests. For the Lucio Tan group of companies, however, succession planning is somewhat vague at this point. There is no clear heir to the throne. Receiving financial rewards from a well-established company like Philip Morris and retaining part of the merged entity in exchange for ceding management control may be an option to resolve conflict in the long run. Is the sale of Fortune Tobacco the start of estate planning for Lucio Tan? Will other Lucio Tan companies like PNB be next in line?

### **Predators and Preys**

With issuance of bank licenses frozen by the Bangko Sentral (BSP), it appears that M&A is the only avenue to achieve higher-than-average growth. There are as many acquirers as there are targets. The numerous combinations of bank marriages are simply overwhelming. We will try to give our readers a glimpse of the frontrunners and the likely target candidates.

### **BPI: M&A Veteran**

BPI's long list of acquisitions only proves that it will always be an acquirer if the right fit comes along. Throughout its history, BPI has engaged in M&A every 3 to 5 years. In 2008, it almost bought out Philam Life to solidify its *Bancassurance* platform. BPI even planned a P15 billion rights offer issue to back up its bid. In the end, however, the acquisition failed to materialize and Philam Life instead bought 51% of Ayala Life.

BPI's History of Acquisitions		
Year	Company	Purpose
1974	People's Bank & Trust	Increased distribution network
1981	Commercial Bank & Trust	Increased distribution network
1982	Ayala Investment & Philsec	Investment banking services
1982	Makati Leasing	Lease finance services
1982	Ayala International Finance	Overseas banking network
1984	People's Development Bank	Rural banking franchise
1984	Family Bank & Filinvest Credit	Retail banking & consumer fin.
1984	Asian International Bank	Overseas banking network
1996	City Trust	Consolidate consumer banking
1999	Ayala Insurance Holdings	Bancassurance
1999	Far East Bank & Trust Co.	Trust banking
2005	Prudential Bank	Middle market presence

BPI used to be at the top of the list but lost its ranking in the past years. BPI is now lagging behind rivals BDO and Metrobank whose assets are in the P800 billion levels. BPI is presently raising capital to the tune of P10 billion via a rights offer issue. The announcement fuelled speculation that it may be in the prowl again for acquisition. This triggered not only the share price of BPI to go up, but also other banking stocks. After a long hiatus and inactivity, BPI may be planning for another acquisition. A BPI-PNB merger will bring it back to a solid #1 with assets more than a trillion.

### **Bank Mergers: Catalyst for the PSEi**

For the market to move to the next level, strong catalysts must be in place. The banking landscape is conducive for M&As. Interest rates are low, competition is stiff, and bank valuations are cheap. Similar to what happened in the late 90s, the round of banking M&As led to the strong rally of the PSE Index. *Due to limited space, we shall continue our write-up on bank M&As in a subsequent article. We shall be identifying the possible acquirers and probable targets.*

### **REIT Implementation Postponed**

The 2<sup>nd</sup> REIT (Real Estate Investment Trust) Asia Pacific Summit was recently concluded. It aims to develop REITs in the Philippines given the recent passage of the law. REIT, as whole, is positive to most stakeholders. It is good for the sponsors since it will allow them to raise capital. It is good for the investors since it will create an alternative asset class. It is good for the banks and brokers since it will generate new business. It is also good for the Philippine Stock Exchange since it helps in the development of the capital market, not to mention the fees the PSE can derive from listings. It is, however, not favourable for the country and the government at this juncture. Since the government is trying to address the fiscal problem, now may not be the time introduce instruments that will limit tax revenues. Foregone revenues will run in the billions. We view REIT as an impetus for the PSEi to move higher. With its delay, a new catalyst must take place. Bank M&As might be that catalyst.

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