

Philequity Corner (September 27, 2010)
By Valentino Sy

Fly High

In the UAAP, the Ateneo Blue Eagles continue to fly high, shocking the FEU Tamaraws with a 72-49 win in their first game. Ateneo needs to win just one more game to bag the men's basketball championship.

In the Philippine Stock Exchange, the bull market is flying high too, leaving the naysayer dumbfounded and catching most experts by surprise. Year-to-date the PSE index is up 33.62 percent, while our Philequity Fund is up 47.15 percent.

Many readers liked the Q&A format last week (see *New High Means Higher*, September 20, 2010). In fact, we have received several more questions on the market and some queries on specific stocks. As a follow-up to our article last week, we are continuing with the Q&A format.

1) Why is the stock price of Philippine National Bank making a huge run-up?

Firstly, PNB is still cheap relative to the sector. With a book value per share of Php50, it is currently priced at 1.4x price-to-book. In comparison, the sector is trading at 1.8x price-to-book.

Secondly, PNB is a likely beneficiary of an M&A play. In fact, we have written about this before. In our article *Size Matters* (August 2, 2010), we said that the coming merger of PNB and Allied Bank is a preparatory move for the eventual sale of the merged bank. Given that Lucio Tan already sold his crown jewel Fortune Tobacco as part of his succession and estate planning, it is highly likely that he will also sell PNB. The merged PNB-Allied (with Total Assets of Php 460 billion) would be a juicy target for those banks that are looking to acquire. The acquisition price can easily reach 2 to 2.5x book.

The price movement seems to support our view. Since we wrote the article eight weeks ago, the price of PNB has surged 60 percent to close at Php 71 per share last week. Foreigners have been net buyers the past 14 trading days (except for one day). Total net foreign buying for PNB from September 6 to 24 amounted to Php1.3 billion or equivalent to almost Php100 million per day.

Talks of M&A with PNB continue to persist despite denials. Aside from BPI which we mentioned in our article *Size Matters*, ICBC (China's largest bank in terms of assets) is also rumored to be interested in PNB.

Even without an M&A play, the stock price of PNB at 1.4x book is still reasonable. For 2011, CLSA has a target of Php85 per share for PNB. Meanwhile, Wealth Securities has a price objective of Php100.

2) Why is the stock price of Philex Mining going up?

Philex, which is majority owned by First Pacific of Hong Kong, is said to be going all-out to acquire major mines in the Philippines. First Pacific's recently raised \$400 million in 10-year bonds at 6.375 percent. The capacity of First Pacific to raise funds quickly shows that they have the ability to secure funding for a major mine.

Among the projects being eyed by Philex are the following: (1) Boyongan-Bayugo area in Surigao which needs to be consolidated because the latter half is owned by Manila Mining; (2) Mt. Diwalwal project which is presently up for bidding; (3) Tampakan Project which needs a new partner to buy the 37.5 percent stake of Indophil; (4) KingKing Project which may need a JV partner to bring it to commercial operations; (5) Toledo Mine as CASOP, an Asian investment fund, may be looking to exit; (6) Dilipido project.

The acquisition of a major mine will address the concern of depleting reserves of Philex's Padcal mine in Benguet. This will be the next catalyst for Philex to move higher. For 2011, Wealth Securities has a Php20 target for Philex.

3) Why did the stock price of Lepanto Mining rise so much?

Lepanto has just entered into an Option and Shareholders' Agreement with Gold Fields of Switzerland Holding AG, a wholly-owned subsidiary of Gold Fields Limited in relation to the development and operation of the Far Southeast Project in Benguet. Under the agreement, Gold Fields will be granted an 18-month option to acquire a total of 60 percent interest in Far Southeast from major shareholders Lepanto and private holding company Liberty Express Assets for a total consideration of \$340 million.

If Goldfields exercises the option, Lepanto's share in the project would be reduced from 60 percent to 40 percent, while Liberty Express' share would be reduced from 40 percent to zero.

Goldfields is required to pay a \$10 million non-refundable option fee to Lepanto and \$44 million non-refundable down-payment to Liberty Express. Should Gold Fields, after a 12-month period decide to proceed with the acquisition, a further non-refundable down-payment of \$66 million will be payable to Liberty. The final payment of \$220 million is payable after 18 months (\$110 million payable to Lepanto and \$110 million payable to Liberty).

Gold Fields CEO Nick Holland is very excited with the transaction, calling Far Southeast "the most significant gold-copper porphyry in the world."

4) Why are the share prices of mining companies (in general) moving higher?

Firstly, metal prices are reaching record highs. Gold has hit \$1,300 per oz. for the first time ever. Silver topped \$21 per oz. for a fresh 30-year high. Copper is at \$3.61 per lb., just 10 percent shy of its all-time high registered in 2008.

Secondly, Philex is on the prowl for acquisitions, thus driving up the prices of other listed mining companies. With the backing and war chest of First Pacific, Philex will have the financial muscle to acquire major mining firms in the country.

Thirdly, the entry of Goldfields in Lepanto is very significant because this may spark the entry of other major mining companies into the Philippines.

5) Why is SMDC (symbol: SMDC – Php10.02) making new all-time highs?

SMDC, in such a short period of time, is now no. 1 in the market. Revenues have tripled during the past two years and earnings per share have expanded 20-fold over the same period.

Last week, SMDC disclosed its 1-for-3 rights offering priced at Php6.38 per share which is at a 36 percent discount to last week's close of Php10.02 per share. Proceeds from the rights offering amounting to Php11.6 billion would be used for landbanking and project development.

Wealth Securities has a target of Php13.0 per share for SMDC (ex-rights).

6) Who will benefit from the private-public partnerships (PPP) that are being espoused by the Aquino government?

Over the next few years, the Philippine government plans to undertake major infrastructure projects via PPP. These multi-billion peso projects will go to investments in expressways, airports and water systems.

The listed companies that will benefit from these PPP projects are Ayala Corp., SM Investment Corp., JG Summit, Aboitiz Equities Ventures, San Miguel Corp., Metro Pacific Investment Corp., DMCI Holdings, EEI Corp., Holcim Philippines and Republic Cement.

Most of the conglomerates and construction companies will benefit from these projects as many of them will join the bidding. The bidding process and the awarding of these projects can be the next catalyst for the PSE index to reach our end-2011 target of 5,000.

7) Why are the closing prices in the PSE so volatile with some going up more than 10 percent in the last second?

The new trading system, PAM, has made trading more volatile, especially at the close. Heavy foreign buying with "market-on-close" orders created a huge trading imbalance at the close. The lack of depth and liquidity in our local market exaggerated the closing prices. This is the reason why there were instances (during the past month) where the stock prices of BPI, SM Prime Holdings and Ayala Land went up more than 10 percent in the last second prior to the close.

This new trading system has exaggerated the price movement of most index issues and accelerated our forecast for the PSEi. Our price target of 4,000 by end-2010 was reached earlier than we anticipated. Thus, we are upgrading our forecast to 4,200 by year-end and 5,000 by end-2011.

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