

## **Philequity Corner (July 4, 2011)**

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### **“Economic Suicide”**

Economic suicide were the words used by PLDT chairman Manny Pangilinan to describe the impact of the Supreme Court (SC) ruling ordering the Securities and Exchange Commission (SEC) to use only common shares and exclude preferred shares in assessing the capital stock of a company. A financial meltdown will occur in the stock market if foreign investors will not only be disallowed to buy, but also be forced to sell to comply with the 40% ownership cap.

### **Beyond PLDT**

The SC decision arose from a petition seeking to reverse the sale of the government’s stake in the Philippine Telecommunications Investment Corp. (PTIC), owner of PLDT, to Hong Kong-based First Pacific Co. whose CEO is Mr. Pangilinan. Presently, foreigners own 64% of PLDT’s common shares. If the SC ruling will be applied and only the common shares will be used to determine its capital stock, then PLDT is in violation of the law. But since preferred shares are included in the capital stock, Filipinos thus own 87% of the telecom giant while foreigners hold only the 13% balance.

The result of this nullification move would be detrimental to PLDT, which carries the biggest weight in the PSE Index. Worse, the damage could extend far beyond PLDT and other public utilities. Numerous companies that also issued preferred shares in view of attracting more foreign investors will be severely affected.

### **What the Law Says**

Under Section XI of the 1987 Constitution, no franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to the corporations or associations organized under the laws of the Philippines **at least sixty percent [60%] of whose capital is owned** by such citizens, nor such franchise, certificate, or authorization be exclusive in character for a longer period than fifty [50] years.

### **Preferred and Common**

The definition of the term “capital” is somewhat vague since the law is silent on its definition. In finance, capital can be comprised of pure common stocks or both preferred and common.

A preferred stock is a class of ownership in a corporation that has a higher claim on the assets and earnings than a common stock. Preferred stock generally has a dividend that must be paid out before dividends to common stockholders are declared. It is like a debt owed to a creditor which carries an interest. A preferred stock is a hybrid security such that it has the characteristics of both a bond and a common stock. Depending on the structure, preferred shares typically do not have voting rights. This is where the ambiguity comes in.

On the other hand, a common stock, another class that represents ownership in a corporation, is at the bottom of the priority ladder in terms of claim on the assets and earnings of the company. Holders of common stocks, however, are able to exercise control by electing the board of directors. The common shares are the ones used to compute for EPS or earnings per share.

### **Php3 Trillion Mess**

We list the publicly traded companies with capital stock composed of both preferred and common shares. They may be affected by the SC reversal ruling. Considering that these companies are leaders in their respective industries, the impact could be financially

devastating. By our estimates, their aggregate market value is near P3 trillion. The consequences of unwinding these investments are too dire for the market to bear. A major catastrophe in the stock market will happen if foreign investors will not be allowed to buy, or even worse, are forced to liquidate. PLDT's ADRs may also have to cease trading in the New York Stock Exchange.

### Listed Companies with Preferred and Common Shares

Index Stock	Market Cap	Common	Preferreds (Non-Voting)	Preferreds (Voting)	Total Shares
PLDT	444,481	187	442	-	629
SM Investments	327,105	612	0.02	-	612
Manila Electric Co.	312,254	1,127	192	-	1,319
San Miguel Corporation	276,753	2,330	971	-	3,300
Aboitiz Equity	231,643	5,522	150	-	5,672
Ayala Land	205,769	13,023	13,035	-	26,058
Ayala Corp.	155,438	484	60	-	544
Petron Corp.	138,564	9,375	100	-	9,475
EDC	126,750	18,750	-	9,375	28,125
Globe Telecom	117,195	132	-	159	291
DMCI Holdings	115,780	2,655	-	0.004	2,655
ICTSI	99,031	1,940	4	700	2,644
Metro Pacific Investments	82,553	22,192	-	5,000	27,192
Megaworld Corp.	51,532	25,638	-	6,000	31,638
First Gen	48,424	3,363	-	1,469	4,831
Belle Corp.	42,901	9,051	1,000	-	10,051
Manila Water	38,335	2,033	500	4,000	6,533
First Phil. Holdings	33,906	574	43	-	617
Filinvest Land	29,100	24,250	8,000	-	32,250

Source: PSE, Wealth Securities Research

### Strong Reservation from the PSE

In reaction to the SC ruling which modifies the concept and computation of the 60-40 capital limitation on foreign ownership, the PSE expressed grave concern on its ramifications. In a press statement, the PSE noted that the decision may result in capital flight of existing foreign investors, increased market volatility, and discouragement of foreign investments in the country. All efforts by the PSE to build investor confidence and stimulate the capital market will be put to waste. We laud the PSE in taking quick action and in voicing its concern about the possible catastrophic effect of the SC ruling. The PSE said that it will work closely with the SEC to resolve the issue.

### P-Noy says it's Disruptive

President Aquino said that the impact could be very large and would be disruptive to the economy. His plans of inviting in foreign investors and creating more jobs for the Filipinos may be at risk because of the SC ruling.

### Hindrance to Country's Progress

Senate President Juan Ponce Enrile and House Speaker Feliciano Belmonte, Jr. shared the same view that the SC ruling will be a hindrance to the country's progress. Leaders of both houses of the Congress propose an amendment of the constitution to widen ownership of foreign investors and address the vague and conflicting interpretation of the law. Both senator Enrile and speaker Belmonte agreed that public utilities, mining, media, and land should be allowed increased foreign ownership. A constitutional amendment is viewed as a solution to prevent this looming financial collapse.

### SEC and PSE are Crucial

The economy is already gaining momentum as far as improving the investment climate in the country is concerned. Confidence in the government remains high as efforts to institute fiscal discipline are showing concrete results. And as a result, ratings upgrades have been achieved. The PSE Index is just a few points shy from exceeding its all-time high. The SC action will cast a major financial disaster and reverse all the positive gains in the past.

Presently, the law, as interpreted, may allow voting preferred shares in the determination of capital stock of a corporation. This move, however, can also be questioned. The SEC and the PSE are therefore crucial in making sure that the financial dislocation does not materialize. They should have an enlightened thinking of the matter, bearing in mind that the economy and the capital market will collapse with a negative interpretation of the law.

The market has taken in stride the SC ruling believing that a solution will be found. The market did not drop and continued its bullish performance as investors anticipated that regulators will step in and address the problem. Investors believe that the consequences are so dire that such an event cannot conceivably come about. Nevertheless, both the SEC and PSE should be vigilant that a black swan event of our own doing will not happen. Meantime, the collective wisdom of the government – executive branch under the President (i.e., DOF, SEC) and the legislative branch (i.e., Senate and Congress), the private sector, the business community, and the PSE should work together in arriving at a permanent solution to prevent the country from committing a so-called economic suicide.

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