



THE WEALTH VAULT

A Product of Wealth Securities, Inc.

Company Update

MANILA ELECTRIC CO. (MER)

RE-INITIATE COVERAGE WITH A LT BUY

4 November 2011

Company Snapshot

Price (P)	234.00
Price Target (P)	303.00
Shares O/S (million)	1,127
Market Cap (P million)	264,458
52-week High (P)	299.60
Low (P)	170.00
12-mo Avg. Value T/O (P'm)	---
EV/EBITDA	11.1x
Dividend yield	2.9%
ROAE	26.3%

Financial Highlights

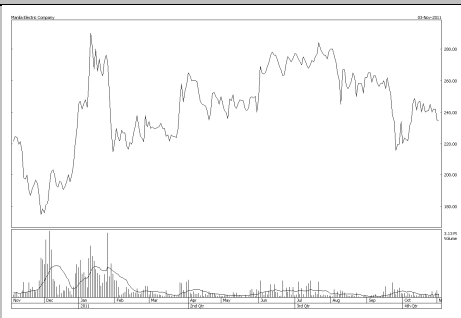
in P'million	2010A	2011E	2012E
Dist. Revenues	43,931	49,301	50,282
EBITDA	18,232	21,249	22,527
Pre-tax profit	14,437	16,812	18,001
Core net profit	12,155	14,346	15,487
EPS (P)	10.78	12.73	13.74
P/E (x)	21.8	18.4	17.1

A = Actual calendar/fiscal year results; C = Bloomberg consensus; I = Annualized interim results; E = Wealth Securities estimates

Price Performance

	1m	6m	12m
MER	+6.4%	-4.6%	+2.9%
PSEi	+8.9%	-2.5%	+0.2%

1-Year Price Chart



Source: Technistock

Corporate Announcement

Nov 2 P1.70 cash dividend declared

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Defying gravity

- **Strong YTD.** Meralco reported a net income of P9.95 billion for the Jan-Sep period, higher by 25% YoY, on the back of a near flat volume trend. Core net income was up 27.4% YoY to P11.6 billion. Distribution rates increased by 13% to P1.61/kWh from P1.42/kWh as a result of the price adjustment implemented last January. System loss was further reduced to 7.43% from 7.78% the prior period. Interestingly, 3Q saw a different volume pattern in spite the disruptions brought about by typhoons Pedring and Quiel. Estimated cost to replace the damage was negligible at P78 million, moreso this will be covered by insurance.

Meralco's 3Q Results Breakdown

	3Q11 (P'bn)	YoY chg	Comments
Volume, gWh	7,944	+3.0%	Higher comm'l and ind'l sales
Gross Revenues	68.1	+11.1%	Distribution rate of P1.61/kWh up 13%
EBITDA	6.8	+34.2%	10% Ebitda margin > 9% a year ago
Reported Net Income	3.9	+23.9%	Possibly higher than most in the sector
Core Net Income	3.8	+14.7%	Lower growth than 9M as provisions accelerated

Source: Company, Wealth Securities

- **Upped guidance, but 4Q to slow.** Following the higher-than-expected year-to-date financial results, management increased its core profit guidance by 3.5% to P14.5 billion (i.e., +19% YoY growth). However, this means that 4Q is projected to decline by about 5% YoY. Already, management indicated soft October sales – lower by 1% – given the 60 gWh unrealized sales as a result of back-to-back typhoons.
- **Cash dividends.** Management likewise declared a P1.70 cash dividend, bringing the total dividends declared (based on 2011 numbers) to P5.15 a share. With a 50% payout policy plus a look-back, at least another P1.28 may be declared upon the announcement of full year results some time in 1Q12.
- **Long-term value driver.** With an infrastructure mindset emanating from parent Metro Pacific Investments (MPI), Meralco forged a re-entry in the power generation business. This is a logical step for Meralco given the opportunities presented by the energy sector's demand-supply imbalance. Under Meralco PowerGen Corp (MPGC), the plan is to create a portfolio of up to 3,000 MW of generating capacity. MPGC's initial salvo is the 2x300 MW coal project within the Subic Bay Freeport Zone, a JV partnership with Aboitiz Power Corp. and Taiwan Cogeneration Int'l Corp. The initial phase of 300 MW is slated for completion by 1Q15 while the balance will be completed six months later.

Power Generation Pipeline		
Capacity	Area	Details
600 MW	Luzon	Circulating Fluidized Bed Coal Fired power plant
150 MW	Luzon	Aero Derivative Combined Cycle power plant
600 MW	Luzon	Coal-fired power plant
1,500 MW	Luzon	LNG / NatGas-fired power plant

Source: Company

- Diminished float.** The move of MPI to gain full control of and consolidate ownership in Meralco limited the shares in circulation. By our estimates, the free float stands at only 11%. We view this to be net positive for three reasons: (1) this allowed Meralco to sustainably trade at above-market multiples, (2) we see a re-rating on Meralco as the company progresses with its long-term integration plans, and (3) given an option to sell to MPI is in effect until November 2012, the possible divestment of the Lopezes' legacy stake would exert influence as the price approximates the likely transaction value. The downside is that Meralco could be removed from the PSEi but we only foresee this to come about by mid-2013.
- Fundamentals to catch up.** While Meralco's relative valuation metrics suggest a price pullback, we think that it is more likely that the fundamental drivers will catch up to its higher-than-market valuation multiples. The diminished free float is the main reason behind its defiance of gravity. Our DCF-based P303/share fair value estimate for Meralco points to an upside of 29%. Already, this factors in a flat tariff structure starting RY12 based on ERC approved rates. We see an upside surprise to our forecasts should Meralco be allowed to collect under-recoveries. We rate MER a LT BUY.

Ownership in Meralco

Beacon Electric	45.4%*
Option from Lopez Group	6.6%
Stake if option exercised	52.0%

Note: Out of the 45.4% economic interest, 4.35% is payable by MPI until 2013.

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