Philequity Corner (February 27, 2012)

By Valentino Sy

Hunting the Hunters

In 1999, a much smaller Equitable Bank acquired the larger PCI Bank. This sparked the 1999-2000 M&A frenzy in the local banking industry. In 2005, we wrote about how the tables had turned when EPCI (Equitable-PCI) Bank, which was previously a hunter, was hunted down and was eventually acquired by BDO in 2007 (*The Hunter Becomes the Hunted, May 30, 2005*). BDO then became the country's largest bank after acquiring EPCI Bank. Instead of slowing down after its merger with EPCI Bank, BDO continued to acquire other smaller banks in order to maintain its ranking as the largest bank in the country.

Since 2006, there has been a prolonged absence of any major M&A activity in the local banking sector. The time seems ripe for another M&A frenzy because of the low interest rate environment and the strong capital position of most local banks. In a previous article (*Acquirers or Targets, September 6, 2010*), we wrote about the possible permutations of the M&A pairings among local banks. In that article, we mentioned how UBP (Union Bank), which was also a hunter before, might be a possible acquisition target for BPI.

From Predator to Prey

In 2006, UBP acquired iBank (International Exchange Bank), which was headed by Ramon Sy. The acquisition price for iBank was equivalent to ~2.5x P/BV. Now, there is speculation that UBP is being targeted for acquisition by BPI. The rumors of the possible M&A, whether true or not, have caused UBP's stock price to surge by 104.5% year-to-date on significantly higher trading volume.

UBP 1-yr Chart

Source: Wealthsec.net

With the recent run-up in its stock price, UBP has soundly outperformed other local banking stocks year-to-date (YTD) and is now trading at 2.2x 2011 P/BV. It is currently valued more expensively than BDO and MBT (Metrobank), the two biggest banks in the country. Considering that UBP has suddenly surged past its peers in terms of valuation, it seems that UBP is currently valued at takeover P/BV multiples.

Stock Performance and Valuation of Local Banks			
	YTD	**2011 P/BV**	**2012E P/BV**
BPI	21.9%	2.82	2.40
BDO	10.2%	1.88	1.75
MBT	22.4%	1.70	1.62
SECB	29.9%	2.07	1.69
UBP	104.5%	2.19	2.06

Sources: Company data, Wealth Securities estimates

A Veteran Hunter

Stock market veterans and the banking community are aware of BPI's long history of acquisitions. BPI is known for growing its assets and businesses via acquisitions. Moreover, BPI has successfully gone from one merger to another without sacrificing its profitability and financial strength. In another article (*Size Matters, August 2, 2010*), we mentioned that BPI usually engages in M&A activity every 3 to 5 years. The last major M&A move of BPI was its acquisition of Prudential Bank in 2005. Considering that BPI has been quiet in the M&A scene for the past few years, local investors and bankers are excited that BPI might be priming itself for another acquisition.

Kuwarta o Kahon

If the BPI-UBP merger were to happen, it would also be interesting to know how the acquisition would be paid for. Will be the acquisition be paid for in cash, just like how UBP paid iBank shareholders in cash? Or will the acquisition be paid for in stocks of the acquirer, just like how PLDT paid the majority shareholders of Digitel (JG Summit Holdings) with PLDT shares? Will UBP minority shareholders be offered to choose between being paid in cash or stock, similar to the choice given by PLDT to the minority shareholders of Digitel?

UBP's parent, AEV (Aboitiz Equity Ventures), can opt for a full cash settlement if it wants to exit the banking scene completely. AEV can then use the cash and funnel it to its capex-heavy power business via AP (Aboitiz Power Corporation). This will give AP the requisite funding needed to pursue the next phase of its growth initiatives.

AEV can also opt for stock by trading its controlling stake in UBP for a smaller but proportionate stake in the merged bank. By giving up its control of UBP, AEV would gain a significant stake in BPI, a bigger bank which is known for its financial strength and consistent profitability. This would be an attractive option if AEV wants to retain its presence in the banking sector.

Gigi and Tito

It is well-publicized that BPI President & CEO Gigi Montinola is due to retire sometime next year, after agreeing to a 2-year term extension last year. Despite the term extension, BPI has not named a clear successor to Mr. Montinola. Considering the apparent succession problems in BPI, it makes sense for BPI to merge with UBP. If BPI were to merge with UBP, it is likely that the merged bank will be headed by Tito Ortiz, the Chairman & CEO of UBP. Mr. Ortiz, who is in his mid-50s, is young enough to lead the merged BPI-UBP for the next 5 years or so. Moreover, he is experienced enough for the job, as he has been UBP's Chairman & CEO since 1993. For UBP, the merger also seems logical considering that the other half of its dynamic duo, UBP President & COO Vic Valdepenas, is already of retirement age.

Strength in Union

The merged BPI-UBP would be a bigger and stronger bank, with ~P1.1T in assets. Given this, the merged bank would contest BDO's status as the largest bank in the Philippines. Moreover, if AEV opts against cashing-out, the merged BPI-UBP would have a strong management team and would be jointly-owned by AEV and AC (Ayala Corporation), two of the country's biggest and most prominent conglomerates. However, if the merger with BPI does not come into fruition, BDO and MBT (Metrobank) might also make their bids for UBP, as this would propel either of them to become the country's biggest bank.

A Bigger Prey

Aside from UBP, another possible takeover target is PNB (Philippine National Bank). With the regulatory obstacles finally taken care of, PNB is scheduled to merge with Allied Bank in late-2012 or early-2013. Absorbing Allied Bank would make PNB a more attractive prey for potential acquirers. The merged PNB-Allied Bank will be the 4th largest local bank with assets of ~P500B. Considering its asset size and extensive branch network (more than 600 branches), the merged PNB-Allied Bank then becomes a more attractive target for banks like BPI, BDO and MBT. Whoever acquires the merged PNB-Allied Bank will become the undisputed leader of the local banking industry. Talks that the merged PNB-Allied Bank will eventually be sold has been bolstered by the recent unconfirmed news that Philippine Airlines, which is another Lucio Tan company, will be acquired by San Miguel Corp. or Metro Pacific Investments.

Hunting Sprees and Bull Markets

As we have repeatedly seen in the past, hunting sprees, takeover battles and M&A mania generally push the market up. We saw this in the banking sector during the 1999-2000 and 2005-2007 M&A frenzies. More recently, we saw this in the Meralco takeover battle, the Philex takeover battle and in PLDT's acquisition of Digitel. These were times when local investors made a lot of money by buying companies which were involved in M&A events.

Now, talks are abuzz of various merger possibilities and permutations. M&A rumors among local banks are getting stronger by the day, considering the long drought for M&A activity in the banking industry. As we have seen before, these rumors, whether true or not, spark strong moves in the stock market and give opportunities for investors to make money. We believe that a steady influx of M&A activity can catapult our stock market higher and become an important catalyst for the next up-leg of our PSE Index.

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