



Union Bank of the Philippines(UBP)

Buy

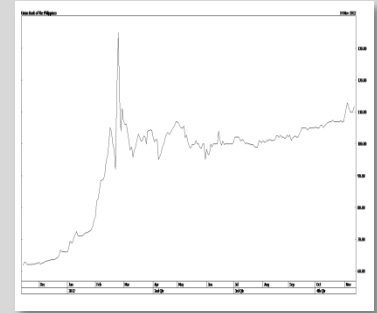
THURSDAY, 15 NOVEMBER 2012

Company Snapshot

Price (P)	111.90
Price Target (P)	130.00
Shares O/S (million)	641.442
Market Cap (P million)	71,775
52-week High (P)	140.00
Low (P)	110.10
12-mo Avg. Value T/O (P'm)	42.611
Shareholders	
Aboitiz Equity Ventures	44.8%
Free Float	35.4%

Price Performance

	1m	6m	12m
UBP	+5.1%	+11.0%	+88.1%
PSEi	+1.6%	+7.2%	+27.0%



Trading the Trading Bank

- **Just a Trading Bank?** President & COO Vic Valdepenas has led UBP to become one of the best trading banks in the country. While Trading Gains may come and go for most banks, UBP has delivered consistent Trading Gains equivalent to at least 28% of its Net Revenues from 2009 to 3Q2012. However, since analysts usually prefer banks that have very strong core banking operations over those that rely quite heavily on trading, UBP has not received heavy analyst coverage in the Street. Moreover, there is concern among investors about the recent decline in UBP's assets, loans and deposits in 3Q2012.
- **More than Meets the Eye.** Upon initial perusal of UBP's 3Q2012 results, one would immediately see that its assets, loans and deposits declined by 10%, 9% and 17% YOY, respectively. However, looking closely at UBP's results would reveal that high-cost deposits caused most of the decline of total deposits while low-cost deposits actually increased by 13% YOY. Consequently, the percentage of low-cost deposits to total deposits increased to 29% as of 3Q2012 from 23% in the same period last year. On the asset side, Net Loans & Receivables showed a year-on-year decline but Gross Customer Loans actually increased by 19% YOY, driven by notable increases in consumer and commercial loans. This clearly shows that bank is serious in expanding its loan portfolio. All these efforts drove the bank's Net Interest Margin higher to 3.66% for 9M2012 vs. 3.37% for the same period last year.

We consider these milestones as impressive achievements considering that most local banks are dealing with slowing loan growth and margin contraction. Further, it shows that the bank is following a clear yet flexible strategy amidst an ever-changing macro environment.

Financial and Valuation Highlights

Amounts in P'million	2010A	2011A	2012E	2013E	2014E
Net Revenues	13,209	14,619	17,637	16,936	18,797
Opex	6,498	6,878	7,945	8,285	8,476
PPOP	6,711	7,741	9,692	8,651	10,320
Net Income	5,353	6,595	8,273	7,336	8,838
ROE	15.9%	16.7%	18.5%	14.8%	15.9%
ROA	2.2%	2.5%	3.0%	2.4%	2.6%
EPS	8.35	10.28	12.90	11.44	13.78
BVPS	56.10	66.79	72.85	81.29	92.07
PE	13.41	10.88	8.68	9.78	8.12
P/BV	1.99	1.68	1.54	1.38	1.22

Sources: Company data, Wealth Securities estimates

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

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- **Low Foreign Ownership.** Since the bank does not enjoy wide analyst coverage, it also has relatively weak foreign following. As of 3Q2012, the bank's foreign ownership level was only at 1.6%. UBP will therefore be unaffected by the anxiety brought about by the issue on foreign ownership limits and may be seen as a possible alternative investment to local banks stocks which already have high foreign ownership.
- **Tito, Vic then Who?** The UBP has successfully segregated the management of the bank between its two senior officers. Chairman & CEO Tito Ortiz handles operations and HR-related matters while President & COO Vic Valdepenas handles the business segments. While Mr. Ortiz is only in his mid-50s, Mr. Valdepenas is already more than 60 years old and may be nearing retirement. While the bank surely has capable officers who may be groomed as possible successors, it is understandable that some investors will be concerned about this peculiar situation since Mr. Valdepenas has been the engine behind the bank's stellar trading performance.
- **M&A Play.** As the succession planning issue looms for UBP, the bank has been the subject of merger rumors. Recently, the rumors circled around a possible BPI-UBP merger, with BPI as the surviving entity. The merger appeared to make sense for both banks considering how BPI shares the same succession planning issues as UBP. Moreover, both banks are controlled by two of the country's biggest conglomerates, as BPI is owned by Ayala Corporation (AC) while UBP is controlled by Aboitiz Equity Ventures (AEV).

These rumors were more than enough to cause a strong movement in UBP's stock price. From a price of P60.90 as of November 2011, the bank's stock surged by 130% and reached a peak of P140.00 in February 2012. At the peak, the stock traded at 2011 trailing P/BV of 2.1x.

Despite having a lot of common things between them, the merger between BPI and UBP, for some reason, did not push through. However, as seen in this recent example, we believe that M&A transactions involving UBP will be a boon to the bank's stock, *whether these rumors are true or not.*

- **Vote of Confidence.** Though the merger rumors have since subsided, there is strong buying that has been supporting the stock. UBP's parent, AEV, has been quietly increasing its stake in the bank. From August 2012 to October 2012, AEV bought 9.56M shares of UBP, equivalent to 1.49% of the bank. Based on this, it seems that AEV is looking to raise its ownership of UBP to 50% or greater so that it can consolidate UBP into its fold. More importantly, this move shows that AEV is very confident about UBP's growth prospects.
- **Undervalued Despite Consistency.** Though the bank is known as a trading bank, it has delivered very consistent returns. In each of the past 3 years (2009 to 2011), UBP's ROE was above 15%, comfortably above the industry's average. While 2012 is not yet over, it appears that the bank will again deliver another good year, as 9M2012 Annualized ROE was at 18.8%

The bank's consistently high ROE has allowed it to deliver consistent dividends to its shareholders. For FY2012, the bank approved to disburse dividends of P3.00, translating to dividend yield of P2.7%.

Despite establishing a track record of high ROE and paying respectable dividends, UBP is one of the cheapest local banks and is only trading at 1.38x 2013E P/BV.

Listed Local Banks - P/BV									
	BDO	BPI	MBT	SECB	CHIB	RCB	PNB	UBP	EW
Prices as of 11/14/12	67.35	85.30	96.05	161.90	52.95	48.05	71.80	111.90	24.75
2013E P/BV	1.65	2.66	1.75	1.84	1.46	1.37	0.88	1.38	1.41

Source: Wealth Securities estimates

- **BUY UBP.** We see further upside in UBP's stock price as it might benefit from the continued buying of AEV or from being involved in another possible M&A transaction. Even without these, we like UBP for executing a clear strategy and delivering consistently high ROE. Moreover, we believe that UBP's relatively cheap valuation and steady dividends may provide investors adequate downside protection. Given these, we recommend a BUY on UBP with a TP of P130. At our TP, the bank is valued at 1.6x 2013E P/BV.

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