Philequity Corner (June 6, 2016)
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Strength in Numbers

It is the NBA Finals and basketball aficionados all over the world are glued to their television sets watching LeBron James and his Cleveland Cavaliers vs. Steph Curry's Golden State Warriors. The Warriors' battle cry – Strength in Numbers – could not have been more apt as their bench brought home the victory in Game 1 of the finals. The slogan is emblazoned on more than 20,000 shirts given away during each Warriors playoff game. However, this mantra "Strength in Numbers" applies not only to the Golden State Warriors but also to the recent mega-deal in the telco industry.

The Numbers Game

700, 850, 2500, 3500 MHz.

These numbers are just some of the frequencies PLDT and Globe have gained in their purchase of San Miguel Corporation's (SMC) telecommunication assets last week. In that transaction, PLDT and Globe jointly agreed to each purchase 50% of Vega Telecom, Bow Arken Holdings and Brightshare Holdings for a total of PhP 70 billion. With this transaction, Ramon Ang (RSA) ended his quest to disrupt the telco industry as a third player promising faster internet speed.

Master stroke

Given the likelihood of a lengthy and expensive legal challenge over SMC's use of the 700MHz spectrum, some are saying that it was in SMC's best interest to sell to the entrenched industry giants. Moreover, with Telstra not pushing through with its investment, SMC would have to spend billions of dollars in capex just to get its network up and running. This would not only enlarge SMC's debt burden, but also divert cash away from other profitable ventures. Thus, even if this effectively ends RSA's telco dreams, this sale gives RSA a PhP 52 billion war chest while extinguishing some PhP 17 billion worth of liabilities, leading some analysts to describe this transaction as yet another master stroke by RSA (see *RSA: Heaven Sent*, 18 April 2011).

Not perishing any time soon

3 months ago, we wrote about why PLDT's stock price fell by 18% in just a single day (see *Adapt or Perish*, 7 March 2016). We said that PLDT has to carefully and decisively transform itself lest it risk obsolescence. This transaction is not only a step in the right direction, but it shows that MVP will not allow PLDT to perish any time soon. This buyout is also reminiscent of MVP's deal with the Gokongweis, where he acquired Digitel in an all-share deal valued at PhP 74 billion (see *Pacman Strikes Again*, 4 April 2011).

New lease on life

While this transaction is good for SMC, it also improved the fundamentals of PLDT and Globe. Not only do they gain access to the much coveted 700MHz spectrum, but they also removed any possibility of SMC becoming a disruptive competitor. Moreover, the National Telecommunications Commission (NTC)

also approved the use by PLDT and Globe of certain radio frequencies in the 700 MHz, 900 MHz, 1800 MHz, 2300 MHz and 2500 MHz bands, allowing both companies to further expand their mobile broadband business. Previously, the profitability and long term viability of PLDT's business model was in question. With this deal, PLDT may have gotten a new lease on life.

Sleeping with the enemy

Though MVP and RSA have gone through many mergers and acquisitions, we want to note that this transaction is very interesting because of the parties involved. For one, MVP and RSA are perennial business rivals in many transactions, such as the buyouts of Meralco and Philex. We wrote about these transactions and their rivalry extensively (see *Turf Wars*, 13 July 2009, *Return Bout*, 17 August 2009, *Mano-a-Mano: MVP vs. RSA*, 10 January 2011).

Unexpected alliance

Even more interesting is the unexpected alliance between PLDT and Globe. These business rivals have been duking it out for years, trying to steal market share from the other through marketing, pricing and new technologies. Therefore, it was quite a surprise when it was announced that they joined forces in this buyout of SMC's telco assets. Moreover, they even agreed to share certain towers and frequencies between each other. Who would have thought that fierce competitors would strike a deal and business rivals would combine to take out a common foe?

PSEi above 7,500

In any industry, competition is always one of the biggest risks that businesses watch out for. Note that when rumors regarding Telstra's entry into the Philippine market started circulating, the stock prices of both TEL and GLO fell more than 30% in a matter of months, dragging the PSEi down with them. With this transaction, the risk of a new player threatening the profitability of the telcos was removed, allowing both telecom stocks to stage a recovery. In just 3 days, TEL rose by as much as 25.7% , GLO gained 17.4% at one point and SMC was higher by 9.1%. By the end of last week, these 3 stocks had contributed more than 100 points to the PSEi, allowing it to rise above the 7,500 resistance level.

Shape up or else

However, there are some clouds in the horizon. With our country plagued by horrendously slow internet speed, a group of economists have urged the incoming administration to review telecom spectrum allocation and determine whether this serves the common good. The NTC has also given the two telcos 12 months to prove that they can provide better services to their customers after this transaction, lest they slap them with sanctions. In light of antitrust concerns, the newly formed Philippine Competition Commission has also pledged to swiftly and thoroughly review this acquisition to ensure that it does not foster uncompetitive business practices. For his part, President-elect Rodrigo Duterte told telcos to "shape up" or he will let a foreign player come in.

Better service in 6 months

In an interview with Bloomberg, MVP said that "whatever info the regulators need from us with respect to the transaction, we are prepared to provide to them." He further said that with more frequencies available to PLDT, they can provide better indoor coverage, enable faster rollout across the country and

significantly improve internet quality and speed. MVP also promised that internet speed will increase in 3-6 months. Moreover, to quell antitrust concerns, PLDT and Globe have agreed to relinquish certain frequencies in the 700 MHz, 850 MHz, 2500 MHz and 3500 MHz bands and return these to the NTC to allow for the entry of a third player.

Everyone wins

Now, whether this transaction is in violation of antitrust legislation or not is something we will leave to the regulators to decide. What matters is that with the bickering out of the way, PLDT and Globe can now work toward improving their services for the benefit of the consumer instead of tearing at each other. As for SMC, it now has a substantial war chest that it can deploy for its infrastructure projects, which also redound to the benefit of the company and the country. Stock market investors also welcomed this transaction, as we have seen in the share prices of PLDT, Globe and SMC. If the telecom companies fulfil their promise of increasing bandwidth, lowering prices and raising download speeds, then the public stands to benefit from this deal. From the looks of it, in this deal, everyone wins.

Numbers bring strength to the stock market

The parties to this deal - TEL, GLO, and SMC - are all components of the benchmark Philippine stock index. With these stocks seemingly finding a bottom, our thesis that the PSEi had bottomed at 6,084 is further reinforced (see *The Bounce*, 22 February 2016). Moreover, because these stocks are strengthening, the PSEi was able to break the strong resistance level of 7,500. With TEL, GLO and SMC benefiting from this deal and many PSE index components reaching all-time highs (see *Groundswell in the Stock Market*, 30 May 2016), the numbers show that our stock market will eventually retest the all-time high of 8,137.

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