

INDEX RECOMPOSITION

Additions	Price
SMC	127.50
SCC	226.00
SMDC	8.05
Removals	
LC	1.13
LCB	1.22
ABS	39.00
FLI	1.30

Key Points

Philippines Stock Exchange to make changes in the main index according to revised guidelines.

San Miguel Corporation set to return to main index.

Among the candidates, we believe that Semirara and SM Development Corporation will get the nod for addition to the main index.

Lepanto, although a very active stock lately, will make its exit. However, this will not hinder LC and LCB from staying on the radars of most investors.

ABS and FLI to exit main index in order to make way for more deserving stocks.

Revised Rules

According to the new guidelines released by the Philippine Stock Exchange (PSE), there will be an index recomposition in September 2011. In a memo released late April 2011, the PSE disclosed new criteria to qualify for inclusion in the PSEi. The three main criteria are a free float level of at least 12%, ample liquidity as measured by the median daily value, and size of the company as measured by full market capitalization. The 12% free float is an increase from the old requirement of 10%. In the past, average daily value was used to gauge liquidity with P5 million as the threshold. However, the PSE is implementing a new liquidity criterion. In order to qualify for inclusion into the PSEi, a stock's median daily value must fall in the top quartile in 9 out of the 12 months under review. For the index recomposition in September, the review period is from July 2010 to June 2011. Stocks that are eligible under the two criteria are then ranked according to full market capitalization using the VWAP for the 12 months under review. Based on data sourced from Technistock, here are the top ranked eligible stocks. The table contains the stock ticker, full market capitalization, VWAP, free float percentage, and the number of months the stock's median daily value reached the top quartile.

Prince Anthony A. Yeung
Maria Arlysa E. Narciso
Equities Analysts

AB Capital Securities, Inc.
3rd Floor, Phinma Plaza
39 Plaza Drive, Rockwell Center
Makati City, Philippines
Tel.: 898-7555
Fax No.: 898-7596

e-mail: abcsi@abcapitalonline.com.ph
website: www.abcapitalonline.com

Stock	Market Cap	VWAP	Free Float	Months
TEL	449,124,543,689.83	2,404.86	49.00%	12
SM	314,801,742,994.26	514.40	29.00%	12
SMC	287,325,426,085.05	121.37	8.90%	11
MER	256,559,691,694.05	227.59	15.00%	12
ALI	207,553,345,597.58	15.94	46.00%	12
AP	201,217,355,472.76	27.34	23.00%	12
AEV	199,840,406,512.27	36.19	46.00%	12
BPI	191,237,363,033.20	53.77	47.00%	12
AC	180,755,315,490.23	311.28	36.00%	12
SMPH	158,024,033,200.26	11.37	30.00%	12
JGS	154,293,411,323.29	22.89	27.23%	12
BDO	144,583,996,405.89	55.45	41.00%	12
MBT	134,119,673,710.48	63.52	47.00%	12
GLO	110,672,082,751.18	836.22	22.00%	12
EDC	109,535,625,000.00	5.84	54.00%	12
AGI	108,307,659,832.13	10.55	40.00%	12
JFC	86,771,068,659.31	83.82	38.00%	12
DMC	83,878,557,879.20	31.59	28.00%	12
ICT	81,737,246,944.67	42.14	46.00%	12
MPI	88,557,292,414.33	3.60	44.00%	12
PX	77,485,052,457.93	15.72	31.00%	12
URC	76,882,889,990.46	37.29	35.00%	12
HLCM	65,517,840,757.75	10.15	15.00%	9
SCC	61,959,391,875.00	173.92	28.00%	12
SMDC	54,982,462,699.09	6.52	16.00%	12
MEG	54,416,195,746.19	2.12	41.00%	12
RLC	42,814,918,836.00	10.46	39.00%	12
FGEN	42,507,781,466.18	12.64	32.00%	12
BEL	38,398,441,306.94	4.24	67.00%	12
MWC	36,850,388,660.99	18.13	65.28%	12
SECB	35,454,689,597.27	84.69	73.00%	12
PNB	35,028,371,908.76	52.89	33.00%	12
FPH	34,030,509,058.52	60.69	52.00%	12
UBP	34,395,956,561.29	53.62	25.00%	12
FLI	30,113,351,354.55	1.24	45.00%	12
RCB	27,022,501,062.11	26.66	38.00%	12
VLL	25,248,991,673.02	2.96	33.00%	12
LC/LCB	25,111,984,958.82	0.56/0.61	84.00%	11/8
LPZ	23,835,815,368.03	5.20	47.00%	12
WEB	19,672,579,059.63	15.59	22.00%	12
AT	19,622,991,952.43	16.78	61.00%	12

Additions

There are additional rules for addition to and removal from the PSEi. An incumbent component of the PSEi shall be removed if its ranking falls below the 35th position. In this case, the non-index issue with the highest ranking will take its place. On the other hand, should a non-index issue rise above the 25th position then it shall be added to the PSEi. Should this happen, the index issue with the lowest ranking shall be removed. Strictly following these guidelines and rules, there will be changes to the index come September. The most obvious is the inclusion of San Miguel Corporation (SMC). The recent secondary offering of SMC has brought its free float to an acceptable level (although data sourced from Technistock is not yet reflective of this). With its high trading activity and huge market cap, SMC is sure to make its return to the PSEi. Aside from SMC, other candidates for inclusion in the PSEi are Holcim (HLCM), Semirara (SCC) and SM Development Corporation (SMDC). The three stocks occupy spots 23 to 25 respectively. Strictly following the guidelines will lead to HLCM and SCC making the index since they are both above the 25th position benchmark. However, there are other factors that can be considered as will be discussed later on.

Removals

If there are new members of the PSEi, then there will be stocks that will be removed as the PSEi has room for only 30 companies. Based on the rankings, the most glaring removal will be Lepanto (LC and LCB). The full market capitalization of Lepanto is only P25.11 billion based on the VWAP of LC and LCB from July 2010 to June 2011. This puts Lepanto at the 38th spot, which merits immediate removal. Another stock making its exit is ABS-CBN (ABS). The recent exit of GMA7 from the index was an omen for its biggest competitor as ABS will surely lose its status as an index issue. The trading activity of ABS has fallen since late 2010 and its median daily value only made the cut in 2 out of the 12 months. This makes ABS ineligible to stay in the PSEi. A third stock in danger of losing its place is Filinvest Land (FLI). FLI occupies the 35th spot. FLI is the lowest ranked incumbent index issue outside of Lepanto and ABS-CBN. With three stocks slated to make their entry into the PSEi, FLI is the third stock that will lose its spot to make way for the new entrants.

Complications

Some complications present themselves in choosing the new entrants into the PSEi. While SMC and SCC are more or less assured of their place in the PSEi, a third spot is up for grabs between three stocks: HLCM, SMDC, and Cebu Air (CEB). The case for HLCM is straightforward, it meets all the requirements and holds the 23rd spot. However, in April 2011 to June 2011, the last three months of the review period, the median daily value of HLCM failed to reach the top quartile indicating that it has been trading less often as of late. Also, HLCM makes the top quartile in 9 out of 12 months because there are stocks that go for months without trading. The dormancy of such stocks makes it easier to reach the top quartile in any given month. Disregarding stocks that go for months without trading would make the requirements more stringent. While the guidelines do not explicitly mention if this should be the case, doing so would disqualify HLCM from making the PSEi. The goal of the PSE is to choose the stocks that best represent the local stock market. This goal will not be best achieved by the addition of HLCM into the PSEi.

Cebu Air's case is a made special because it listed in late October 2010. Therefore, the stock's median daily value could only reach the top quartile in 8 months (November 2010 to June 2011). A literal reading of the 9 out of 12 requirement would disqualify CEB. However, since CEB made the cut in 8 out of 9 months (88.88%), it is an indication that CEB would meet that 9 out of 12 criterion (75%) if it were trading in all 12 months. The VWAP of CEB is also skewed by its IPO price of P125.00. Its VWAP of over P103 is a level CEB has not reached since early January 2011. If both HLCM and CEB are deemed ineligible then it would pave the way for SMDC to enter the PSEi. SMDC would move up to the 24th spot if HLCM is removed from the list. Rising above the 25th spot merits immediate inclusion in the PSEi. SMDC definitely meets the other requirements and feels more like an index issues than HLCM. The case for SMDC is strong; making it only a matter of time before it enters the PSEi.

Conclusion and Recommendation

Taking into consideration that index issues should be stocks that represent the local stock market we believe that SMC, SCC, and SMDC will enter the PSEi come September. They will take the place of ABS, FLI, and LC (and LCB). SMC earns a strong buy recommendation as its re-entry into the PSEi can serve as a trigger for its stock price to return to price levels seen prior to its secondary offering at P110.00. The strong earnings growth of SMC and the eventual IPO of its energy subsidiary are more reasons for our belief that SMC will have a much better second half. Investors are also advised to accumulate SCC and SMDC in preparation for their entry into the PSEi. Both are undergoing corrections at the moment. For SMDC, the best entry price would be P7.50. However, investors may already start accumulating SMDC at its current price as there is no guarantee that it will correct all the way to P7.50. The same can be said for SCC. The target entry price for SCC is at P220.00 but investors may already start accumulating. Both stocks are seen to hit their recent highs with their entry into the PSEi serving as catalysts.
