

# The **A**DVISOR

Metro Pacific Investments - BUY

December 13, 2011



## Infrastructure Builds Value

Metro Pacific Investments Corporation (PSE: MPIC) is one of the country's leading investment firm that relentlessly seeks investment opportunities on defensive industries. MPIC holds controlling interest over Maynilad (Water), Manila Electric Corporation. (Electricity), Metro Pacific Tollways (Toll roads), and hospitals including Riverside Medical Center, East Manila Hospital Managers, Davao Medical Doctors and Medical Doctors Inc.

### Investment Merits:

The Philippines' infrastructure is lagging compared to other neighboring countries. In response to this situation the current administration has lined up 17 billion worth of projects. These projects serve as MPIC's opportunity to further increase its presence in Philippine infrastructure.

Valuation Summary	
Maynilad	2.14
Meralco	1.61
MPTC	1.30
Hospitals	0.34
<b>NAV</b>	<b>5.39</b>
net debt	-0.80
EFV	4.59
Discount	0.46
<b>Target price</b>	<b>4.13</b>

We think that MPIC's Group performance will show stable earnings in the future. We project Maynilad's net income to be P6.2 billion FY 2012 and P6.8 billion FY 2013. Non Revenue Water is estimated to decrease to 44.33% FY 2012 and 36.16% FY 2013 based on Maynilad's Sahara system. Volume of Water billed will hit 425.60 MCM FY 2012 and 449.48MCM FY 2013. On the other hand, We think that Meralco's lower Maximum Allowable Price (MAP) as mandated by ERC will adversely affect revenues. However, GWh energy sales should be able to keep it afloat. We estimate GWh energy sales to improve by at least 3%. Meanwhile MPTC's revenues is projected to be P6.1 billion FY 2012 and P6.2 billion FY 2013 driven by constant average daily traffic growth. Lastly, MPIC's Hospital group remains steady with continuous acquisitions prompting growth in the past years. The group aims to reach a 3,000 bed capacity.

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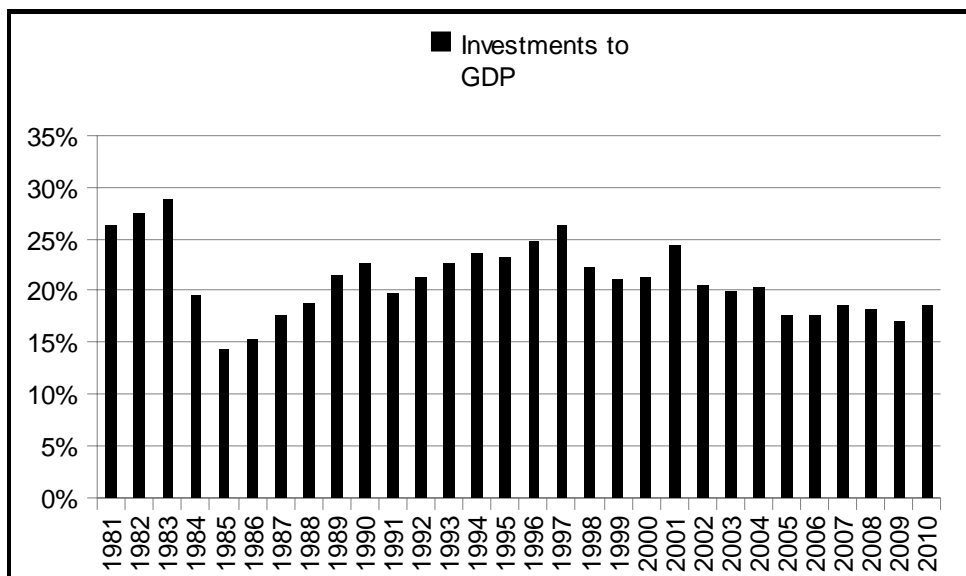
We initiate our coverage on MPI with a **BUY** rating due to its favorable business stance on Philippine infrastructure and solid growth prospects on top of defensive investments. Using sum of the parts valuation, we arrive at a conservative 18% upside with a target price of **P4.13**.

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Earnings Summary (in Php Millions)				
MPI	2009	2010	2011E	2012E
Operating Revenues	16,107	18,564	20,279	21,654
EBITDA	10,103	12,705	14,999	15,925
%	62.72%	68.44%	73.96%	73.54%
Net Income	4,369	5,310	6,096	8,437
%	27.12%	28.60%	30.06%	38.96%
EPS	0.18	0.22	0.25	0.34
EPS Growth		21.54%	14.80%	38.40%
EV/EBITDA	12.09	12.68	10.30	10.65
<b>P/NAV</b>	<b>0.57</b>	<b>0.85</b>	<b>0.76</b>	<b>0.76</b>

## Philippine Infrastructure



Investments in our economy have been lower these past 5 years compared to its historical levels. Furthermore Public-Private Partnership (PPP) projects of the Philippines are lagging compared to other countries. Infrastructure to GDP is only 3% compared to a 5% average on neighboring countries. The current administration has taken action and they have lined up several projects to improve the situation. There are over \$17 billion worth of PPP Projects lined up for 2011-2016. These projects are opportunities for MPIC to expand their defensive investments and gain additional returns in the future. MPI has extensive expertise in handling infrastructure deals with the government which makes us confident that they will be able to benefit from this opportunity.

## Core Income per Segment

	2009		2010		2011E	
<b>Maynilad</b>	1,538	48.00%	2,414	44.00%	3,098	46.68%
<b>Meralco</b>	224	7.00%	1,481	27.00%	1,938	29.20%
<b>MPTC</b>	1,282	40.00%	1,426	26.00%	1,380	20.79%
<b>Hospital</b>	160	5.00%	165	3.00%	221	3.33%
<b>Total core income</b>	<b>3,205</b>		<b>5,486</b>		<b>6,637</b>	

MPIC's portfolio delivered significant results last year and better results are expected this year. Maynilad will continuously contribute majority of the group's core income as they head into the future. Meralco will be able to contribute more income than MPTC this year and hospitals will contribute the least.

Majority of MPI's invested capital is in Meralco (54.83%), followed by MPTC (21.20%), then Maynilad (21%) and Hospitals (2.97%).

## Analysis of Major Subsidiaries and Affiliates

### Maynilad

Earnings summary (in Php millions)					
<b>Maynilad</b>	2008	2009	2010	2011E	2012E
Revenue	8,245	10,619	12,050	13,561	14,770
EBITDA	4,980	6,976	7,953	9,115	9,927
Net Income	1,994	2,825	4,780	5,703	6,211

Maynilad is MPIC's subsidiary that specializes on distribution of water to the west zone. They have been granted exclusive concession for the west zone until 2037. MPIC owns an effective 55.41% on Maynilad through DMCI-MPIC Water Co Inc. Maynilad's profitability remains stable with EBITDA staying above 60% for the past 3 years although net income margins tend to be more volatile due to interest payments and non recurring losses. Revenues will be driven by continuous volume of water billed growth due to the company's efforts to drive down Non Revenue Water (NRW). NRW are leaks on the pipeline. The company has decreased NRW by 6% in 2010 and has already reached 7% NRW Reduction as of 9m2011. Management projects 40% average NRW for next year, which is a decrease of 8%. We expect a more conservative 4% reduction next year and in 2013. We believe that the 8% reduction is unsustainable in the long run. Strong reduction of Maynilad's NRW is due to the Sahara system. It runs a survey on primary pipes without disrupting the water supplied enabling them to find leaks.

### Valuation of Maynilad

Annual Cash Flows( in Php Millions)	2,779,910
Terminal Cash Flows	0
WACC	6.72%
total DCF	109,322
Debt(In Php Millions)	16,729
<b>Equity Value (In Php Millions)</b>	<b>92,593</b>
percentage of Debt	79.51%
percentage of Equity	20.49%

Maynilad is highly leveraged, so we used FCFF since it also accounts cash flows before paying debt holders. Cash flows will have an average annual growth rate of 6% with more growth in the first ten years then slower growth in the last 20 years. NRW reduction will be the main catalyst in driving cash flows. We think that Maynilad's growth will slow down after 2022 when it reaches a mature stage. We also assumed that Maynilad's concession ends in 2037 in order to factor in the regulatory risk of the future. Estimated Fair Value of Maynilad is 92.5 billion, with 53 billion attributable to MPIC

### Manila Electric Corporation

Earnings Summary (in Php Millions)					
<b>Meralco</b>	2008	2009	2010	2011E	2012E
Revenue	191,842	184,940	246,561	260,450	266,158
EBITDA	11,000	13,200	18,400	19,436	19,862
Net Income	2,800	6,000	9,700	10,418	10,646

Manila Electric Corporation (MERALCO, MER) functions as the primary distributor of electricity in the Philippines, serving prime business areas and top corporations. MPIC owns an effective 18.24% of Meralco through Beacon Electric. We expect a moderate 3% growth on Meralco's GWh energy sales given the energy outlook by the Asia Pacific Economic Cooperation (APEC). Meralco will also experience slower growth in revenues because of the downward adjustment in the Maximum Allowable Price (MAP). ERC sets MAP at P1.5828 per kwh for 2012 lower than Meralco's proposed P1.7056. Revenue growth is expected to be 5% FY 2011 and 2% FY 2012. Meralco has very low Net Income margins ranging 3-4% and EBITDA margins of 6-8% in the past 5 years.

### Valuation of Meralco:

Annual Cash Flows( in Php Millions)	50,052.16
Terminal Cash Flows	194,605.56
WACC	7.64%
total DCF	236,373.91
Debt(In Php Millions)	19,266.00
<b>Equity Value (In Php Millions)</b>	<b>217,107.91</b>
percentage of Debt	66.83%
percentage of Equity	33.17%

Meralco was also valued by using FCFF since it has more debt than equity. We project 12 billion steady and recurring cash flows for the next four years. Terminal Value was used for Meralco since its concession is different from Maynilad and MPTC. We used a terminal value of 3%, this is the energy consumption compounded annual growth rate from 1991-2010. Power generation valuation was not included since it is still being planned by the company. Estimated Fair Value of Meralco is 217 billion, with 39.6 billion attributable to MPI.

### Metro Pacific Tollways Corporation

Earnings summary (in Php millions)					
<b>MPTC</b>	2008	2009	2010	2011E	2012E
Revenue	5,489	5,876	6,003	6,003	6,132
EBITDA	2,966	3,313	3,692	3,782	3,863
Net Income	1,109	666	1,427	1,457	1,489

Metro Pacific Tollways Corporation (MPTC) is the subsidiary that operates toll road infrastructure. MPTC has the exclusive concession for the North Luzon Expressway (NLEX) until 2037. MPTC plans to build the Harbour Link and the Connector Road. It is also bidding for other road projects. Similar to Maynilad, MPTC's EBITDA margins remain healthy, above 60%. On the other hand, net income does not appear to be stable. We project overall average daily traffic to grow by at least 1.7% for next year applying conservatism, possible effects of rise in oil prices and heavy rain fall. Management projects 3% traffic growth for NLEX and 6% for SCTEX in the coming year.

**Valuation of MPTC:**

Annual Cash Flows( in Php Millions)	109,040
Terminal Cash Flows	0
WACC	8.63%
total DCF	42,279
Debt(In Php Millions)	10,182
<b>Equity Value (In Php Millions)</b>	<b>32,097</b>
percentage of Debt	59.74%
percentage of Equity	40.26%

MPTC is also valued by using FCFF because there is more debt than equity in its balance sheet. Our estimates show that cash flows will have an average annual growth rate of 2.15%. Unlike Maynilad, MPTC's cash flows is steady due to flat traffic growth assumptions. We also presume that MPTC will not be granted extension after 2037. Harbour Link and Connector Road projects were not added in the valuation to take into account regulatory risk. This is to address the delays of PPP projects. MPTC's estimated Fair Value is P32 billion.

**Hospitals**

Earnings summary (in Php millions)			
<b>Hospitals</b>	2009	2010	2011E
Revenue	5,959	6,989	7,426
EBITDA	1,252	1,344	1,428
Net Income	528	474	514

MPIC is in continuous pursuit of making a large hospital portfolio. It aims to reach a 3000 bed capacity. As of 9m2011 it already has 1,593 beds. We expect bed capacity to reach 1,799 by 2012 assuming a small additional capacity of 100 beds per year. Hospital contributes the smallest increments to core income and revenues of the group.

**Valuation of the Hospital:**

<b>Name</b>	<b>P/E</b>	<b>Sector</b>
Ansell Limited	15.78	Healthcare
Blackmores Limited	16.91	Healthcare
CMIC CO., LTD.	12.27	Healthcare
EPS Co., Ltd.	12.69	Healthcare
Jubilant Life Sciences Ltd	11.36	Healthcare
Lijun Int'l Pharma (Hldg) Co., Ltd.	8.65	Healthcare
Mitsubishi Tanabe Pharma Corporation	19.38	Healthcare
NICHII GAKKAN COMPANY	13.74	Healthcare
Otsuka Holdings Co Ltd	13.42	Healthcare
PT Tempo Scan Pacific Tbk.	19.39	Healthcare
SAWAI PHARMACEUTICAL CO., LTD.	18.43	Healthcare
Sihuan Pharmaceutical Holdings Group Ltd	21.99	Healthcare
Sonic Healthcare Limited	15.77	Healthcare
SYSMEX CORPORATION	23.06	Healthcare
TERUMO CORPORATION	22.83	Healthcare
TSUMURA & CO.	12.47	Healthcare
<b>AVERAGE</b>	<b>16.13</b>	

Hospital Valuation is based on Comparable P/E of regional listed companies. These companies have medical supply or hospitals as their main line of business. Using the projected 2012 net income we arrive at an P8 billion estimated Fair Value. All of this is attributable to MPIC

## Parent

Parent Cash flow (in Php Millions)		
	2009	2010
Dividends	1,153	1,939
Opex and Interest	-857	-1,452

In order to fully assess the capability of the group, the Parent Company must be analyzed based on its separate cash flows. As stated in the table, the company's dividend income can cover the temporary cash disbursement of the parent thus letting the group have ample liquidity. Debt to equity of the Parent Company is still 0.10x which is a favorable level if the firm decides to take up more debt to cover capital expenditure needs.

## Group performance

Comparative table as of 9M2011										
Conglomerates	Revenue Growth	EPS growth	EBITDA Margin	Net income Margin	Current Ratio (x)	D/E (x)	P/E (x)	P/BV (x)	ROA	ROE
<b>MPI</b>	23.07%	34.17%	60.00%	18.31%	1.9	0.72	19.11	0.89	3.28%	6.90%
FPH	2.00%	-97.38%	11.70%	49.00%	2.41	0.9	51.27	0.35	-0.82%	-1.51%
AEV	37.00%	-4.73%	53.00%	37.00%	3.05	1.41	14.09	2.57	9.28%	25.00%
SMC	143.00%	-5.90%	10.66%	3.23%	1.65	2.62	23.37	0.96	1.72%	6.76%
DMC	20.00%	21.90%	20.00%	15.77%	2.05	1.47	14.79	2.76	11.73%	31.32%
<b>Average</b>	45.01%	-10.39%	31.07%	24.66%	2.21	1.42	24.53	1.51	5.04%	13.69%

MPI's performance against other conglomerate peers is indeed notable. MPIC's Margins are doing better than most peers. MPI has the highest EBITDA Margin. Net Income margins are near the average of peers. Debt levels remain healthy compared to other conglomerates and ROA are acceptable compared to other firms. Revenue Growth and EPS Growth are moderately better compared to companies in the group. ROE of MPI is lower due to its equity raising activities which is in conjunction with its low debt to equity levels.

	2009	2010
Target core income	1.5 billion	3.5 billion
Actual core income	3.2 billion	5.4 billion

The company has always outperformed its core income target for the past 2 years. We may see this trend continue for the next few years as the company is still in its high growth stage.

<b>Profitability</b>	2009	2010	2011E	2012E
Return on Equity	5%	5%	4%	6%
Return on Assets	2%	2%	2%	3%
EBITDA Margin	63%	68%	74%	74%
Net Profit Margin	12%	19%	30%	39%
EPS	0.18	0.22	0.25	0.34
<b>Liquidity and Solvency</b>	2009	2010	2011E	2012E
Current Ratio	2.21	0.76	0.74	0.79
Quick Ratio	2.02	0.58	0.51	0.55
Debt Ratio	0.53	0.5	0.47	0.46
Debt to Equity	1.35	1.22	0.89	0.86

The group's profitability has been improving. This is because of continuous higher returns from investments. Short term liquidity of the group does not appear ample, low liquidity is due to higher investments in fixed assets and higher current liabilities. On the other hand, long term solvency is improving because of continuous debt payments.

### Absolute Valuation

<b>Sum Of The Parts Valuation</b>			
<b>Subsidiaries</b>	<b>Value</b>	<b>Interest</b>	<b>Value to MPI</b>
Maynilad	92,593,464,784	56.80%	52,593,087,997
Meralco	217,107,912,085	18.24%	39,600,483,164
MPTC	32,097,477,667	99.85%	32,049,331,451
Hospitals	8,288,171,932	100.00%	8,288,171,932
Total Value			132,531,074,545
less net debt			19,623,000,000
Equity Value			112,908,074,545
Less 10% discount			11,290,807,454
Estimated Fair Value			101,617,267,090
Shares Outstanding			24,592,993,752
<b>TARGET PRICE</b>			<b>4.13</b>
price (as of 12/13/11)			<b>3.49</b>
upside			<b>18.39%</b>

Sum of the Parts Valuation best measures the value of a holding company, thus we deem this method appropriate for MPI since it has a diverse business. We estimated the value of each subsidiary then we deducted the net debt of the parent. Then we applied a discount a 10% holding company discount. MPI's Estimated Fair value is P101 billion leading to a target price of P4.13.

**Relative Valuation**

Valuation Multiples				
	2009	2010	2011E	2012E
P/E*	21.7	27.36	26.04	18.81
P/BV	0.99	1.45	1.13	1.04
P/NAV	0.57	0.85	0.76	0.76
EV/EBITDA	12.09	12.68	10.32	10.67

\* uses net income attributable to parent company

The Company historically has been trading at higher P/E levels due to equity raising activities. This is also the reason why P/BV appears cheaper. In order to properly gauge its relative value, we included EV/EBITDA. This ratio is a modest way to compare MPI to other holding companies. We adjusted EBITDA as a net of controlling interest to have a more accurate measure of the denominator. This ratio is unaffected by capital structure changes, thus it shows proper value in relation to companies in the same industry. We can also notice that the company has historically trading below its NAV.

	P/E	P/BV	EV/EBITDA*	P/NAV**
MPI	19.11	0.89	12.68	0.76
FPH	51.27	0.35	1.78	0.70
AEV	14.09	2.57	5.83	0.87
SMC	23.37	0.96	10.27	0.75
DMC	14.79	2.76	8.13	1.12
Average	24.53	1.51	7.74	0.84

\* trailing twelve months  
\*\* based on various sources

MPI seems to be trading at a premium compared to its peers in terms of EV/EBITDA last 2010. However, We think that the premium is warranted given MPI's stronger performance and healthy financial position. Moreover we estimate a lower EV/EBITDA for MPI in 2011 driven by stronger margins. To further assess MPI's relative value we included P/NAV. This includes the quality of portfolio relative to the price. MPI is trading at a lower P/NAV compared to the peer average implying that it is still cheap even with the high quality of its portfolio.

We reiterate our **BUY** rating on MPI given the favorable valuation prospects

**Risks:***Dilution Risk*

MPI has always been doing equity raising activities. This tends to make the company's share price cheaper despite its true value and it makes EPS smaller.

*Supply side risk*

Maynilad gets water supply from Angat Dam. The water level on Angat Dam drops whenever El Nino happens thus posing threats to Maynilad's revenues.

*Foreign Debt Exposures*

Foreign denominated debt poses uncertainty on its peso value especially at times that peso depreciates. this results to higher foreign exchange gains and losses

*Operational Risk*

MPTC's revenues is adversely affected by heavy rain, oil prices and other new toll ways. Meanwhile Meralco is also affected by heavy rain and typhoon.

*Regulatory Risk*

Most of MPI's business is through a concession agreement. The Company operates at a high degree of regulatory as they are easily affected by new government policies on their concession.

These are the Summary of Assumptions:

Variable	Value	Basis
<i>Risk free rate</i>	5.66%	10 year bond running average
<i>market return</i>	8.68%	Mean PSEI Monthly HPY 2001-2011
<i>Average corporate bond yields</i>	6.55%	Includes all corporate bonds
<i>beta of MWC</i>	0.57	Published by Bloomberg
<i>beta of meralco</i>	1.39	Published by Bloomberg
<i>beta of MPTC</i>	2.01	Published by Bloomberg
<i>Comparable hospital P/E</i>	16.13	Includes listed hospital firms in the Asia Pacific
<i>WACC Meralco</i>	9.86%	According to Meralco's Capital Structure
<i>WACC Maynilad</i>	6.72%	According to Maynilad's Capital Structure
<i>WACC MPTC</i>	8.63%	According to MPTC's Capital Structure