

Philippines Strategy

Year Ahead 2023: Back to basics

Refocus back to fundamentals; maintain POSITIVE

We expect 2023 to be a continuation of 2022, in a good way. Coming from 20% YoY earnings growth in FY22E, we forecast the PSEi to sustain this double-digit earnings growth momentum, at 15% YoY, with the earnings of 29 of its 30-stock composition exceeding pre-pandemic levels by year-end. Amid tapering inflation expectations, a more stable PHP forecast, a steady regulatory environment and capped flow-driven downside risks to the market, we expect the PSEi's improving fundamentals to be the key catalyst for this year.

Sustained double-digit earnings growth momentum

We forecast the earnings of PSEi stocks to grow by 15% YoY on average in FY23E (FY22E: +20% YoY), with all sectors, except the industrials/utilities sector, expected to sustain earnings growth in FY23. We expect growth will be led by the cyclical sectors; we forecast earnings of the property sector to grow by 24% YoY on the back of normalized operations and construction activity, while our +22% YoY F223E earnings growth forecast for the banks hinges on NIMs expanding following the 300bps interest rate increase in 2022 and our 8-12% YoY loan growth assumption. Our earnings forecasts factor in oil at USD100/bbl, 4.6% inflation and YE23E FX at USD1.00:PHP54.

YE23E PSEi target of 7,800pts

At our FY23E PSEi earnings growth forecast of 15% YoY, our 12-month forward target (from a bottom-up approach) is 7,800pts. The bulk of the upside should come from the conglomerate, property and banking sectors. The implied PER of 15x at our target is more than 1SD below the index's 10-year mean PER of 19x, which highlights the meaningful re-entry level current valuations are offering.

Undervalued economic moats

The derating of the PSEi in 2022 as a result of the high inflationary environment and weak PHP has opened a BUYing window for several quality stocks with strong economic moats and multi-year earnings growth profiles. We prefer stocks with significant exposures to improved mobility and domestic consumption. Philippine proxy **SM** is our preferred consumption play. **GTCAP**, which owns the market-leading Toyota franchise in the Philippines, is among the best way to play mobility, along with **BLOOM**, the leading casino operator in the Philippines and global port operator **ICT**. **BDO** is our top pick in the banking sector as its consumer-based ecosystem and aggressive lending appetite positions it to benefit from the ramp up in economic activity. Home improvement retailer **WLCN** offers a less volatile play into the property development sector, which should be among the PSEi's best growth drivers in 2023. Finally, **TEL** and **DMC**, which both offer yields of 8%, should partially hedge against any potential inflation- and FX-related market volatility.

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Stocks mentioned:

Aboitiz Power (AP PM, CP: PHP35, BUY, TP: PHP40)
ACEN Renewables (ACEN PM, CP: PHP7.3, HOLD, TP: PHP8)
Ayala Land (ALI PM, CP: PHP30, BUY, TP: PHP42)
BDO Unibank (BDO PM, CP: PHP111, BUY, TP: PHP156)
Bloomery Resorts (BLOOM PM, CP: PHP9, BUY, TP: PHP11.3)
Converge ICT (CNVRG PM, CP: PHP18, HOLD, TP: PHP12.9)
DMCI Holdings (DMC PM, CP: PHP11.7, BUY, TP: PHP12.1)
Filinvest REIT (FLIRT PM, CP: PHP5.6, BUY, TP: PHP6.9)
GT Capital (GTCAP PM, CP: PHP441, BUY, TP: PHP870)
International Container Terminal (ICT PM, CP: PHP203, BUY, TP: PHP232)
AllHome (HOME PM, CP: PHP2.2, BUY, TP: PHP3.3)
JG Summit (JGS PM, CP: PHP56.2, SELL, TP: PHP43)
Philippine National Bank (PNB PM, CP: PHP19, BUY, TP: PHP23)
PLDT (TEL PM, CP: PHP1,433, BUY, TP: PHP2,075)
SM Investments (SM PM, CP: PHP904, BUY, TP: PHP1,120)
Wilcon Depot (WLCN PM, CP: PHP29.8, BUY, TP: PHP33)

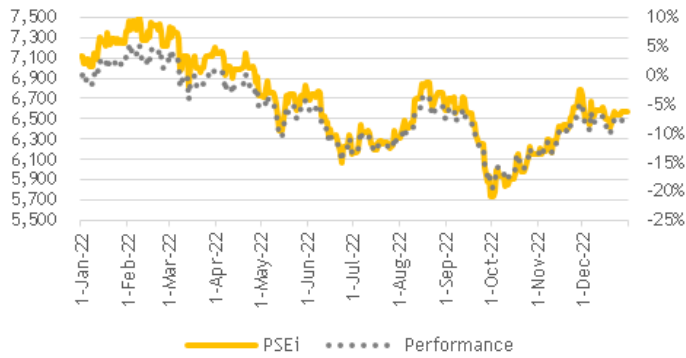
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1. FY23E catalysts

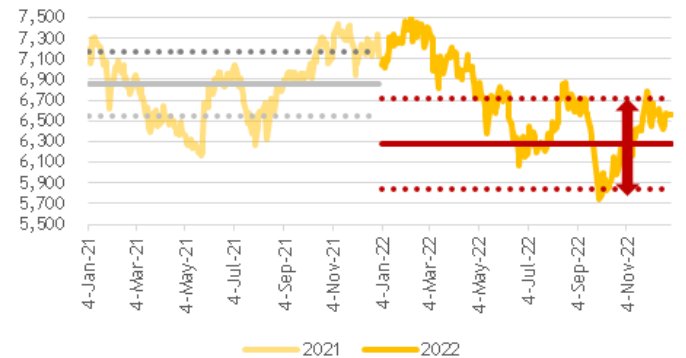
The easing of the country’s quarantine restrictions and the resulting earnings growth momentum since 4Q21 only marginally buoyed the PSEi in 2022.

Fig 1: PSEi performance in 2022



Source: Maybank IBG Research, Bloomberg

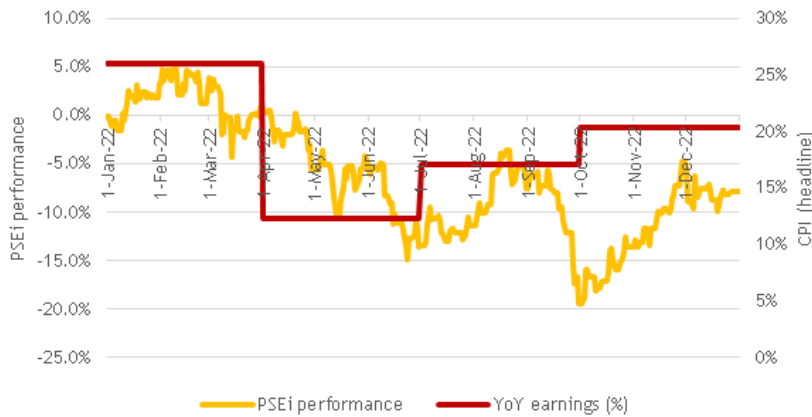
Fig 2: Relative volatility in 2021 vs 2022



Source: Maybank IBG Research, Bloomberg

Investors seemed to have ignored the consistently strong earnings growth momentum of corporates in FY22, and were instead more focused and reacted to the presidential elections, rising inflation and PHP weakness. Considering the consistent double-digit earnings growth delivered by corporates each quarter, inflation and PHP weakness still showed a more meaningful inverse correlation to the PSEi performance in 2022, implying that much of the market activity is sentiment-driven.

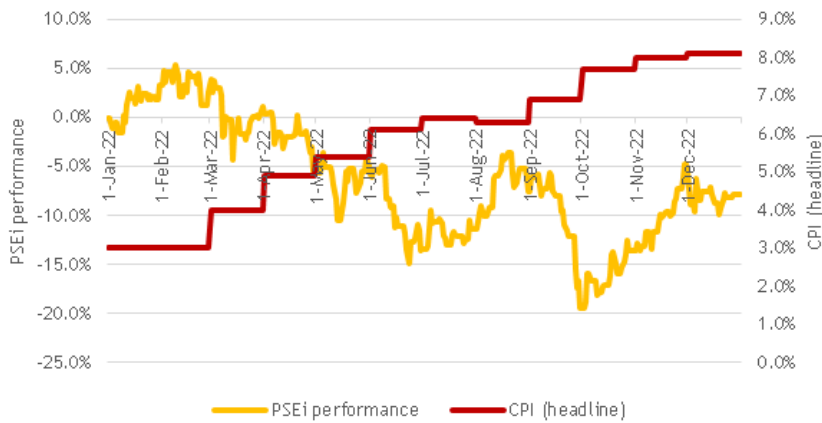
Fig 3: Correlation between PSEi and earnings growth



The PSEi performance and earnings growth had an insignificant correlation co-efficient of 0.42x in 2022

Source: Maybank IBG Research, Bloomberg, Company disclosures

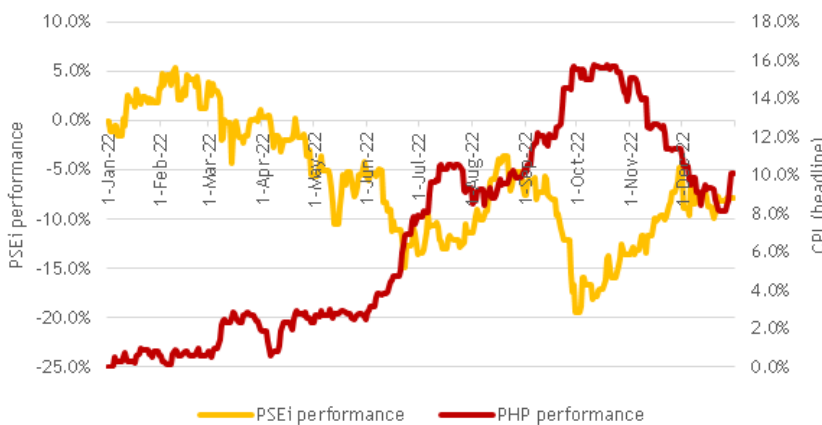
Fig 4: Correlation between PSEi and inflation



The PSEi performance and inflation had a correlation co-efficient of -0.83x in 2022

Source: Maybank IBG Research, Bloomberg, Philippine Statistics Authority (PSA)

Fig 5: Correlation between PSEi and PHP movement



The PSEi performance and PHP movement had a correlation co-efficient of -0.84x in 2022

Source: Maybank IBG Research, Bloomberg, Bangko Sentral ng Pilipinas

However, we expect domestic inflation to taper and PHP to stabilize in FY23E, enabling the market to refocus back on the economy’s fundamentals.

1.1 Improving macroeconomic conditions

Maybank IBG forecasts GDP in the Philippines to normalize to 5.5% in 2023E, buoyed by healthy growth in domestic consumption. Apart from continued improvement in employment rates and sustained OFW remittances, which we expect to grow by 3% YoY in YE23E (see [Philippines OFWR, Sep 2022: Modest OFWR growth in USD amid FX translation gains in PHP](#) report), the reduction in personal income tax rates should boost domestic consumption by 6.4% YoY in 2023.

Fig 6: Philippines - Key Macroeconomic Indicators

	FY19A	FY20A	FY21A	FY22E	FY23E	FY24E
Real GDP (%)	6.1	(9.5)	5.7	7.3	5.5	6.2
Private Consumption (%)	5.9	(8.0)	4.2	8.5	6.4	6.5
Government Consumption (%)	9.1	10.5	7.1	5.5	5.2	5.0
Gross Fixed Capital Formation (%)	3.9	(27.3)	9.9	11.4	8.9	10.1
Exports of Goods & Services (%)	2.6	(16.1)	8.0	9.8	7.6	9.6
Imports of Goods & Services (%)	2.3	(21.6)	13.0	14.9	10.1	10.9
Current Account Balance (% of GDP)	(0.8)	3.3	(1.4)	(6.3)	(3.8)	(3.5)
Fiscal Balance (% of GDP)	(3.4)	(7.6)	(8.6)	(7.0)	(6.0)	(5.5)
Inflation Rate (% , period average)	2.4	2.4	3.9	5.8	4.6	3.0
Unemployment Rate (% , period average)	5.1	10.4	7.8	5.5	5.0	5.0
Exchange Rate (per USD, end-period)	50.7	48.0	51.0	55.6	54.0	54.0
Benchmark Interest Rate (% p.a., end-period)	4.00	2.00	2.00	5.50	6.00	4.25
Real GDP (%)	6.1	(9.5)	5.7	7.3	5.5	6.2
Private Consumption (%)	5.9	(8.0)	4.2	8.5	6.4	6.5
Government Consumption (%)	9.1	10.5	7.1	5.5	5.2	5.0

Source: Maybank IBG Research

1.2 Sustained double-digit earnings growth in FY23E

The Marcos administration's optimistic economic agenda and medium-term plans include the following:

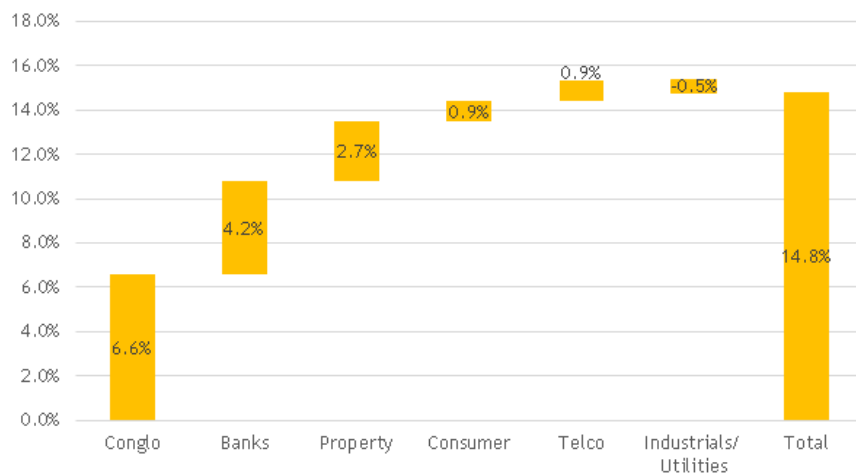
- Arresting inflation through cash subsidies, addressing rising food, energy and transportation costs challenges, and pro-actively importing food;
- 2023-28 GDP growths of 6.5-8.0%;
- Reduction of poverty incidence to 9% by YE28 (2021: 18.1%);
- Reduction of government deficit to 3% in 2026-28 (Sep 2022: 6.5%);
- Reduction of debt to GDP to 60% (YE22: 63.7%); and
- Increase per capita income to USD4,256 by YE28 (2021: USD3,460).

Achieving these economic milestones is likely going to be driven first by private sector-led economic activity, before meaningful foreign direct investments flow into the country. This implies that this administration will need to strategically sustain economic activity (by avoiding lockdowns) and implement the incentives made available to the Filipino private sector. Among these incentives are:

- the reduction of corporate tax rates from 30% to 25%/20% (under the recently passed Comprehensive Recovery and Tax Incentives for Enterprises Act);
- the creation of special purpose vehicles to enable banks and financial institutions to dispose of the non-performing assets (under the Financial Strategic Transfer Act); and
- the programed reduction of personal income taxes under the Tax Reform for Acceleration and Inclusion (TRAIN) Act.

As such, our 15% YoY earnings growth forecast for the market appears achievable as the economy has been fully reopened and is likely to remain open, while the adjustments to the corporate and personal tax rates should enhance corporate and domestic spending, driving economic activity.

Fig 7: PSEi FY23E earnings composition



Excluding the conglomerates, the top earnings contributors would be the property and banking sectors:

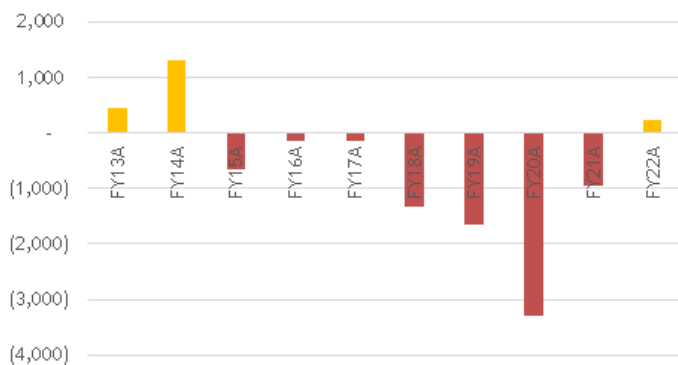
Sector	FY22E	FY23E
Conglo	4.6%	20.8%
Property	20.3%	24.0%
Banks	35.1%	22.2%
Consumer	17.4%	12.3%
Industrials/Utilities	58.6%	-2.5%
Telco	-1.3%	9.7%
PSEi	20.4%	14.8%

Source: Maybank IBG Research

1.3 Risk of foreign outflow capped

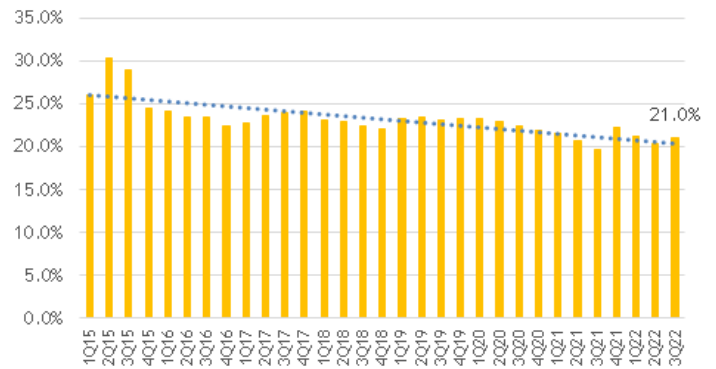
The market is trading at 15x FY23E PER, 1SD below its 10-year PER of 19x. BSP data shows that the market had a net inflow of USD228m in 2022, an improvement from the net outflow of USD1.3-1.7b in 2018-19. This is not surprising as the massive foreign outflows in 2020-21 had already significantly reduced foreign holdings in the country. While less foreign investor participation in the country has reduced the market’s momentum, it also implies that downside to flows from reactionary sell downs by foreign investors could be capped.

Fig 8: Net foreign portfolio investment in PSEi-listed assets



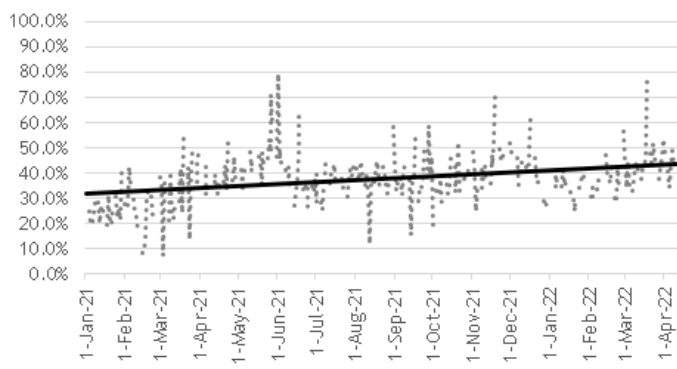
Source: BSP

Fig 9: Foreign ownership level in the Philippines



Source: Philippine Stock Exchange (PSE)

Fig 10: Foreign-local split



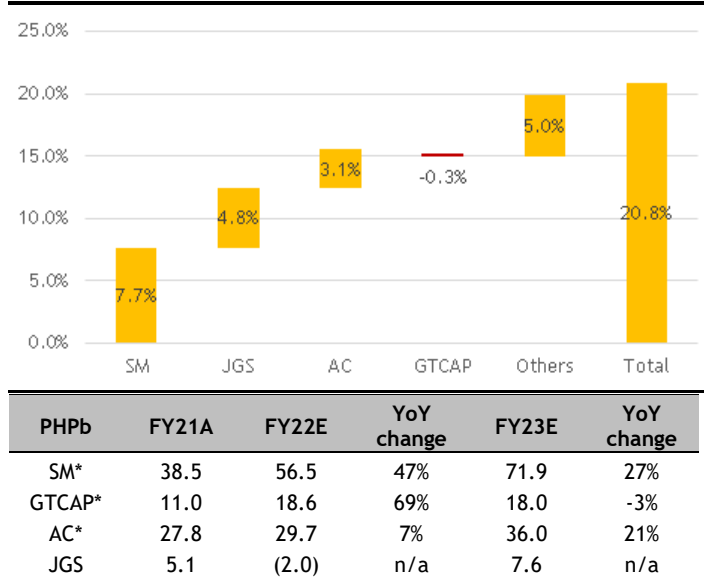
Source: PSE

2. FY23E earnings growth

2.1 FY23E earnings growth

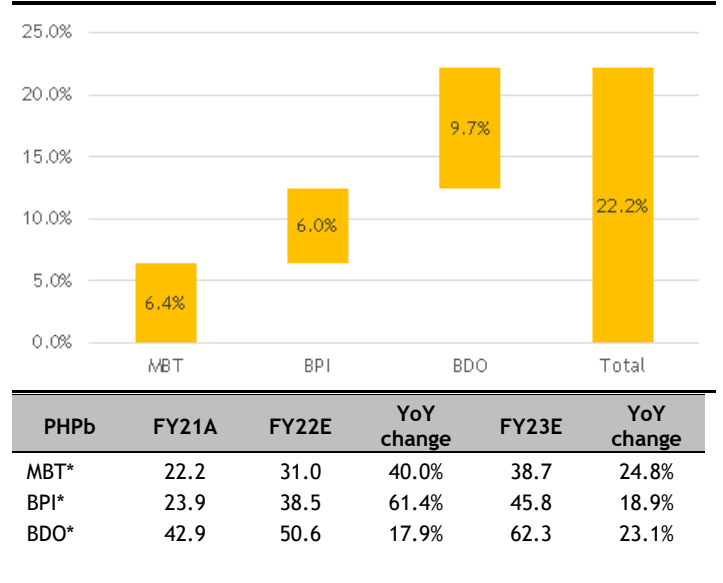
We expect the earnings of all the sectors to grow in FY23E, with 29 of the 30 index stocks expected to exceed FY19A income levels. The only exception may be the industrials/utilities sector, as we forecast earnings to decline by 2.5% YoY in FY23E due to softer coal price forecasts.

Fig 11: FY23E earnings growth composition - CONGLOMERATES



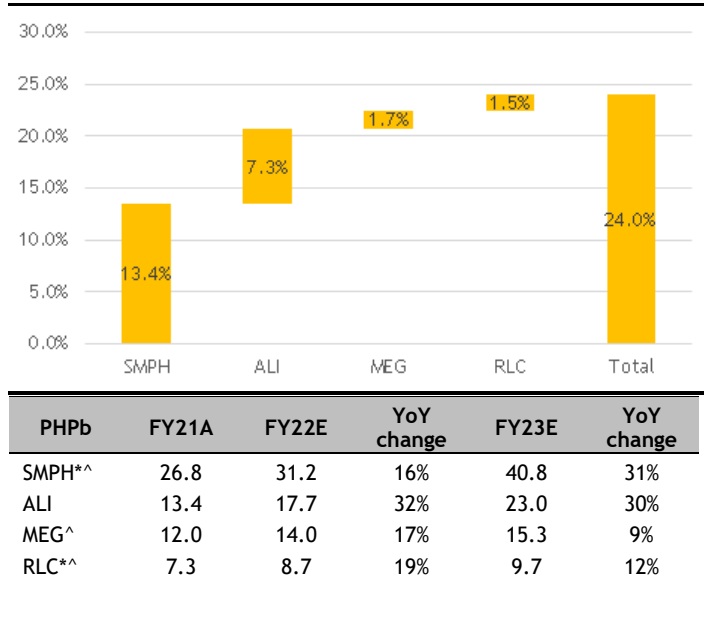
Source: Maybank IBG Research
 *back to pre-pandemic levels
 ^under review

Fig 12: FY23E earnings growth composition - BANKS



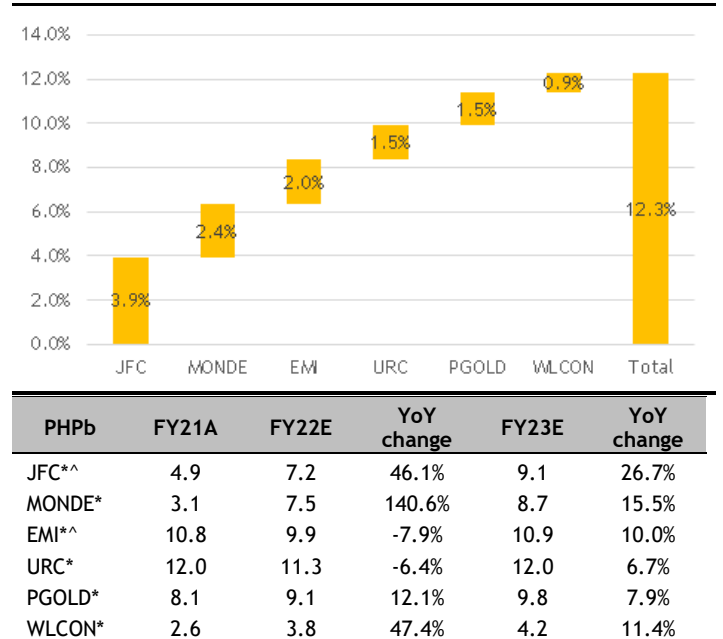
Source: Maybank IBG Research
 *back to pre-pandemic levels
 ^under review

Fig 13: FY23E earnings growth composition - PROPERTY



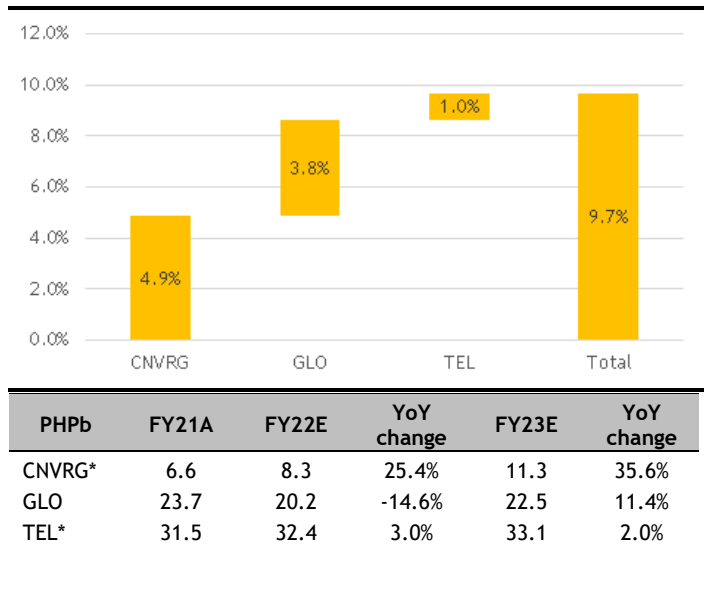
Source: Maybank IBG Research
 *back to pre-pandemic levels
 ^under review

Fig 14: FY23E earnings growth composition - CONSUMER



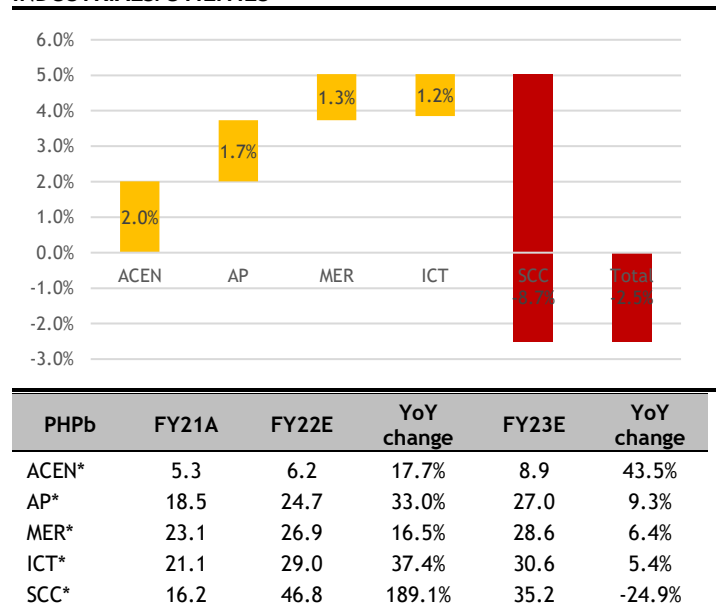
Source: Maybank IBG Research
 *back to pre-pandemic levels
 ^under review

Fig 15: FY23E earnings growth composition - TELCO



Source: Maybank IBG Research
 *back to pre-pandemic levels
 ^under review

Fig 16: FY23E earnings growth composition - INDUSTRIALS/UTILITIES



Source: Maybank IBG Research
 *back to pre-pandemic levels
 ^under review

2.2 Sector outlook and Top Picks

Among the abundance of discounted stocks in the market, we recommend stocks that are undervalued, have tangible economic moats and visible, multi-year earnings growth momentum.

Fig 17: Sector outlook

Rank	Sector	Outlook	Investment strategy	Top Pick	Least Preferred
1	Conglomerates	Neutral	We expect upside to be macro-driven; Maybank IBG forecasts the Philippines' GDP to grow by 5.5% in 2023, underpinned by a projected 6.4% YoY increase in domestic consumption. The improvement in consumption alone should be sufficient to boost the NAVs of conglomerates, particularly those with the most exposure to improvement in consumption and rise in mobility.	SM As the biggest retailer, mall operator and bank, SM offers the best exposure to the Philippines' domestic consumption story	JGS Its air transport and petrochemicals businesses will remain a drag to earnings. We recommend URC, RLC/RCR, TEL and MER for direct exposure to this group.
2	Transport	Positive	We recommend trade-related transport companies as the economic reopening should raise trading volumes and translate to higher throughput for ports, particularly origin-destination ports.	ICT Its predominantly origin and destination ports should ensure a multi-year growth profile, which could possibly be boosted by its ongoing M&A efforts.	NA
3	Gaming	Positive	We expect domestic demand-driven mass and slots to sustain their momentum through FY23E. Historical data shows inflation has a minimal impact on gross gaming revenue (GGR), likely due to the income and wealth profiles of players. Although we expect a deceleration from the c.60% YoY growth in FY22, we expect GGR to continue to post quality growth of 8-10% YoY in FY23E, mainly driven by improving domestic foot traffic and a possible boost from Chinese players following China's reopening.	BLOOM Leading casino operator in the Philippines. We forecast EPSg of 30%/72% for FY23/24E, driven by sustained growth in mass and slots, and fresh contributions from Solaire North beginning 2Q24E.	NA

Source: Maybank IBG Research

Fig 18: Sector outlook (Cont'd)

Rank	Sector	Outlook	Investment strategy	Top Pick	Least Preferred
4	Property/REITs	Positive	We believe developers will outperform landlords in 2023 as the increase in construction activity should translate to accelerated revenue recognition. Also, the sector is the least exposed to commodity price risk as most construction contracts are locked-in.	ALI Diversified portfolio, large landbank and strong brand name ensure long-term growth.	FILRT Lowest occupancy rate in REIT space and it's the most vulnerable to new incoming office supply. It also has a vague acquisition strategy, particularly after the acquisition of the land where Crimson Hotel in Boracay is located.
5	Banks	Positive	The sector should see significant NIM expansion after the 350bps interest rate hike in 2022, which should be fully reflected by 2H23, given the timing of the repricing of loans. We expect this margin improvement to be more than sufficient to offset any potential slowdown in lending growth caused by higher interest rates.	BDO Expecting BDO, which has the highest CA/SA ratio of 82.3% and relatively low deposit cost of 0.27%, to deliver the most NIM expansion.	PNB Has highest NPL ratio in our coverage universe. Stock offers limited catalyst after the property dividend.
6	Consumer	Neutral	While we anticipate lower raw material prices and a more stable PHP to help improve profit margins in FY23E, we expect inflation to continue to affect domestic purchasing power and remain a challenge to this sector, which is highly sensitive to costs and consumer confidence.	WLCON Its niche expansion strategy and inherent pricing power should enable it to benefit from the expected uptick in residential construction activity.	HOME Inflation reduces discretionary spending by Filipino households.
7	Telco	Neutral	Despite only c.25% penetration rate, the growth in fixed-line customers significantly decelerated in Jan-Sep 2022. This heightens competition among the telcos, which are grabbing market share by offering higher speeds at unchanged price points. While these initiatives are good for consumers and deepens digital penetration in the Philippines, ARPUs and margins of telcos may see drop.	TEL Market leader in fixed line and enterprise. It also has less exposure to the wireless segment where we expect competition to become intense.	CNVRG As the newest and smallest telco player, it is most vulnerable to competition in the fixed-line segment.
8	Power/Utilities	Neutral	While strong RE-based pipelines ensure long-term earnings growths for power generation companies, the looming supply tightness in the Luzon grid in 2023 presents near-term opportunities for power generation companies with: (i) new MWs additions in FY22/23E; and (ii) high exposure to the spot market.	AP Offers strong exposure to the domestic-driven volumes growth story in the power sector.	ACEN Potential upside from long-term pipeline has already been priced in at current valuations.

Source: Maybank IBG Research

Fig 19: Maybank IBG Stockwatch

Stock	Mkt Cap USDb	CP	TP	Upside	Rec	EPSg		PER		PBV		Div Yield		ROE	
						FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
CONGLOMERATES															
SM	20.0	903.5	1,120	24%	BUY	47%	27%	19.3	15.1	2.3	2.1	1%	2%	12%	14%
AC	7.9	703.0	1,030	47%	BUY	8%	21%	14.7	12.1	1.1	1.0	1%	1%	9%	9%
JGS	7.7	56.2	43	-23%	SELL	NA	NA	NA	55.9	1.3	1.3	1%	1%	NA	2%
DMC	2.9	11.7	12.1	3%	BUY	104%	-16%	4.1	4.9	1.4	1.2	9%	8%	34%	24%
GTCAP	1.8	440.6	870	97%	BUY	69%	-3%	5.1	5.3	0.4	0.4	3%	3%	9%	8%
BANKS															
BDO	10.7	110.9	156	41%	BUY	18%	23%	9.6	7.8	1.1	0.9	2%	1%	12%	13%
BPI	8.4	104.5	108	3%	BUY	61%	9%	12.2	11.2	1.5	1.3	2%	2%	12%	13%
MBT	4.7	57.2	60	5%	BUY	40%	25%	8.3	6.6	0.8	0.7	5%	3%	9%	11%
UBP	3.7	84.0	96	14%	BUY	-28%	27%	14.2	11.2	1.1	1.0	2%	2%	9%	10%
SECB	1.3	92.9	105	13%	BUY	46%	24%	6.9	5.6	0.5	0.5	3%	3%	8%	9%
PNB	0.5	19.0	23	21%	BUY	-58%	-26%	2.2	2.9	0.2	0.2	0%	0%	8%	6%
PROPERTY															
ALI	8.1	30.0	42.0	40%	BUY	44%	30%	25.2	19.4	1.8	1.7	1%	1%	7%	9%
RCR	1.2	5.9	7.9	33%	BUY	10%	0%	15.3	15.3	0.9	0.9	7%	8%	6%	6%
AREIT	1.0	36.1	49.5	37%	BUY	-4%	18%	19.0	16.1	1.2	0.9	6%	7%	6%	6%
MREIT	0.7	14.2	19.4	36%	BUY	26%	8%	15.4	14.2	0.7	0.8	7%	7%	5%	5%
FILRT	0.5	5.6	6.9	24%	BUY	-15%	14%	19.1	16.8	4.9	5.3	7%	7%	25%	31%
TELCO															
TEL	5.5	1,433	2,075	45%	BUY	47%	-23%	8.1	10.6	2.4	2.3	10%	8%	36%	18%
GLO	5.5	2,114	2,695	27%	BUY	35%	-11%	9.0	10.1	4.0	3.7	5%	5%	21%	18%
CNVRG	2.4	18.0	12.9	-28%	HOLD	25%	36%	15.7	11.6	3.0	2.4	0%	0%	21%	23%
CONSUMER															
URC	5.5	138.0	144.0	4%	BUY	-6%	7%	27.0	25.3	2.7	2.7	3%	3%	10%	10%
MONDE	4.1	12.3	15.0	22%	BUY	141%	15%	29.5	25.5	3.0	2.8	1%	2%	10%	11%
WLCON	2.2	29.8	33.0	11%	BUY	47%	11%	32.4	29.1	6.0	5.2	1%	1%	19%	18%
PGOLD	1.8	34.9	48.0	38%	BUY	12%	8%	11.0	10.2	1.2	1.1	1%	1%	11%	11%
RRHI	1.6	58.4	68.0	16%	BUY	9%	20%	19.7	16.4	1.2	1.2	4%	4%	7%	7%
CNPF	1.5	24.0	28.0	17%	BUY	14%	13%	16.6	14.6	3.0	2.6	2%	2%	18%	18%
DNL	1.0	8.1	10.0	23%	BUY	15%	19%	19.0	16.0	2.8	2.5	2%	3%	15%	16%
HOME	0.1	2.2	3.2	47%	BUY	-37%	14%	9.0	7.8	0.5	0.5	4%	1%	6%	6%
POWER and UTILITIES															
MER	6.2	306.0	370.0	21%	BUY	9%	6%	12.8	12.0	3.3	3.0	5%	5%	26%	25%
ACEN	5.3	7.3	8.0	10%	HOLD	-13%	44%	46.8	32.6	2.9	2.7	1%	0%	5%	8%
AP	4.7	34.7	40.0	15%	BUY	33%	9%	10.4	9.5	1.6	1.4	4%	5%	15%	15%
SCC	2.8	35.9	42.0	17%	BUY	193%	-25%	3.3	4.3	2.1	1.7	14%	11%	50%	33%
FGEN	1.2	17.8	28.0	57%	BUY	9%	13%	4.6	4.1	0.4	0.4	4%	4%	10%	10%
TRANSPORT															
ICT	7.4	203.0	232.0	14%	BUY	35%	5%	14.3	13.5	5.3	5.0	5%	6%	43%	45%
GAMING															
BLOOM	1.8	8.9	11.3	27%	BUY	-211%	29%	20.9	16.2	3.0	2.6	0%	1%	15%	17%

Source: Maybank IBG Research

*Coverage under review for: SMPH, RLC, MEG, VLL, FLI, DMW, JFC, FB

3. PSEi target

3.1 YE23E PSEi target of 7,800pts

To derive our 12-month forward PSEi target, we apply a bottom-up approach, using Maybank IBG and consensus FY23 earnings forecasts and target prices for the 30 index names that make up the PSEi.

Fig 20: PSEi uplift composition

We expect the largest contributions to come from the conglomerates, property and bank stocks.

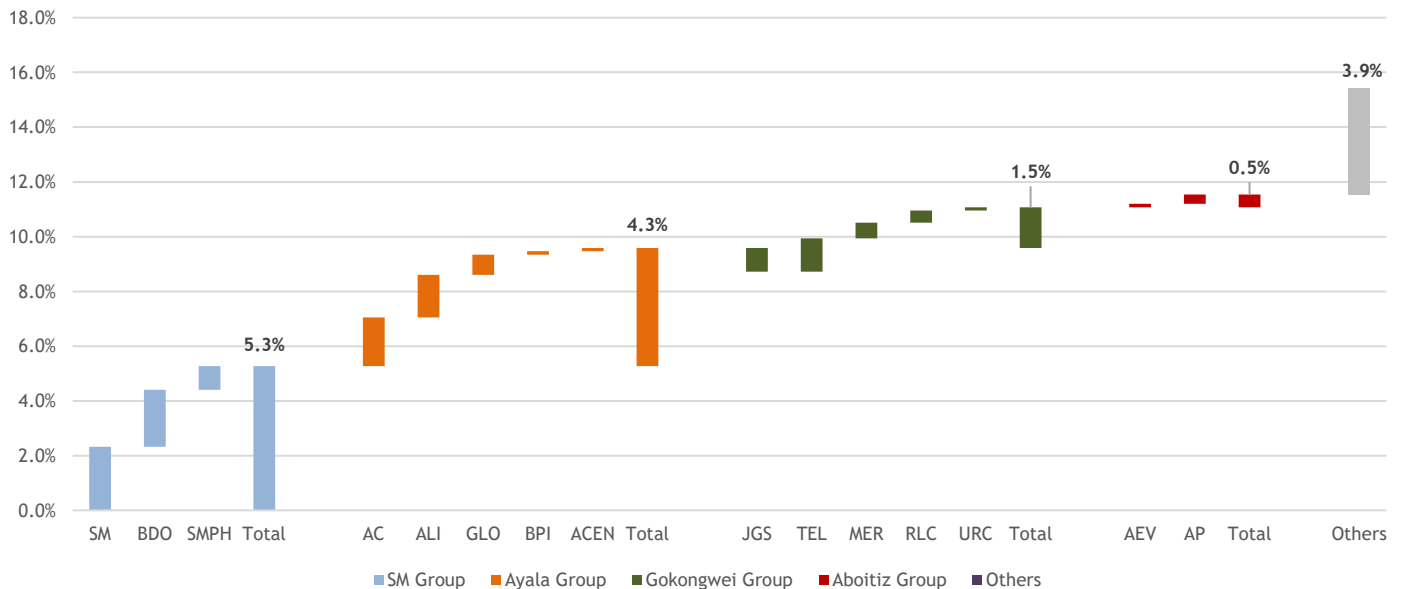


Source: Maybank IBG Research

We expect the bulk of the contributions to reaching our 7,800pts index target to come from the property, banks and property- and banking-led conglomerate stocks, which are positioned for strong earnings recovery in FY23E, we believe.

We expect the majority of the market upside in 2023 to come from the SM group, particularly SM, whose stock price last year was dragged down by its exclusion from the FTSE Global Index in Feb 2022.

Fig 21: Upside contributions to our 2023 PSEi target - by group

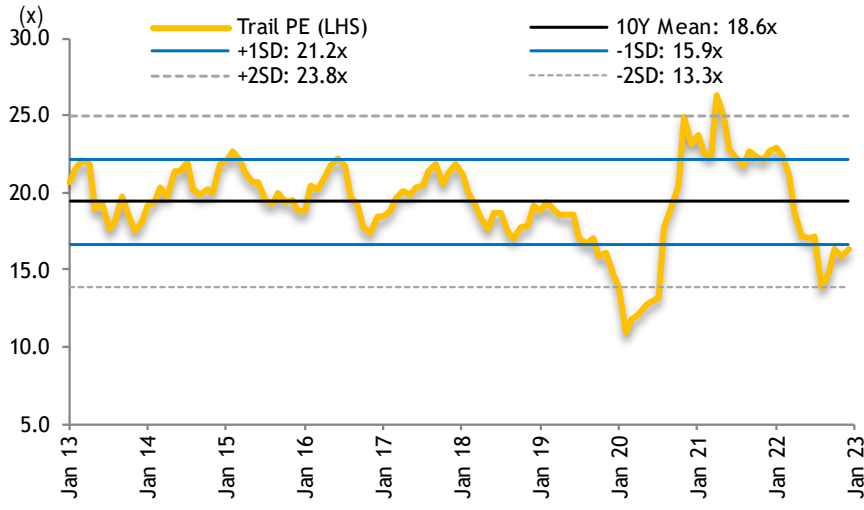


Source: Maybank IBG Research

3.2 Our 15x target PER for FY23E is reasonable

Our 7,800pts YE23E index target implies 15x PER, which is already more than 1SD below the market’s 10-year trailing PER average of 19x.

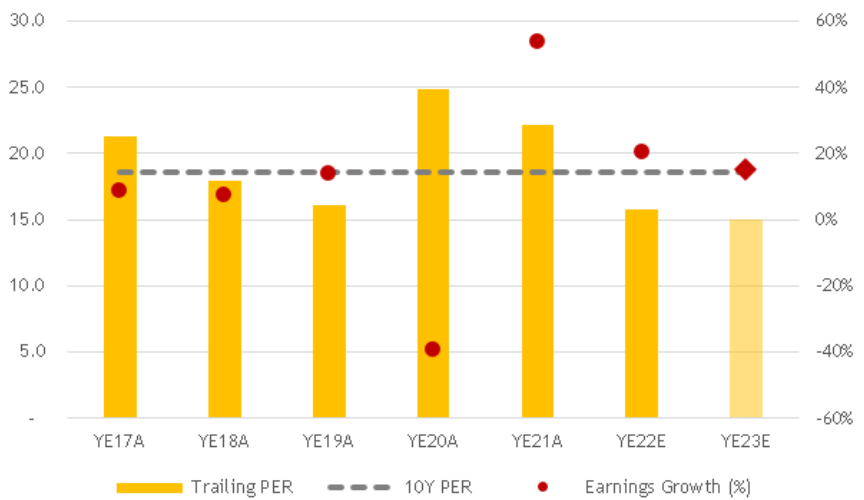
Fig 22: PSEi PER band



Source: Maybank IBG Research

Considering our 15% YoY earnings growth forecast for FY23E, we believe this multiple is justifiable, especially as the market traded at a higher trailing PER of 16x-21x in FY17-19A, despite delivering lower earnings growths of 7-14%.

Fig 23: PSEi valuations and earnings growth



Our 15x PSEi PER target, based on our 7,800pts YE23 index target, is much lower than historical average of 19x despite earnings growth forecast of 15% YoY for FY23.

Source: Maybank IBG Research

4. Sector outlooks

Philippines Conglomerates

NEUTRAL

[Unchanged]

Year Ahead 2023: go with the giants

Exposure-driven uplift

The stock prices of 3 of the 4 conglomerates under our coverage underperformed the PSEi by 2.6-13.9ppt YTD despite earnings growth potential of 7-69% (excludes JGS' -139% YoY) in FY22E. SM (flat) performed the best, implying that beyond earnings growth, the market is also looking for resilient, multi-year and hedged earnings growth. Given the expected stable regulatory environment over the medium term, we expect the uptrend in macroeconomic data to be the sector's key catalyst for FY23E. Consumption- and mobility- themed SM and GTCAP are our Top Picks.

Back to basics

Maybank IBG expects the Philippines' GDP to grow by 5.5% in 2023, underpinned by a projected 6.4% YoY growth in domestic consumption. The improvement in consumption alone is sufficient to boost the NAVs of conglomerates, which have varying exposures to consumption and mobility. Of the 4 conglomerates we cover, we expect GTCAP and SM to benefit the most, as 98%/62% of their pre-pandemic earnings were from the consumer, mobility (excluding air-transport) and/or banking sectors.

Defensive giants

Elevated inflation rates could partially offset the positive impact of the increased domestic economic activity and sustained OFWR on Filipinos' purchasing power. In 3Q18, which recorded the highest quarterly inflation rate prior to 2022, at 6.4%, total household expenditure still grew by c.6% YoY (in real terms), from 1Q-4Q19. The resilience of domestic consumption, which should further improve with increasing mobility, raises the earnings growth quality and longevity of consumption- and mobility-based stocks in an inflationary environment. This long-term earnings growth story is further secured by stocks that have irrefutable pricing power in their relevant sector exposures.

Top Picks: SM and GTCAP

This is why we like SM, the country's largest bank, mall operator and retailer, and GTCAP, owner of the country's largest auto distribution company. Beyond offering FY23/24E core earnings growths of 27%/17% and 22%/12%, respectively, SM and GTCAP are both trading at wide discounts of 19% and 47% to our TPs, pricing in any negative headwind both at the parent and subsidiary levels. Given both names' positive momentum and tangible growth prospects, reiterate BUY on both names.

Analyst

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Other stocks mentioned:

2Go (2GO PM, CP: PHP6.9, Not rated)
ACEN (ACEN PM, CP: PHP7.1, BUY, TP: PHP8.0)
Atlas Mining (AT PM, CP: PHP3.5, Not rated)
Ayala Land (ALI PM, CP: PHP31.5, BUY, TP: PHP41)
Banco de Oro (BDO PM, CP: PHP130, BUY, TP: PHP156)
Bank of the Philippine Islands (BPI PM, CP: PHP105.9, BUY, PHP111)
Cebu Air (CEB PM, CP: PHP38, Not rated)
China Bank (CHIB PM, CP: PHP27.6, Not rated)
Globe Telecoms (GLO PM, CP: PHP2,300, BUY, TP: PHP2,650)
Manila Water (MWC PM, CP: PHP21.6, Not rated)
Meralco (MER PM, CP: PHP280, BUY, TP: PHP355)
Metro Pacific Inc (MPI PM, CP: PHP3.5, Not rated)
Metrobank (MBT PM, CP: PHP57.3, BUY, TP: PHP60)
PLDT (TEL PM, CP: PHP1,752, BUY, TP: PHP2,075)
Robinsons Land (RLC PM, CP: PHP16, Not rated)
SM Prime (SMPH, CP: PHP36.4, Under Review)
Universal Robina Corp (URC PM, CP: PHP133, BUY, TP: PHP144)

Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)		P/B (x)		Div yld (%)	
							22E	23E	22E	23E	22E	23E
SM Investments	SM PM	19,324	Buy	901.50	1,120.00	25	19.2	15.1	2.3	2.1	1.1	1.6
Ayala Corp	AC PM	7,653	Buy	694.00	1,030.00	49	14.5	12.0	1.1	1.0	1.0	1.0
JG Summit Holdi	JGS PM	5,742	Sell	45.05	43.00	(4)	nm	44.8	1.0	1.0	0.8	0.8
GT Capital	GTCAP PM	1,678	Buy	438.00	870.00	100	5.1	5.2	0.4	0.4	3.2	3.2

5. Sector exposures

Maybank IBG’s economics team expects the Philippines’ GDP to grow by +5.5% in 2023, underpinned by a forecast 6.4% YoY growth in domestic consumption, which in turn is partially sustained by a +3% YoY growth in OFWR.

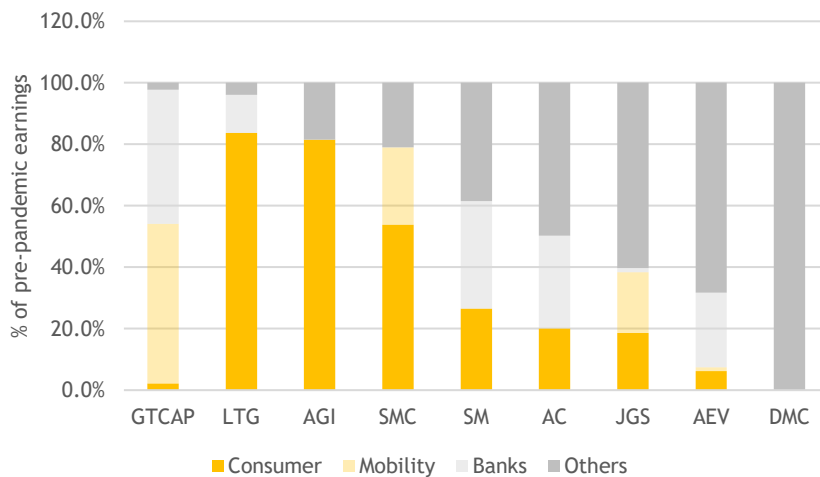
Fig 1: Key macroeconomic indicators for the Philippines

	FY19	FY20	FY21	FY22E	FY23E
Real GDP (%)	6.1	-9.6	5.7	7.3	5.5
Private Consumption (%)	5.9	-7.9	4.2	8.5	6.4
Government Consumption (%)	9.1	10.5	7.1	5.5	5.2
Gross Fixed Capital Formation (%)	3.9	-27.5	9.9	11.4	8.9
Exports of Goods & Services (%)	2.6	-16.3	8.0	9.8	7.6
Imports of Goods & Services (%)	2.3	-21.6	13.0	14.9	10.1
OFR remittances (%)	4.1	-0.8	5.1	2.8	3.0
Inflation Rate (% , period ave)	2.5	2.6	3.9	5.7	4.3
Unemployment Rate (% , period ave)	5.1	10.4	7.8	5.5	5.0
Exchange Rate (per USD, YE)	50.7	48.0	51.0	58.5	56.0
10Y Government Bond Yield (% , YE)	4.3	2.9	4.69	5.00	5.00
Benchmark Interest Rate (% p.a., YE)	4.0	2.0	2.00	5.50	5.50

Source: Maybank IBG Research

These projected macroeconomic improvements alone are sufficient to boost the NAVs of conglomerates, in general, given their varying exposures to consumption and mobility. Among the stocks under coverage, we expect GTCAP and SM to benefit the most, as 98%/62% of their pre-pandemic earnings were from the consumer, mobility (excluding air-transport) and/or the banking sectors.

Fig 2: Exposure to consumption and mobility



Consumer includes earnings from mall operations, retailing, food and beverage and gaming sectors.

Mobility sectors include earnings from auto and infrastructure.

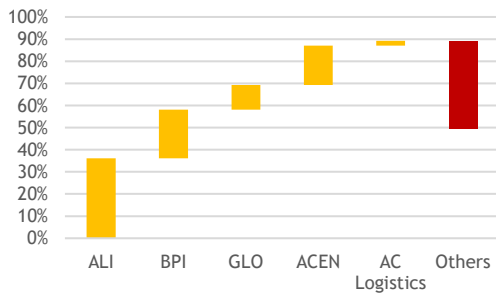
Source: Maybank IBG Research

6. Upside drivers

Among the conglomerates under our coverage, GTCAP offers the highest upside potential to our TPs, at 91% over the next 12 months. Much of that upside is attributable to its auto subsidiary, Toyota Motors Philippines (TMP).

For AC, upsides are mainly driven ALI, while BDO and SMPH are the primary NAV growth drivers for SM.

Fig 3: Stock upside composition of AC



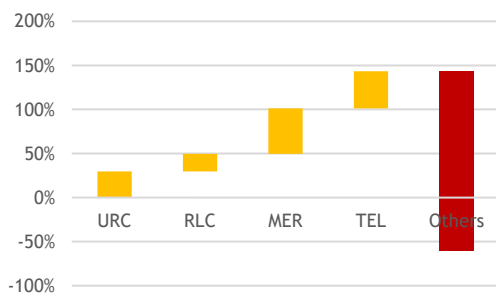
Source: Maybank IBG Research

Fig 4: Stock upside composition of GTCAP



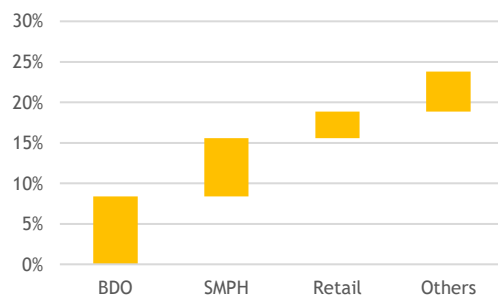
Source: Maybank IBG Research

Fig 5: Stock upside composition of JGS



Source: Maybank IBG Research

Fig 6: Stock upside composition of SM



Source: Maybank IBG Research

We expect JGS to underperform. While we expect URC, RLC, MER and TEL to perform well, we expect the continued weakness in JGS' air transport and petrochemicals segments to create an earnings and stock performance drag.

Fig 7: TP calculation for AC

Segment	Shares (m)	Stake	Real-time valuation		Forward valuation			
			Current Valuation	Attributable Value	Target Price	Valuation method	Attributable Value	% of NAV
ALI	15,107	49.5%	31.5	235,559	41.0	NAV	306,600	38%
BPI	4,507	48.6%	105.9	231,967	111.0	PBV	243,138	30%
GLO	133	30.9%	2,300.0	94,671	2,650.0	DCF	109,078	14%
ACEN	38,240	57.8%	7.1	157,152	8.0	SOTP	176,823	22%
MWC	2,065	30.4%	21.6	13,559		MV	13,559	2%
Infra				5,556		BV	5,556	1%
Other power assets				19,391		BV	19,391	2%
AC Logistics				6,101		DCF	9,039	1%
Others				32,945		BV	32,945	4%
Asset Value (PHP m)				796,901			916,130	113%
Net debt (PHP m)				(123,100)			(105,768)	-13%
Net asset value (PHP m)				673,801			810,361	100%
NAV/sh (PHP)				1,087			1,308	
Conglo discount				-36%				
Target price (PHP)							1,030	

Source: Company disclosures, Maybank IBG Research

Note: "BV" stands for book value, "MV" stands for market value

Fig 8: TP calculation for GTCAP

Segment	Shares (m)	Stake	Real-time NAV		Target price	12-month forward NAV		
			Current Valuation	Attributable Value		Valuation method	Attributable Value	% of NAV
MBT	4,497	37.2%	57.3	95,736	55.0	PBV	100,247	44%
Toyota Motors	-	51.0%	143,036	72,948	152,539	DCF	77,795	34%
Federal Land	-	100.0%	75,467	75,467	75,467	BV	75,467	33%
MPI	31,252	16.0%	3.5	17,279		MV	17,279	8%
Others			13,807	13,807	13,807	BV	13,807	6%
Asset Value (PHP m)				275,238			284,596	124%
Net debt (PHP m)				(67,000)			(54,878)	-24%
Net Asset value (PHP m)				208,238			229,718	100%
NAV/sh (PHP)				967			1,067	
Conglo discount				-55%			-15%	
Target price (PHP)							870	

Source: Company disclosures, Maybank IBG Research

Note: "BV" stands for book value, "MV" stands for market value

Fig 9: TP calculation for JGS

Segment	Shares (m)	Stake	Real-time NAV		Target price	12-month forward NAV		
			Current Valuation	Attributable Value		Valuation method	Attributable Value	% of NAV
URC	2,204	55.3%	133	161,967	144	DCF	175,363	37%
RLC	5,194	61.0%	16	50,857		MV	50,857	11%
CEB	610	67.8%	38	15,827	38	MV	15,827	3%
Robinsons Bank		60.0%	43,631	26,179		2x PBV	26,179	5%
MER	1,127	26.4%	280	83,206	355	DCF	105,493	22%
TEL	216	11.2%	1,752	42,509	2,075	DCF	50,346	11%
UIC	1,433	37.1%	93	49,528	93	MV	49,528	10%
Petrochem		100.0%	51,506	51,506		BV	51,506	11%
Others			10,491	10,491			10,491	2%
Asset Value (PHP m)				492,069			535,589	112%
Net debt (PHP m)				(70,800)			(58,212)	-12%
Net Asset value (PHP m)				421,269			477,378	100%
NAV/sh (PHP)				58.8			66.6	
Conglo discount				-17%			35%	
Target price (PHP)							43.0	

Source: Company disclosures, Maybank IBG Research

Note: "BV" stands for book value, "MV" stands for market value

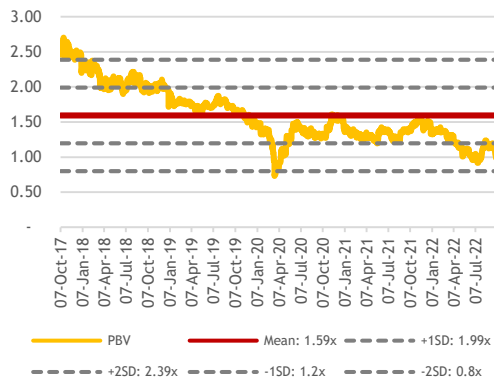
Fig 10: TP calculation for SM

Segment	Shares (m)	Stake	Real-time valuation		Target Price	Forward valuation		
			Current Valuation	Attributable Value		Valuation method	Attributable Value	% of NAV
SM Retail		77.0%	652,501	502,426	599,939	DCF	461,953	33%
SMPH	28,879	50.0%	36.4	525,602	36.4	DCF	525,602	38%
BDO	4,384	47.0%	130.0	267,856	156.0	PBV	321,428	23%
CHIB	2,686	23.0%	27.6	17,053	27.6	MV	17,053	1%
BEL	9,763	26.0%	1.2	3,122	1.2	MV	3,122	0%
2GO	1,421	52.9%	6.9	5,180	6.9	MV	5,180	0%
AT	3,560	34.1%	3.5	4,230	3.5	MV	4,230	0%
AC	628	0.2%	718.5	1,041	1,030.0	MV	1,492	0%
PCPG		100.0%			26,600	MV	26,600	2%
Others				51,494		BV	51,227	4%
Asset Value (PHP m)				1,378,004			1,417,887	101%
Net debt (PHP m)				-39,969			-17,449	-1%
Net asset value (PHP m)				1,338,035			1,400,439	100%
NAV/sh (PHP)				1,111			1,120	
Conglo discount				-15%			0%	
Target price (PHP)							1,120	

Source: Company disclosures, Maybank IBG Research

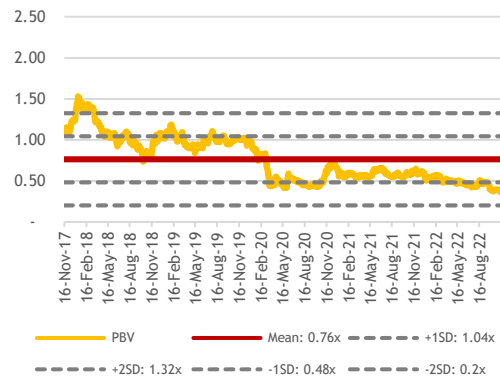
Note: "BV" stands for book value, "MV" stands for market value

Fig 11: 5Y PBV band for AC



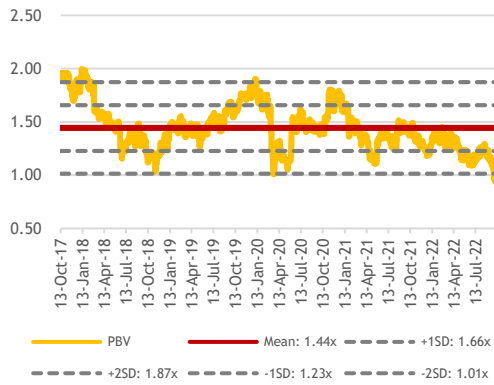
Source: Bloomberg, Maybank IBG Research

Fig 12: 5Y PBV band for GTCAP



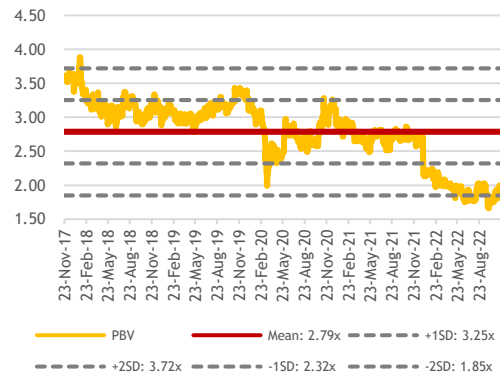
Source: Bloomberg, Maybank IBG Research

Fig 13: 5Y PBV band for JGS



Source: Bloomberg, Maybank IBG Research

Fig 14: 5Y PBV band for SM

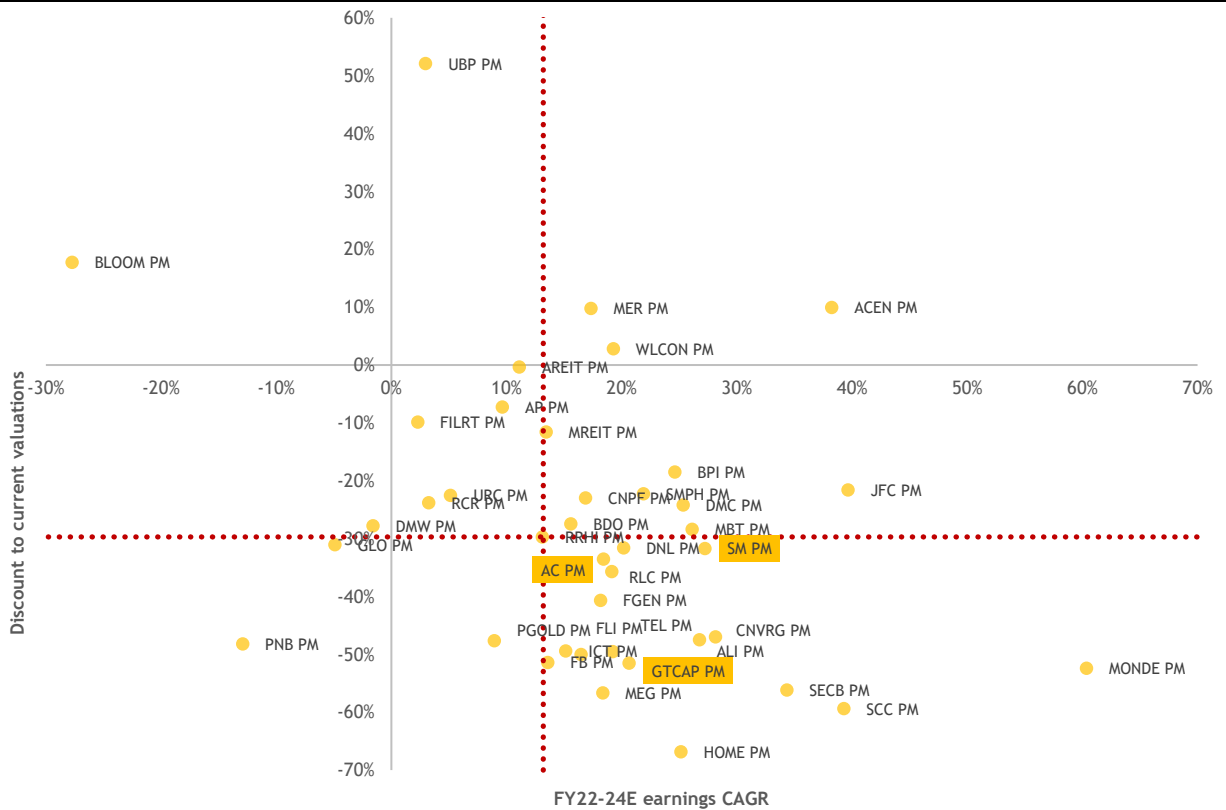


Source: Bloomberg, Maybank IBG Research

7. Deep discounts reinforce preference for parent for SM and GTCAP

The conglomerates under coverage are trading at deep discounts, not only relative to their historical discounts but also relative to the growth they offer. Except for JGS, where we recommend direct exposure to its subsidiaries, URC, RLC or RCR, MER and TEL, to avoid exposure to the challenged air transport and petrochemicals business, we recommend parent-level exposures for SM and GTCAP.

Fig 15: Growth-valuation matrix



Source: Maybank IBG Research, Bloomberg

Philippines Gaming

POSITIVE

[Unchanged]

Year Ahead 2023: more to come

Maintain POSITIVE view on Philippine gaming

The sector has seen faster GGR recovery relative to peer gaming hubs in the region. Even beyond the headline recovery in 2022, we expect GGR to still post growth YoY in FY23E on the back of robust domestic demand. A faster-than-expected recovery of foreign fly-in business presents substantial upside risk for the sector. Our Top Pick for the sector is BLOOM.

Sustained GGR growth in FY23E

We expect domestic demand-driven mass and slots to sustain their momentum through FY23. Historical data shows inflationary pressures have minimal impact on GGR (Fig 3), likely due to the income and wealth profiles of players. Although we expect a deceleration from the c.80% YoY growth posted in FY22, we expect GGR to continue to post quality growth of 8-10% YoY in FY23E, driven by volumes.

Likely no new capacity additions

We do not expect any new capacity additions in FY23E, implying stable market share dynamics in the coming year. In 3Q22, GGR market share stood at 36% for BLOOM's *Solaire*, 22% for AGI's *Newport Manila*, 25% for *Okada Manila*, and 19% for Melco's *City of Dreams* (Fig 4). New capacity with construction visibility include: (i) BLOOM's *Solaire North* (250 tables, 2,500 slot machines) by 1H24E; and (ii) SUN's *Resorts World Westside* (400 tables, 1,200 slot machines) by 1H25E.

Top Pick: BLOOM

Our Top Pick is BLOOM, which is currently the only viable play in the gaming sector. We forecast BLOOM to deliver EPS growth of 30%/72% YoY in FY23/24E, driven by sustained growth in mass and slots and fresh contributions from *Solaire North* beginning 2Q24E. BLOOM is trading at an attractive 8.1x FY23E EV/EBITDA, a 61% discount to Macau peers.

Analyst

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Acronyms used:

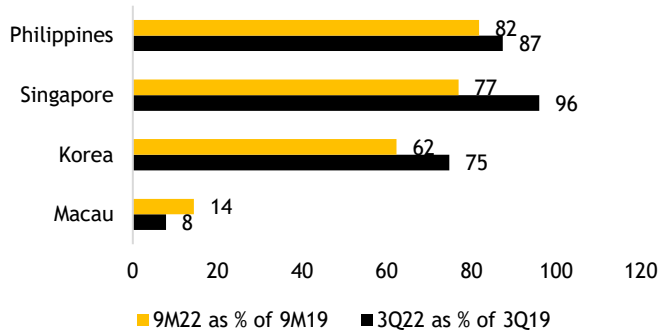
GGR - gross gaming revenues
PAGCOR - Philippine Amusement and Gaming Corporation

Other stocks mentioned:

Alliance Global Inc (AGI PM, CP: PHP10.38, Not rated)
Suntrust Resorts Holdings (SUN PM, CP: PHP0.96, Not rated)

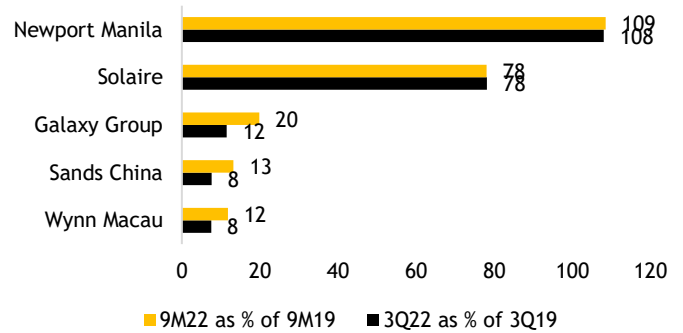
Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)		P/B (x)		Div yld (%)	
							22E	23E	22E	23E	22E	23E
Bloomberry	BLOOM PM	1,427	Buy	7.33	11.30	54	17.2	13.3	2.5	2.1	0.0	1.5

Fig 1: 3Q22/09M2 GGR as a % of 3Q19/9M19 levels (by country)



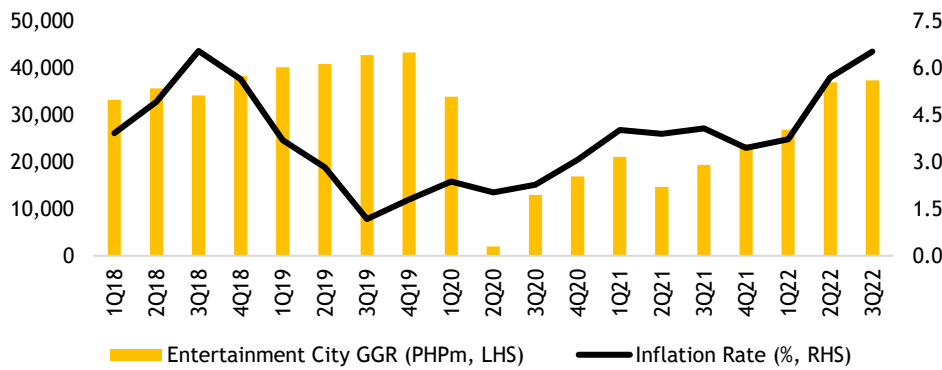
Source: PAGCOR, Bloomberg

Fig 2: 3Q22/9M22 GGR as a % of 3Q19/9M19 levels (by company)



Source: Company, Bloomberg

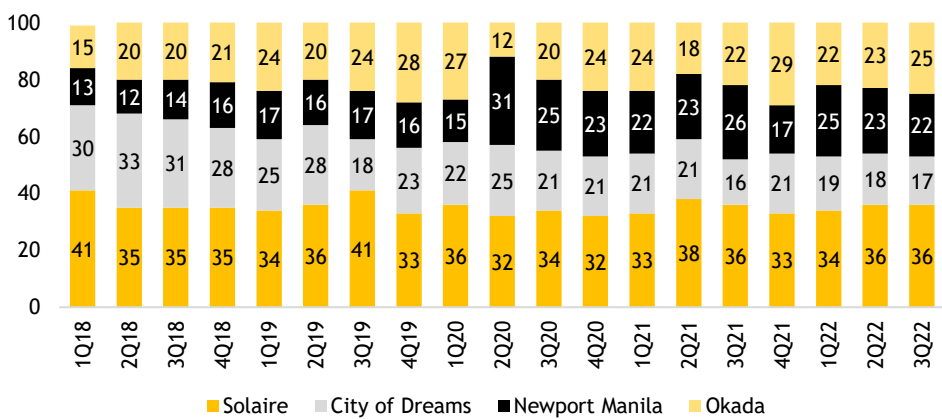
Fig 3: Entertainment City GGR vs. inflation



Historical data shows that inflation does not have a real-time or lagged effect on GGR growth, likely due to the income and wealth profiles of players. GGR growth in FY19 still stood at 13%, following higher-than-average inflation observed in FY18.

Source: PAGCOR, Philippine Statistics Authority

Fig 4: Entertainment City market shares (%)



We expect market shares for the four players in Entertainment City to remain stable in FY23E as we do not expect any new capacity to enter the market until 1H24E. BLOOM will likely sustain its market leadership, supported by its strength in mass and slots. BLOOM notably gained market share in 2Q22-3Q22.

Source: Company, Maybank IBG Research

Fig 5: Peer comparison

Ticker	Company	Mkt Cap (USDm)	Rating	CP (LC)	TP (LC)	Upside (%)	EV/EBITDA (x)		P/E (x)		EPS G (%)		ROE (%)	
							FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Macau														
2282 HK	MGM China	4,077	NR	8.33	n.a.	n.a.	nm	24.7	nm	nm	(29.2)	74.2	nm	29.0
3918 HK	NagaCorp Ltd	3,523	NR	6.23	n.a.	n.a.	12.8	8.0	24.3	10.7	nm	127.4	8.4	15.1
1928 HK	Sands China	26,655	NR	25.70	n.a.	n.a.	nm	25.5	nm	75.1	(38.0)	nm	nm	nm
1128 HK	Wynn Macau	6,048	NR	8.97	n.a.	n.a.	nm	25.9	nm	nm	(28.7)	75.7	49.8	9.3
Korea														
035250 KS	Kangwon Land	3,940	NR	24,000.00	n.a.	n.a.	11.3	7.4	31.4	14.1	nm	123.3	4.8	10.2
ASEAN														
GENT MK	Genting Bhd	3,920	BUY	4.44	5.59	25.9	8.4	6.3	58.7	9.3	nm	nm	1.1	5.7
GENM MK	Genting Malaysia	3,597	BUY	2.66	3.03	13.9	9.3	6.1	58.3	11.9	nm	388.6	3.0	9.3
MAG MK	Magnum Bhd	432	HOLD	1.32	1.42	7.6	11.2	7.7	18.4	11.1	nm	65.6	5.4	7.8
SPTOTO MK	Sports Toto	509	HOLD	1.64	1.59	(3.0)	9.9	7.9	15.9	10.3	(11.6)	36.3	5.3	6.9
GENS SP	Genting Singapore	8,215	HOLD	0.92	0.88	(4.3)	9.7	7.1	26.3	15.2	155.3	72.6	4.8	8.1
Averages														
	Macau						12.8	21.0	24.3	42.9	(32.0)	92.4	29.1	17.8
	Korea						11.3	7.4	31.4	14.1	nm	123.3	4.8	10.2
	ASEAN						9.7	7.0	35.5	11.6	71.9	140.8	3.9	7.6
	Overall						10.4	12.7	33.3	19.7	9.6	120.5	10.3	11.3
BLOOM PM	Bloomberry Resorts	1,426	BUY	7.33	11.30	54.2	9.7	8.1	16.7	12.9	nm	29.5	15.3	17.2

Source: Maybank IBG Research, Bloomberg

Notes:

1. Market prices are updated as of 15 Dec 2022.
2. Unrated names reflect Bloomberg consensus estimates.
3. Current prices (CP) and target prices are reflected in local currency.

Philippines REITs

POSITIVE

[Unchanged]

Year Ahead 2023: bottom-up consistency, top-down relief

Maintain POSITIVE view

We maintain our POSITIVE view on PH-REITs in FY23E as we expect: (i) consistent earnings growth, underpinned by a stable office market; and (ii) a less reactive interest rate environment, which should shift investment appetite to higher yielding REITs. PH-REITs currently offer FY23E dividend yields of 7.2-8.6% and potential total returns of 28-75%. Our Top Picks for the sector continue to be AREIT and MREIT, which offer FY23E dividend yields of 7.2%/8.6% and potential total returns of 49%/75%.

Consistent bottom-up

We forecast PH-REITs to deliver FY23/24E AFFO growth of 14%/6%, driven by stable occupancy, healthy rental escalation and contributions from acquired properties. We maintain the view that the hybrid work set-up will not have a meaningful impact on office occupancy due to internet infrastructure-related barriers. Our view was validated by industry statistics and PH-REITs' 9M22 results, which showed steady occupancy levels (88-99%) and increasing office transactions. We like REITs well-positioned against incoming new office supply in Metro Manila and with exposure to the growing provincial office sector.

Relief top-down

The stock prices of PH-REITs declined by 23-38% YTD, underperforming the PSEi's -9% and the median ASEAN REIT's -7%. The deep correction is largely a function of the steep rise in policy interest rates. The BSP raised interest rates by 300bps to 5.0%, which pushed the 10-year government bond yield to 7.0% (+215bps) YTD. PH-REITs currently offer decent yield differentials of 20-160bps over the 10-year yield and are likely to become more attractive next year as expectations of further interest rate hikes dissipate. Our economics team projects the BSP's policy rate remains flat at 5.5% by YE23E before normalizing to 4.25% in FY24E.

Upside risk from infusions

Asset infusions continue to present substantial upside risk for the sector, with FY23-24E infusions potentially adding 9-54% to GLA. The sponsors of AREIT and MREIT have the largest office asset bases for infusion at 1.1m sqm and 887k sqm respectively. While we expect office assets to remain the primary acquisition targets due to longer lease terms, we may see retail asset injections following the reinstatement of pre-pandemic rents.

Analyst

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Acronyms used:

AFFO - adjustment funds from operations
BOI - Board of Investments
BSP - Bangko Sentral ng Pilipinas
BPO - business process outsourcing
GLA - gross leasable area
PEZA - Philippine Economic Zone Authority
REIT - real estate investment trust

Stocks mentioned:

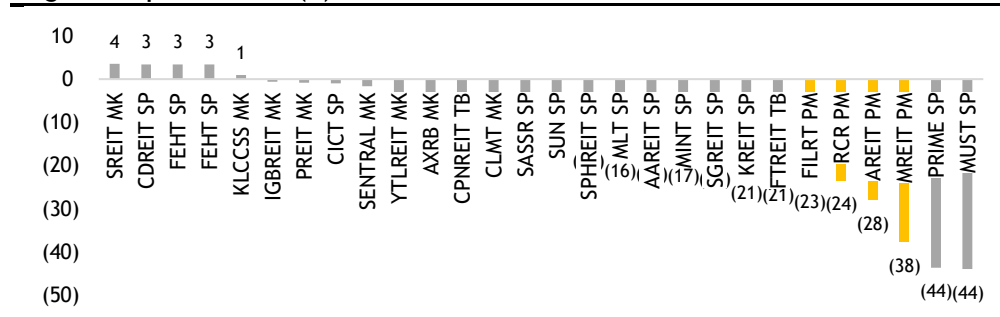
AREIT Inc (AREIT PM; CP: PHP35.00; BUY, TP: PHP49.50)
Filinvest REIT Corp (FILRT PM; CP: PHP5.70; BUY, TP: PHP6.90)
MREIT Inc (MREIT PM; CP: PHP12.26; BUY, TP: PHP19.40)
RL Commercial REIT (RCR PM; CP: PHP5.82; BUY, TP: PHP7.70)
Ayala Land (ALI PM; CP: PHP29.20; BUY, TP: PHP42.00)
Megaworld (MEG PM; CP: PHP2.28; Under Review)

Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	Price/DPU (x)		P/B (x)		Div yld (%)	
							22E	23E	22E	23E	22E	23E
RL Comm. REIT	RCR PM	1,118	Buy	5.84	7.70	39	13.8	13.1	0.9	0.9	7.3	7.6
AREIT Inc	AREIT PM	1,100	Buy	35.00	49.50	47	16.3	14.0	1.1	0.9	6.1	7.2
MREIT Inc	MREIT PM	612	Buy	12.26	19.40	64	12.5	11.6	0.6	0.7	8.0	8.6
Filinvest REIT Co	FILRT PM	498	Buy	5.70	6.90	28	15.3	13.8	5.0	5.4	6.5	7.3

8. Relief top-down

PH-REITs declined by 23-38% YTD, underperforming the PSEi's -9% and the median ASEAN REIT's -7% (Fig 1).

Fig 1: YTD performance (%)

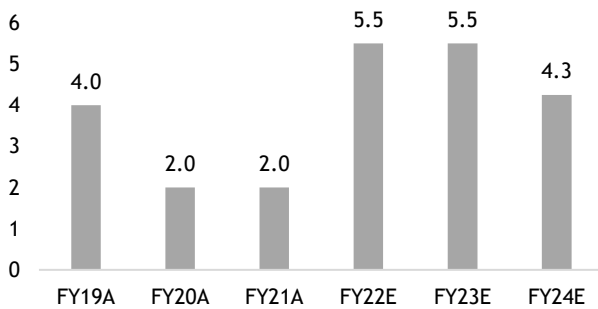


PH-REITs underperformed the PSEi and ASEAN REITs YTD due to the steep rise in domestic interest rates.

Source: Bloomberg

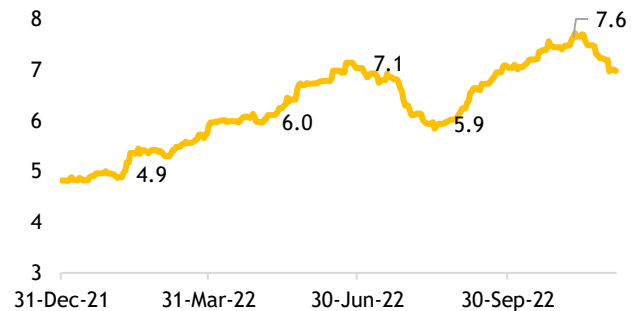
We attribute the deep correction to the steep rise in domestic interest rates, with the BSP's policy rate increasing by 300bps to 5.0% and the 10-year government bond yield increasing by 215bps to 7.0% and reaching 7.7% (+290bps) in Nov 2022 (Fig 3).

Fig 2: BSP policy rate (%)



Source: Maybank IBG Research

Fig 3: 10Y government bond yield (%)



Source: Maybank IBG Research, Bloomberg

PH-REITs are likely to become more attractive in FY23E as expectations of further rate hikes dissipate. Our economics team projects the BSP's policy rate remains flat at 5.5% by YE23E before normalizing to 4.25% in FY24E (Fig 2).

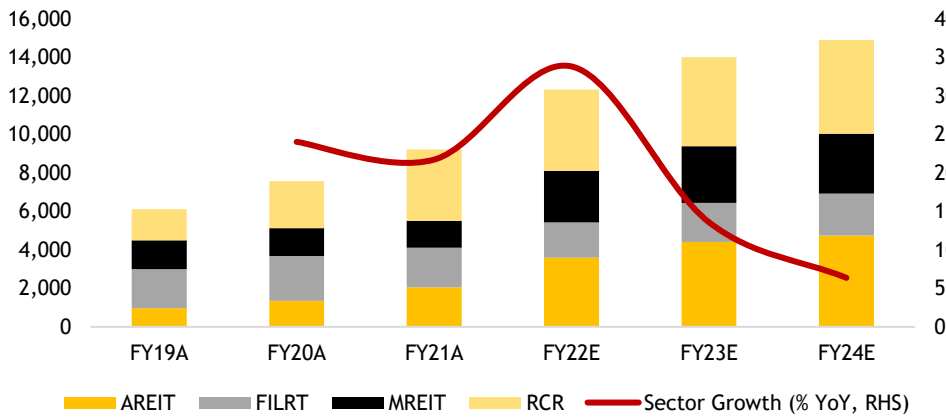
See [Philippines BSP Monetary Policy: Another +75bps rate hike to 5.00%](#), 18 November 2022.

9. Consistent bottom-up

We forecast PH-REITs to deliver FY23/24E AFFO growth of 14%/6%, driven by stable occupancy, healthy rental escalation and contributions from acquired properties (Fig 4). We believe PH-REITs are well-positioned to deliver consistent earnings growth, backed by quality office assets and BPO demand.

See *Philippines REITs: Just getting started*, 18 September 2022.

Fig 4: Adjustment funds from operations and AFFO growth



We forecast PH-REITs to deliver AFFO growth of 14%/6% in FY23/24E.

Source: Company, Maybank IBG Research

We maintain the view that remote work will not have a meaningful impact on office occupancy as internet infrastructure constraints present a barrier to 100% remote work arrangements. Fixed broadband penetration in the Philippines was only 24% in 3Q22 (Fig 5). Moreover, the current PEZA tax incentives package offers exemption from 12% value-added tax, as opposed to the BOI package. As call rates per hour in the Philippines are already trending higher than India (Fig 6), we expect BPO firms to maximize tax incentives to maintain cost competitiveness regionally.

See *Philippines REITs: Office sector steady amid headwinds*, 27 October 2022.

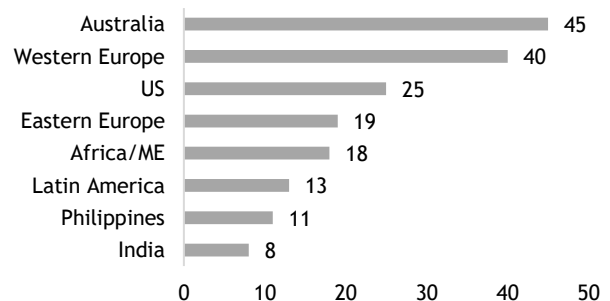
Our view was validated by industry statistics and PH-REITs' 9M22 results, which showed steady occupancy levels (88-99%, Fig 7) and increasing office transactions (Fig 8).

Fig 5: Fixed broadband penetration in the Philippines (%)



Source: Maybank IBG Research

Fig 6: Outsourced call centres' price per hour



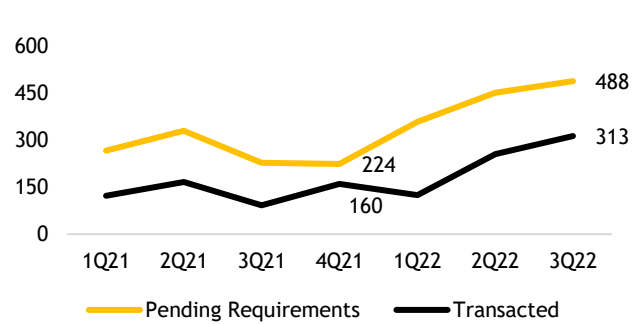
Source: Syrow, Maybank IBG Research

Fig 7: Occupancy rates (%)

	1Q22	2Q22	3Q22
AREIT	97.0	97.0	97.0
FILRT	88.0	88.0	88.0
MREIT	96.0	97.0	95.0
RCR	99.0	99.0	99.0

Source: Company

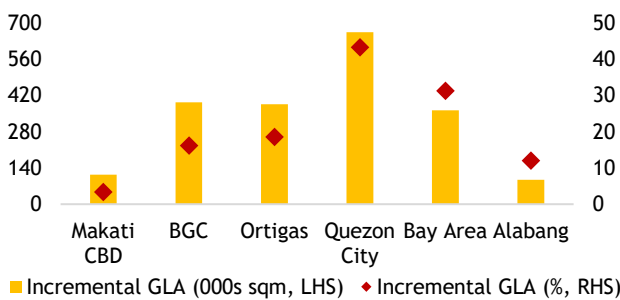
Fig 8: Office transactions and pending demand (000s sqm)



Source: Leechiu Property Consultants

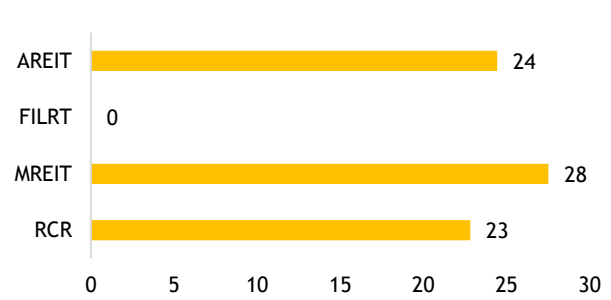
We may see pressure from additional office supply, but only in key locations. Among the commercial hubs in Metro Manila, Quezon City is expected to see the most additions to office stock over the next four years (Fig 9). Quezon City properties represent 0-28% of PH-REITs' GLA, with MREIT having the highest exposure of 28% (Fig 10).

Fig 9: FY23-26E incremental office supply



Source: Colliers Philippines

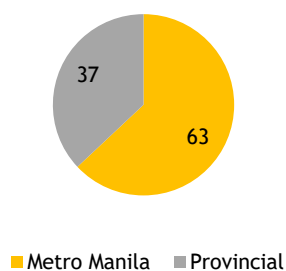
Fig 10: Exposure to Quezon City (% of GLA)



Source: Company

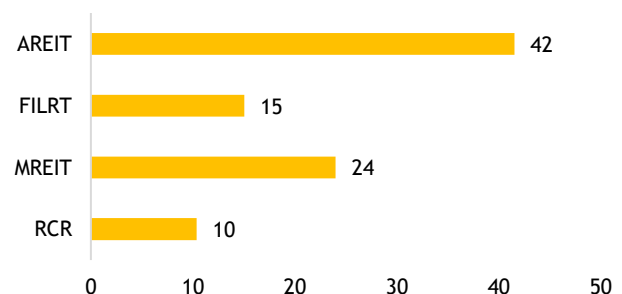
Providing a tailwind for sector earnings is the robust growth of provincial office locations, which continue to benefit from BPOs' and traditional corporates' expansion activities outside of Metro Manila. We believe BPOs and traditional corporates continue to take advantage of cheaper rental rates and sizeable talent pools in key provincial locations like Cebu and Iloilo. 10-42% of PH-REITs' GLA are based in provincial locations, with AREIT and MREIT having the highest exposures of 42% and 24% respectively (Fig 12).

Fig 11: Mix of 9M22 office transactions (%)



Source: Leechiu Property Consultants

Fig 12: Percentage of provincial GLA (%)



Source: Company

10. Substantial upside risk from asset infusions

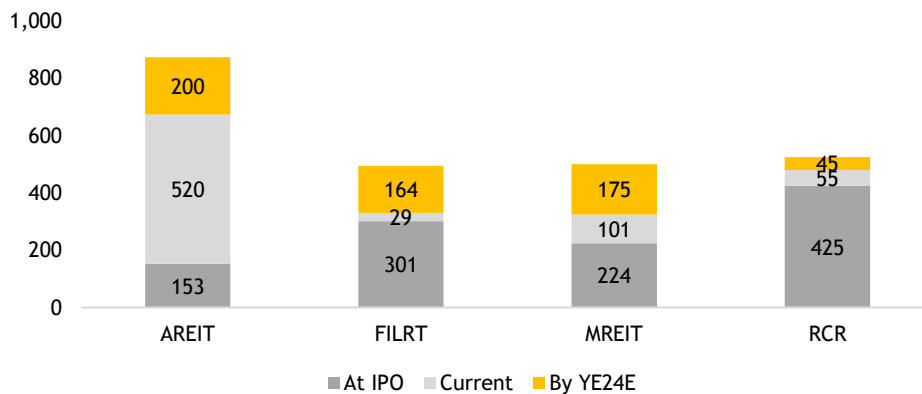
Based on their disclosed investment plans, PH-REITs are set to add 45-200k sqm in GLA over FY23-24E, which will potentially boost their current GLA by 9-54%. We view infusions as an additional source of DPU uplift, with the sponsors still holding sizeable bases of potential infusions.

Fig 13: Infusion plans

	GLA at IPO (000s sqm)	Current GLA (000s sqm)	Projected GLA by YE24E (000s sqm)*	Additional GLA in FY23-24E	Additional GLA as % of Current	Disclosed investment plans
AREIT	153	673	873	200	29.7	Infuse 100k sqm annually over FY22-24E
FILRT	301	330	494	164	49.6	Infuse eight properties with combined GLA of 164k sqm by YE24E
MREIT	224	325	500	175	53.9	Reach 500k sqm by FY23-24E and 1m sqm by FY270-30E
RCR	425	480	525	45	9.3	Add 40-100k sqm to its portfolio 12-18 months after IPO

Source: Company, Maybank IBG Research

Fig 14: PH-REITs' GLA (000s sqm)

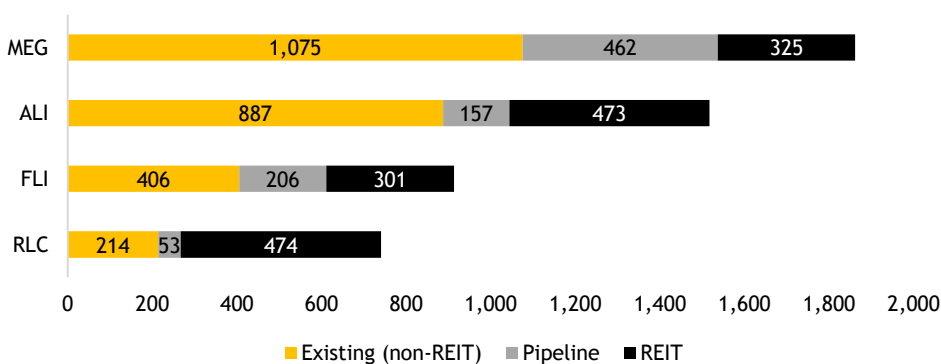


PH-REITs' expansion plans may raise their current GLA by 9-54% by YE24E.

Source: Company, Maybank IBG Research

Among PH-REITs, MEG and ALI have the largest office asset bases that can be infused into the REITs (Fig 15).

Fig 15: Office GLA (000s sqm)



The sponsors of MREIT and AREIT, MEG and ALI have the largest base of 'REIT-able' office assets.

Source: Company

11. Valuation

PH-REITs offer FY23E dividend yields of 7.2-8.6% and potential total returns of 28-75%. Current yields provide a decent differential of 20-161bps over the 10-year treasury yield (7.0%).

Fig 16: Peer comparison

Ticker	Company	Mkt Cap (USDm)	Rating	TP (PHP)	CP (PHP)	Upside (%)	P/DPU (x)		Div. Yield (%)		P/BV (x)	DPU G (%)		ROE (%)	
							FY22E	FY23E	FY22E	FY23E		FY22E	FY23E	FY22E	FY23E
AREIT PM	AREIT Inc	936	BUY	49.50	35.00	41.4	16.3	14.0	6.1	7.2	1.1	20.7	16.7	7.0	7.2
FILRT PM	Filinvest REIT	495	BUY	6.90	5.70	21.1	19.7	17.3	6.5	7.3	5.0	(12.2)	11.2	24.5	30.0
MREIT PM	MREIT Inc	550	BUY	20.40	12.26	66.4	11.8	11.0	8.0	8.6	0.6	33.0	7.8	4.9	5.4
RCR PM	RL Comm REIT	1,107	BUY	7.70	5.82	32.3	13.7	13.1	7.3	7.7	0.9	13.9	5.0	6.2	6.2
Market Cap-Weighted Average						39.3	15.1	13.6	6.9	7.6	1.6	15.2	10.0	9.2	10.2

Source: Maybank IBG Research; Updated as of 06 December 2022

Philippines Banks

POSITIVE

[Unchanged]

Year Ahead 2023: more pros than cons

A NIM-expansion story

Banks' 9M22 results have shown partial NIM expansion from the series of rate hikes this year (YTD: 300bps) but we don't expect its full impact to be reflected until 2H23 given the timing of the loan repricing. We expect BPI, BDO and MBT ("the big three banks") to be the top beneficiaries of the rate hikes and expect their NIMs to expand by 26-32bps YoY in FY23E. Although banks are able to reprice deposits faster, CA/SA ratios have been declining, coinciding with the drop in system liquidity. We expect BDO, which has the highest CA/SA ratio of 82.3% and relatively low deposit cost of 0.27%, to benefit the most. We reiterate our POSITIVE outlook for the sector as margin improvement should more than offset any potential slowdown in lending growth.

Loan growth to continue, albeit at a slower pace

We forecast loan growth to hover between 8-12% YoY in 2023 (FY22E: +4 to 25%) as the rising interest rate environment triggered some corporates to frontload their funding requirements and, for some, tempered their credit appetite. We expect demand for capex-related loans to be subdued in 2023, with the tenors of newer loan bookings to be shorter term, mostly for working capital. A deceleration in credit growth could lead to heightened competition among banks, which could ultimately reduce their pricing power. BDO and BPI are best positioned to see growth even in a slower credit cycle given their strong corporate book and robust deposit franchises.

Asset quality less of a concern

While the rising interest rate environment may raise NPLs, the banks' well-provisioned NPL exposures and more prudent credit underwriting standards should sufficiently mitigate this risk. Nevertheless, we are closely monitoring system gearing and maturity levels as higher rates negatively impact corporates' debt-servicing capacity. Among our coverage, the telco and property sectors have the highest net gearing ratios, averaging at 2.8x and 1.3x as of 9M22. Still, banks only have between 3-5% exposure to telcos (% of loan book), and these companies continue to pose healthy cashflows, with additional windfall coming from asset sales; hence, mitigating credit risk. Real estate exposure is higher at 15-25%, but this is mitigated by improving sales reservation and leasing income of property companies.

BDO still our Top Pick

BDO remains our Top Pick as its scale and hybrid digital/brick-and-mortar strategy puts it at the forefront to capture lending growth in a recovering economy. Coupled with high CA/SA percentage, which would keep funding costs at bay, BDO is also the top beneficiary of the rising interest rates environment. BPI is also seen to benefit largely from margin growth given its relatively high CA/SA and percentage of short-term repricing of corporate loans.

Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)		P/B (x)		Div yld (%)	
							22E	23E	22E	23E	22E	23E
BDO Unibank	BDO PM	10,197	Buy	129.00	156.00	21	11.2	9.1	1.2	1.1	1.6	0.9
Bank of Phil Is.	BPI PM	8,055	Buy	99.00	108.00	9	11.6	10.6	1.4	1.2	2.1	2.1
Metrobank	MBT PM	4,460	Buy	55.00	60.00	12	8.0	6.4	0.7	0.7	5.5	2.9
Union Bank of P.	UBP PM	3,087	Buy	80.00	96.00	22	13.5	10.6	1.1	1.0	1.8	1.9
Security Bank	SECB PM	1,223	Buy	90.00	105.00	20	6.7	5.4	0.5	0.5	3.3	3.3
Phil. National Bk	PNB PM	531	Buy	19.30	26.00	35	2.7	2.8	0.2	0.2	0.0	0.0

Analyst

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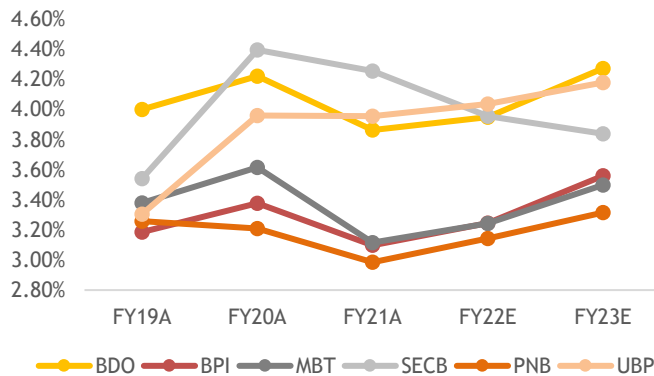
Acronyms used:

BSP: Bangko Sentral ng Pilipinas
 CAR: Capital Adequacy Ratio
 CA/SA: Current account/Savings account
 CET1: Common Equity Tier 1
 NIM: Net interest margin
 NPL: Non-performing loans
 ODF: Overnight Deposit Facility
 TDF: Term Deposit Facility

12. NIM expansion to be more pronounced in 2023

The 300bps YTD rate hike by the BSP has partially expanded NIMs in 9M22, but we don't expect the full impact to be reflected until 2H23 due to the repricing lag, which we anticipate to range between 6-12 months. We expect the big three banks to be the top beneficiaries of higher interest rates and see between 26-32bps NIM expansion for FY23E as c.70% of their corporate loans will be repriced within a year.

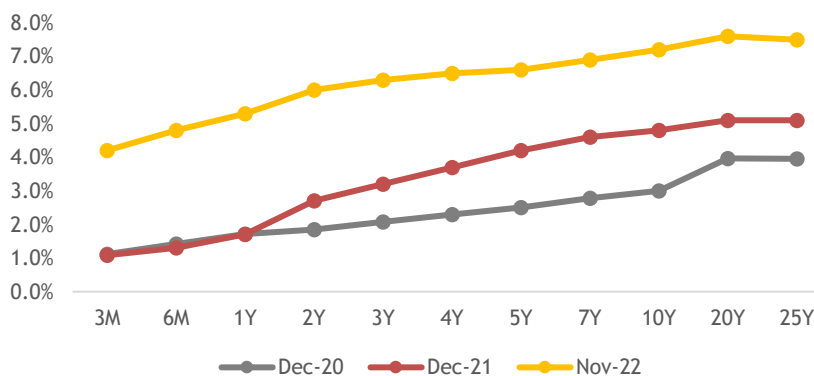
Fig 1: Historical and forecasted NIMs of banks



The expansion of UBP's NIM will be driven by the higher consumer loan percentage over total loans due to the consolidation of Citi's retail assets. SECB's flattish or even declining margins forecast is a result of the lower higher-yielding consumer loan percentage over total loans.

Source: Company disclosures, Maybank IBG Research

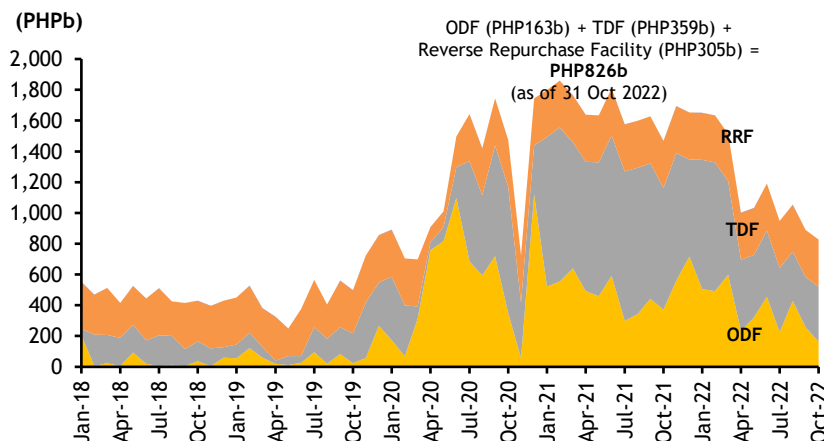
Fig 2: Yield curve



The yield curve has risen significantly from end-Dec 2021 across all tenors.

Source: Bloomberg, Philippine Dealing System Holdings

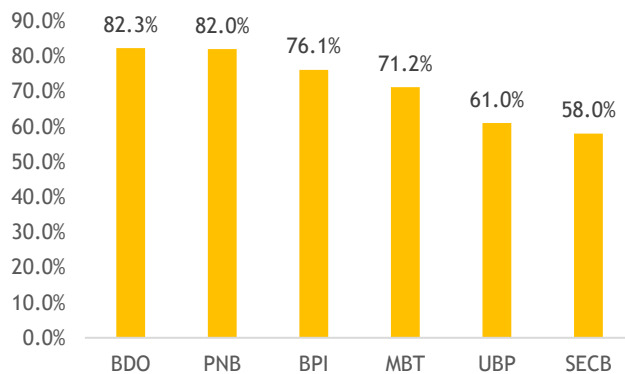
Fig 3: System liquidity



Source: BSP

Deposits, meanwhile, reprice faster, and we have been seeing a decline in CA/SA ratios since 2Q22, coinciding with the drop in system liquidity, which is currently almost back to pre-pandemic levels. BDO, which has maintained its CA/SA ratio at 82.3%, has the highest ratio among the banks under coverage and coupled with its relatively low deposit cost (0.27%), is the top candidate for NIM expansion.

Fig 4: CA/SA ratios of banks as of 9M22



CA/SA ratios have been dropping since 2Q22. BDO, though, has kept its CA/SA percentage high due to its dual growth strategy of branch expansion and digitalization.

Source: Company disclosures, Maybank IBG Research

Except for PNB, our FY23E net income growth of 18.9-23.9% YoY is predicated on NIM expansion, steady fees growth, and normalized credit costs. We expect PNB to post an earnings decline in FY23E due to the absence of one-off asset sale gains.

Fig 5: Income growth forecasts

	Net Interest Income (PHPm)			Fee income (PHPm)			Net income (PHPm)		
	FY21A	FY22E	FY23E	FY21A	FY22E	FY23E	FY21A	FY22E	FY23E
BDO	131,346	146,497	173,509	30,485	36,503	40,698	42,920	50,611	62,292
BPI	69,583	80,446	97,872	11,204	13,359	14,852	23,880	38,540	45,811
MBT	75,049	82,488	97,653	13,418	14,533	16,033	22,156	31,029	38,712
SECB	27,456	28,249	31,821	4,531	4,951	5,479	6,917	10,109	12,524
PNB	34,845	36,731	39,825	5,289	5,689	6,137	31,631	10,951	10,448
UBP	29,815	34,831	42,697	3,773	4,498	4,843	12,525	12,675	16,108
<i>Growth</i>									
BDO	-1.8%	11.5%	18.4%	22.8%	19.7%	11.5%	52.0%	17.9%	23.1%
BPI	-3.7%	15.6%	21.7%	25.9%	19.2%	11.2%	11.5%	61.4%	18.9%
MBT	-12.8%	9.9%	18.4%	14.7%	8.3%	10.3%	60.2%	40.0%	24.8%
SECB	-10.4%	2.9%	12.6%	24.7%	9.3%	10.7%	-6.9%	46.2%	23.9%
PNB	-2.7%	5.4%	8.4%	42.9%	7.6%	7.9%	1109.7%	-65.4%	-4.6%
UBP	3.8%	16.8%	22.6%	60.8%	19.2%	7.7%	8.4%	1.2%	27.1%

Source: Company disclosures, Maybank IBG Research

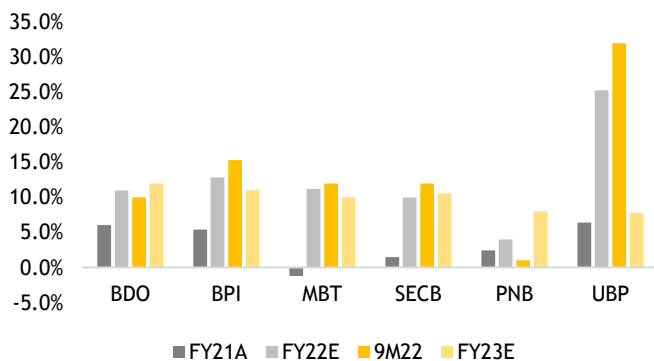
13. Lending growth still in the horizon

We expect loan growth to hover between 8-12% YoY in 2023 (from our 10-14% YoY 2023E growth forecast at the beginning of the year, and 4-25% YoY growth forecast for 2022E) as the rising interest rate environment triggered some corporates to frontload their funding requirements and, for some, tempered their credit appetite. We expect demand for capex-related loans to be subdued in 2023, with the tenors of newer loan bookings to be shorter-term, mostly for working capital. A deceleration in credit growth could lead to heightened competition among banks, which could ultimately reduce their pricing power. BDO and BPI are best positioned to see growth even in a slower credit cycle given their strong corporate book and robust deposit franchises.

We expect the banks' loan book composition to be minimally changed, with corporate loans to accounting for c.75-78%, while consumer loans account for 22-25%. We expect the loan books of the home and auto segments to grow in line with our industry forecast, at +8-10% YoY, driven by higher property turnover and rising auto sales trend.

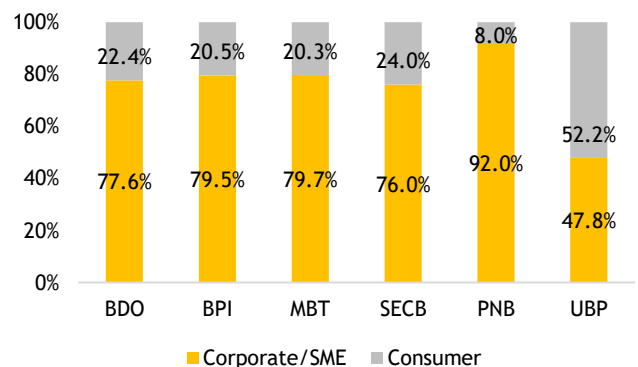
A potential tailwind would be the resumption of infrastructure spending that could give rise to private-public partnerships. Should this happen, we expect it to be towards the end of 2023 and would likely impact 2024 NIMs.

Fig 6: Loans growth comparison



Source: Company disclosures, Maybank IBG Research

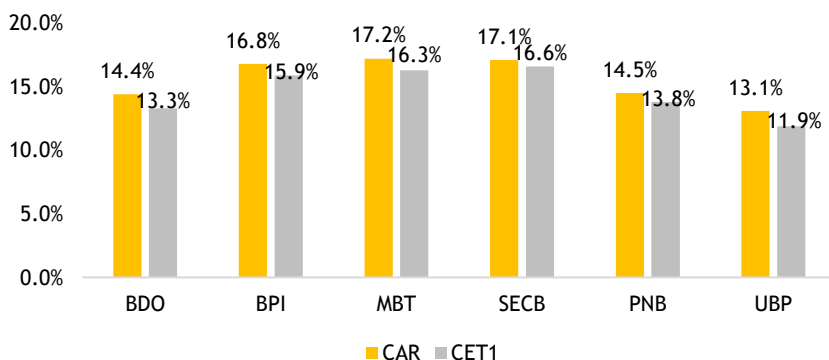
Fig 7: Corporate and consumer loans as of 9M22



Source: Company disclosures

Our covered banks continue to have healthy capital levels, which could support lending growth. For UBP, its Citi consolidation resulted in a lower CET1 ratio of 11.9%, which it plans to increase by raising PHP20b in capital through either a stock rights offer or a private partnership.

Fig 8: CAR and CET1 as of 9M21



Source: Company disclosures

14. NPL ratios to remain manageable

While the rising interest rate environment may raise NPLs, the banks' well-provisioned NPL exposures and more prudent credit underwriting standards should sufficiently mitigate this risk. Nevertheless, we are closely monitoring system gearing and maturity levels as higher rates negatively impact corporates' debt-servicing capacity.

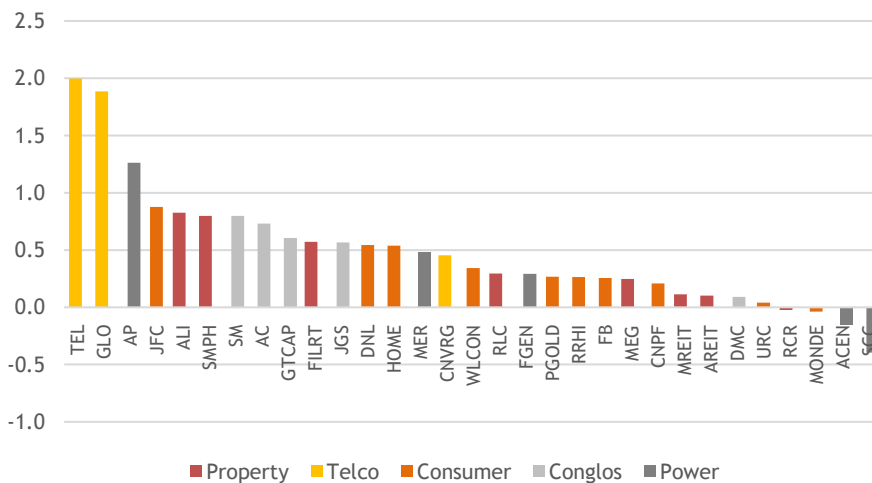
Fig 9: NPL ratios and cover

	FY19	FY20	NPL % FY21	FY22E	FY23E	NPL %	NPL Cover 9M22
BDO	1.18%	2.72%	2.91%	2.75%	2.58%	2.23%	126.0%
BPI	1.66%	2.67%	2.49%	2.20%	2.08%	1.94%	176.8%
MBT	1.30%	2.41%	2.16%	2.14%	2.33%	2.10%	172.0%
SECB	1.20%	3.91%	4.27%	3.89%	3.87%	3.24%	94.0%
PNB	3.07%	10.20%	10.53%	Under review		6.30%	82.0%
UBP	2.96%	4.83%	5.05%	5.62%	5.63%	Not disclosed	

Source: Company disclosures, Maybank IBG Research

Among our coverage, the telco and property sectors have the highest net gearing ratios, averaging at 2.8x and 1.3x as of 9M22. Still, banks only have between 3-5% exposure to telcos (% of loan book), and these companies continue to pose healthy cashflows, with additional windfall coming from asset sales (i.e. tower and data center sales); hence, mitigating credit risk. Real estate exposure is higher at 15-25%, but this is mitigated by improving sales reservation and leasing income of property companies.

Fig 10: Net gearing ratio of covered stocks as of 9M22 (x)



Source: Bloomberg

15. BDO is our Top Pick

BDO remains our Top Pick as we believe it has the best scale to capture lending growth in a growing economy. We also believe it has the best digital/branch mix to gain more market share, especially in a low-banked country like the Philippines. Coupled with high CA/SA percentage, which would keep funding costs at bay, BDO is also the top beneficiary of high interest rates.

BPI is also seen to benefit largely from margin growth given its relatively high CA/SA and percentage of short-term repricing of corporate loans. Its strong digital push will also help boost income in the form of higher fees.

Fig 11: BDO TP computation

	Target Price
BVPS (PHP)	118.1
Sustainable ROE	10.9%
Dividend payout	20.0%
Sustainable growth rate	8.7%
Cost of equity	10.4%
Risk-free rate	6.0%
Equity risk premium	5.5%
12M fwd P/B (target) (x)	1.32
Target price (PHP)	156.0

Source: Maybank IBG Research

Fig 12: BPI TP computation

	Target Price
BVPS (PHP)	79.71
Sustainable ROE	11.28%
Dividend payout	30.00%
Sustainable growth rate	7.90%
Cost of equity	10.40%
Risk-free rate	6.00%
Equity risk premium	5.50%
12M fwd P/B (target) (x)	1.35
Target price (PHP)	108.0

Source: Maybank IBG Research

Fig 13: MBT TP computation

	Target Price
BVPS (PHP)	82.5
Sustainable ROE	9.5%
Dividend payout	7.1%
Sustainable growth rate	25.0%
Cost of equity	10.4%
Risk-free rate	6.0%
Equity risk premium	5.5%
12M fwd P/B (target) (x)	0.73
Target price (PHP)	60.0

Source: Maybank IBG Research

Fig 14: SECB TP computation

	Target Price
BVPS (PHP)	183.2
Sustainable ROE	8.8%
Dividend payout	25.0%
Sustainable growth rate	6.6%
Cost of equity	10.4%
Risk-free rate	6.0%
Equity risk premium	5.5%
12M fwd P/B (target) (x)	0.6
Target price (PHP)	105.0

Source: Maybank IBG Research

Fig 15: UBP TP computation

	Target Price
BVPS (PHP)	77.5
Sustainable ROE	10.9%
Dividend payout	25.0%
Sustainable growth rate	8.2%
Cost of equity	10.4%
Risk-free rate	6.0%
Equity risk premium	5.5%
12M fwd P/B (target) (x)	1.24
Target price (PHP)	96.0

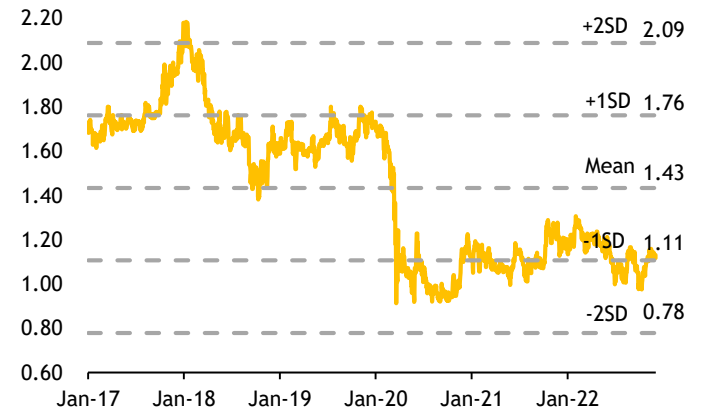
Source: Maybank IBG Research

Fig 16: PNB TP computation

	Target Price
BVPS (PHP)	110.76
Sustainable ROE	5.59%
12M fwd P/B (target) (x)	0.23
Target price (PHP)	26.0

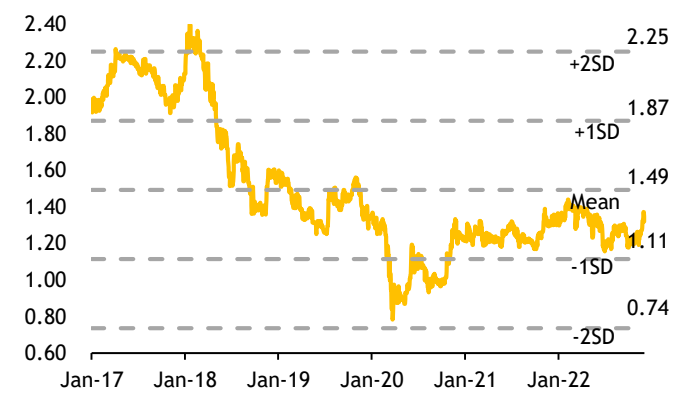
Source: Maybank IBG Research

Fig 17: BDO 5-yr P/BV



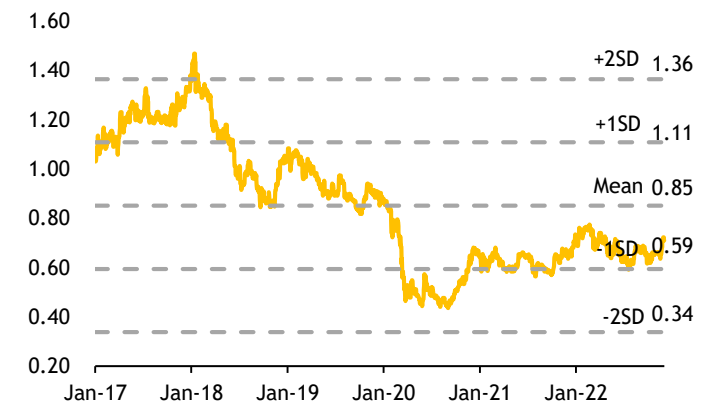
Source: Bloomberg

Fig 18: BPI 5-yr P/BV



Source: Bloomberg

Fig 19: MBT 5-yr P/BV



Source: Bloomberg

Fig 20: SECB 5-yr P/BV



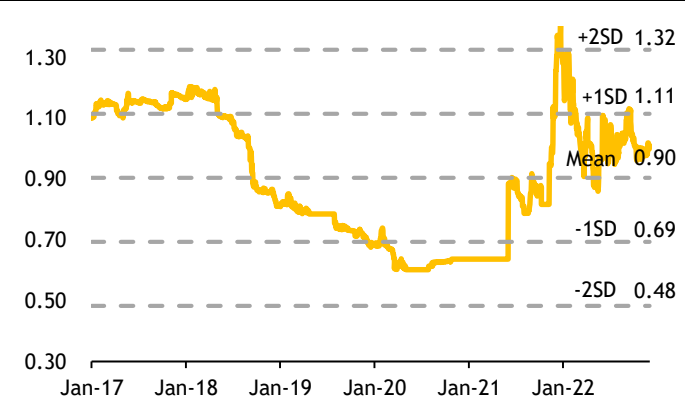
Source: Bloomberg

Fig 21: PNB 5-yr P/BV



Source: Bloomberg

Fig 22: UBP 5-yr P/BV



Source: Bloomberg

Philippines Consumer - Retailers

NEUTRAL

 [Unchanged]

Year Ahead 2023: Retailers holding up

Normalising FY23E EPSg reinforces our NEUTRAL view

With three of the four retailers under our coverage back to pre-pandemic earnings as of YE22E, we expect the sector's earnings growth to decelerate to 12.6% YoY in FY23E, from 14.0% in FY22E. Apart from sustained store expansions, the bulk of this growth will be attributable to: i) SSSGs of 2-6%, following an unprecedented year of price hikes in FY22E; and ii) 10-30bps GPM expansion from inventory frontloading. We maintain NEUTRAL on the sector, as headwinds of softened demand as a result of the pandemic trumps the cheap valuation of the sector; recommend selective stock picking on inflation-proof names. Home improvement retailer WLCON is our top sector pick for its industry-leading ROE at 18% for FY23E, and a strong fundamental growth outlook premised on the developing Philippines property story.

Analyst

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Acronyms used:

SSSG- same store sales growth
GPM - gross profit margin

Inflation-related consumption pattern changes

Aside from its impact on margins, an inflationary environment could also impact retailer revenues as consumption patterns shift towards essentials. This typically occurs 6-8 months after inflation starts its rapid ascent and is particularly evident in the low-end market. Based on 3Q18, which, at 6.4%, recorded the highest quarterly inflation rate prior to 2022, expenditure on essentials (food and non-alcoholic beverage, clothing, housing, transportation and education) in real terms rose 10% YoY, while expenditure on discretionary items rose at a slower pace of 6% YoY (from 10.6% in 3Q18) in 3Q19.

Revenue vulnerability to inflation

This implies that WLCON and HOME have the most sensitivity to inflation-driven revenue growth drags, given that 100% of their revenues are discretionary-based. However, this is not the case for WLCON, which still saw topline/earnings growth of 16%/16% in FY19A and is resilient amid an inflationary environment, underpinned by its strong brand equity and established presence.

Top Pick - WLCON

Our top pick for the retailers is WLCON, as it commands market leadership in a highly fragmented home improvement space. Its strong brand equity strengthens its pricing power, which supports its margin strength. WLCON's outperformance is a function of its: i) inelastic middle-to-upper class target market; ii) strong presence in the hard and soft categories; and iii) availability of SKUs/inventory. Our BUY call and DCF-based TP of PHP33 reflect our confidence that WLCON's nationwide presence and positioning in the market will continue to be its competitive advantage.

Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)		P/B (x)		Div yld (%)	
							22E	23E	22E	23E	22E	23E
Wilcon Depot	WLCON PM	2,189	Buy	30.20	33.00	9	32.8	29.4	6.1	5.3	0.7	1.0
Puregold	PGOLD PM	1,674	Buy	33.00	48.00	45	10.4	9.7	1.1	1.0	1.4	1.4
Robinsons Retail	RRHI PM	1,602	Buy	57.90	68.00	17	19.5	16.3	1.2	1.2	3.9	4.3
Allhome Corp	HOME PM	109	Buy	1.64	6.20	278	5.3	4.2	0.4	0.4	4.7	2.8

16. Maintain NEUTRAL call on PH retailers

Retailers performed largely in line with expectations in FY22E, as topline was driven by an improvement in both basket size and foot traffic, which should remain steady given the complete lifting of restrictions in the Philippines. Mall foot traffic has normalized to pre-COVID levels, boding well for mall-based staples and discretionary stores, and even stand-alone stores showed similar improvement, but on a less dramatic scale. Nevertheless, much of this upside has been priced in.

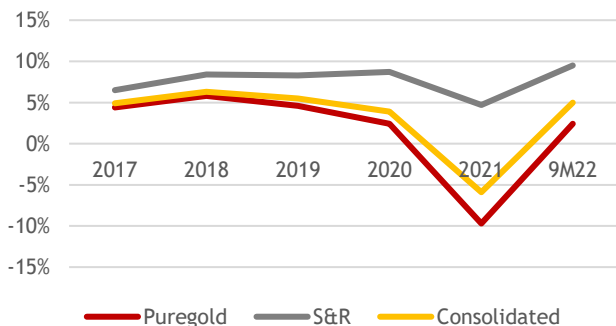
Our 8-20% earnings growth forecasts for FY23E already take into consideration this normalization as we expect SSSGs to normalize and inventory strategies to have diminishing effect on margins. As such, we remain NEUTRAL on the sector.

16.1 Normalizing SSSG

For FY23E, foot traffic has returned to pre-pandemic levels, and basket size has notably increased due to multiple ASP hikes in FY22E. However, consumer inflation-triggered downtrading to value brands and smaller pack sizes could drag basket sizes, causing SSSG to fall in FY23E.

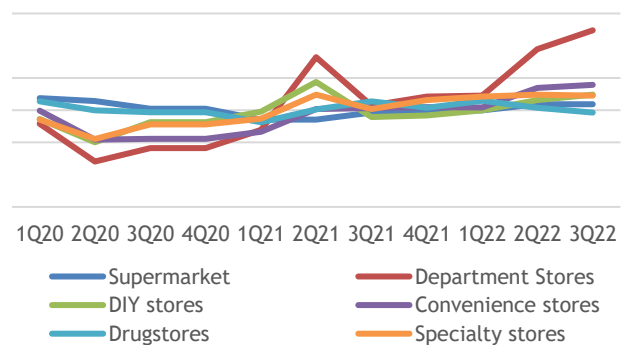
Our 2-6% SSSG forecast for FY23E factors in: (i) the lack of base effects; (ii) effect of downtrading; and (iii) the effect of lower purchasing power, which would likely shift purchase behaviour to more frequent shopping trips for smaller basket size.

Fig 24: PGOLD's SSSG (9M22)



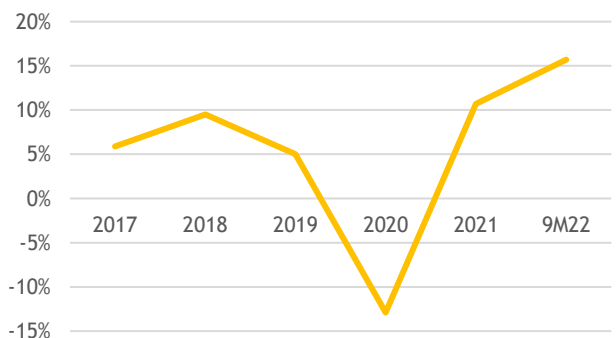
Source: Company disclosures

Fig 25: RRHI's SSSG (9M22)



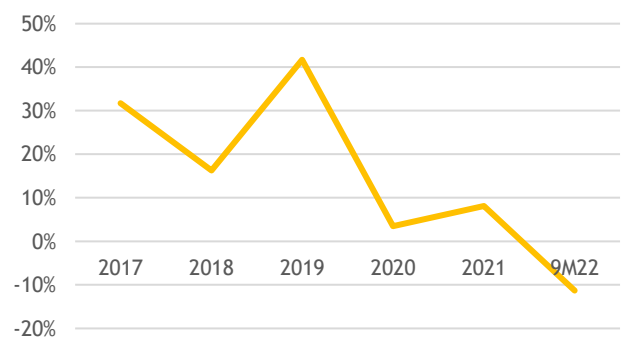
Source: Company disclosures

Fig 26: WLCON's SSSG (9M22)



Source: Company disclosures

Fig 27: HOME's SSSG (9M22)



Source: Company disclosures

16.2 Inventory frontloading and supply chain management

Retailers have re-strategized their approach to inventory keeping amid the rising inventory, freight and logistics costs and supply chain disruptions. In 4Q22, retailers have raised inventory days to 69-309, from 53-248 pre-pandemic, in anticipation of the holiday season.

Except for HOME, which was unable to push out its older inventories despite having a flush-out sale in 2Q22, we expect retailers to mirror their FY22E inventory frontloading strategy. In our view, WLCN and RRHI are the biggest beneficiaries of inventory frontloading as it enables them to obtain lower-priced inventory, but sell the items at the prevailing SRP, owing to its one-month price protection orders in anticipation of FMCG manufacturers’ price hike cycle. This strategy, when executed properly, results in margin expansion, as evident in WLCN and RRHI’s GPM in 9M22.

Fig 28: Inventory days of retailers

In days	Inventory days				Cash conversion days			
	FY19A	FY20A	FY21A	9M22	FY19A	FY20A	FY21A	9M22
PGOLD	55	53	58	69	39	35	36	52
RRHI	58	69	78	76	-9	1	17	25
WLCN	189	224	214	230	87	94	84	150
HOME	171	248	262	309	157	200	225	274

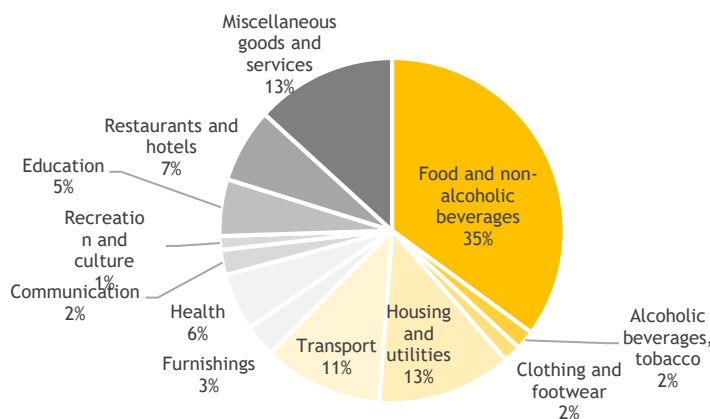
Source: Company, Maybank IBG Research

16.3 Softer demand due to inflation

Based on the breakdown of 3Q22 household final consumption expenditure, food and non-alcoholic beverage remains the largest contributor at 34.9%, and in an inflationary environment, a potential squeeze in household expenditure caused by lower household income could sharply alter the spending habits of a typical Filipino household.

Nonetheless, we are cognizant that inflation tends to have a lag effect on consumption patterns. Based on anecdotal evidence, inflation, on average, manifests into softer demand about 6-8 months after it hits, particularly for the low-end market. Based on data from 3Q18, which recorded the highest quarterly inflation rate prior to 2022, at 6.4%, expenditure on essentials (food and non-alcoholic beverage, clothing, housing, transportation and education) in real terms rose 10% YoY, while expenditure on discretionary rose at a slower pace of 6% YoY (from 10.6% in 3Q18) in 3Q19.

Fig 29: Household final consumption expenditure (3Q22)



Source: PSA

As such, FMCG manufacturers have already acknowledged and guided for topline mean reversion in FY23E, as ASP hikes would not be as pronounced as in FY22E. Nonetheless, given the cost pass-through pricing strategy of retailers, the impact on retailers should be varied, depending on the target market they cater to.

A typical illustration would be the impact of 2018’s inflation on Puregold and S&R SSSG. By 4Q19, Puregold’s SSSG remained positive at 2%, but had decelerated from 4Q18’s 5.7%. S&R, on the other hand, remained stable and its SSSG even accelerated to 8% in 4Q19, coming from 7.3% in 4Q18. The notable difference in the movement shows that topline sales move in tandem with the captured market, given an inflationary environment.

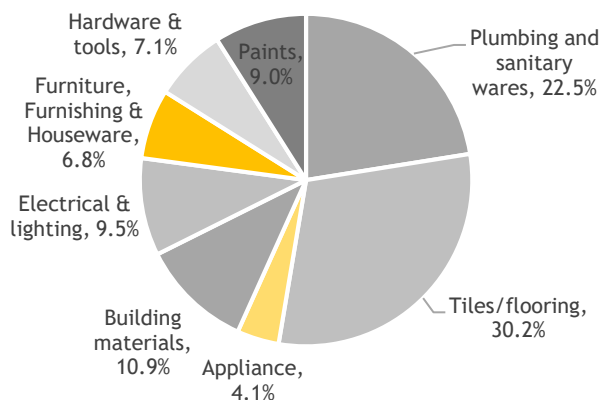
17. WLCON is our Top Pick

Our top pick for the retailers is WLCON, as it commands market leadership in a highly fragmented home improvement space. Its strong brand equity strengthens its pricing power, which is highly margin-accretive. Our thesis of sustained 2-year earnings momentum CAGR of 28%, underpinned by: (i) stable store rollouts; (ii) rising contribution from higher-margin, in-house/exclusive brands; and (iii) improving operating leverage; still holds and is sustainable.

WLCON's outperformance should be a function of its: i) inelastic middle-to-upper class target market; ii) strong presence in the hard and soft categories; iii) availability of SKUs/inventory; and iv) ability to monetize its margin-accretive in-house and exclusive brands.

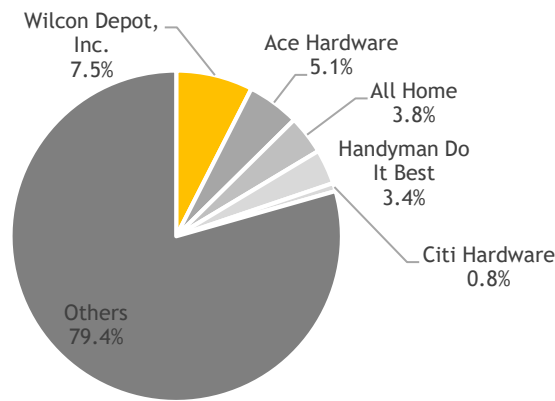
Our BUY call and DCF-based TP of PHP33 reflect our confidence that WLCON's nationwide presence and positioning in the market will continue to be its competitive advantage, grabbing market share from traditional mom-and-pop retailers.

Fig 30: WLCON’s category mix (9M22)



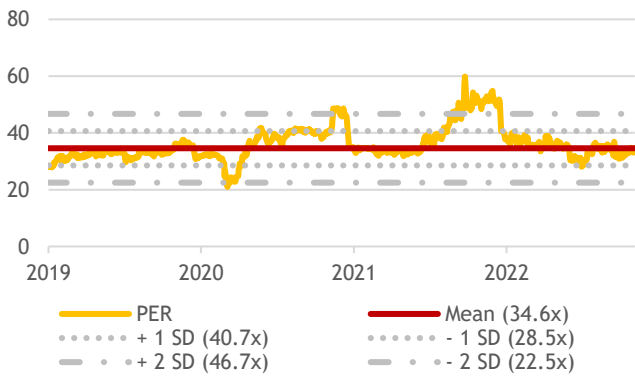
Source: Company

Fig 31: Brand shares of home improvement and gardening stores, in sales value (2021)



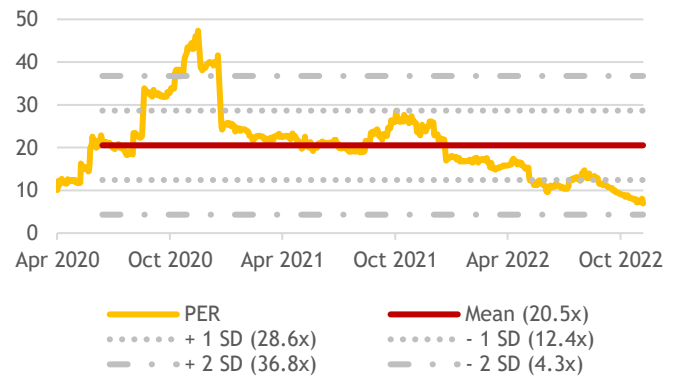
Source: Euromonitor

Fig 32: WLCON's 5Y PER



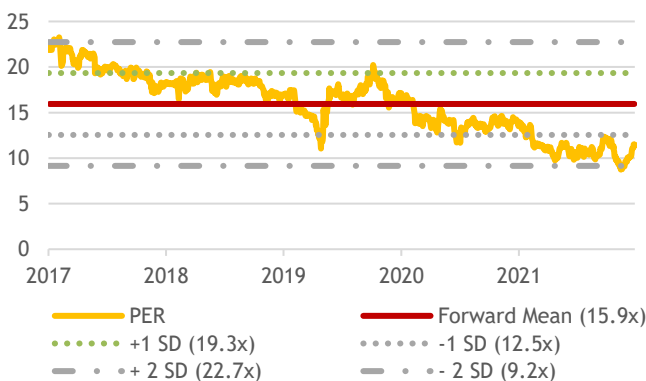
Source: Company

Fig 33: HOME's 5Y PER



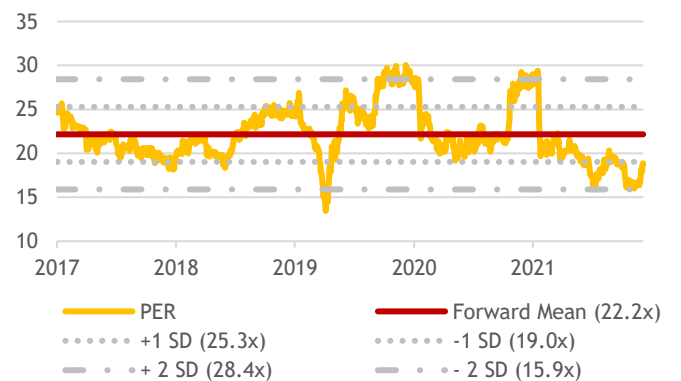
Source: Company

Fig 34: PGOLD's 5Y PER



Source: Company

Fig 35: RRHI's 5Y PER



Source: Company

Philippines Consumer - FMCGs

NEUTRAL

 [Unchanged]

Year Ahead 2023: Be selective

Top Pick URC: a value-creator with economic moat

We maintain a NEUTRAL view on the FMCG sector. We forecast FY23E margins to rise as we expect commodity prices to decline and the PHP to appreciate; but inflation is likely to continue to reduce purchasing power and challenge this price-sensitive sector. Even as the sector has been deeply de-rated in 2022, we remain selective and expect the stock prices of companies that have a track record of managing input costs and FX volatilities to outperform those with no economic moat. We also favour companies with pricing power. URC, which has a strong economic moat and is a clear value-creator, is our Top Pick in the FMCG space.

Analyst

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FMCG - fast-moving consumer goods
FX - foreign exchange
GPM - gross profit margin
ASP - average selling price

Higher FY23E margins as input prices set to ease

We expect commodity prices to decline from early 1Q23E, but we still expect input prices to remain high in domestic currency terms relative to 2021 averages, before meaningfully falling in 2H23E. That said, we forecast margins of the FMCGs under our coverage to be 24-34% for FY23E, 10-80bps higher than 24.5-33.2% for 9M22, even after we factor in normalized, mid-single digit ASP increases in FY23E to account for inflation (MIBG: 4.3% for FY23E).

Expecting PHP appreciation in 2023

The USD:PHP closed at PHP55.90:USD1 on 13 Dec 2022, implying a c.10% depreciation of the PHP YTD. Maybank IBG forecasts the PHP to close at PHP56.50 against the USD at YE22E before it appreciates to PHP54.00 by YE23E. This should bode well for FMCG manufacturers that import 50-60% of their raw materials. The expected PHP appreciation should partially account for FMCGs' margin expansion in FY23E. Our sensitivity analysis indicates that for every PHP1 appreciation in the PHP, the gross profit margin of the FMCGs under our coverage increase by 10-80bps.

URC to benefit from higher mobility, school spending

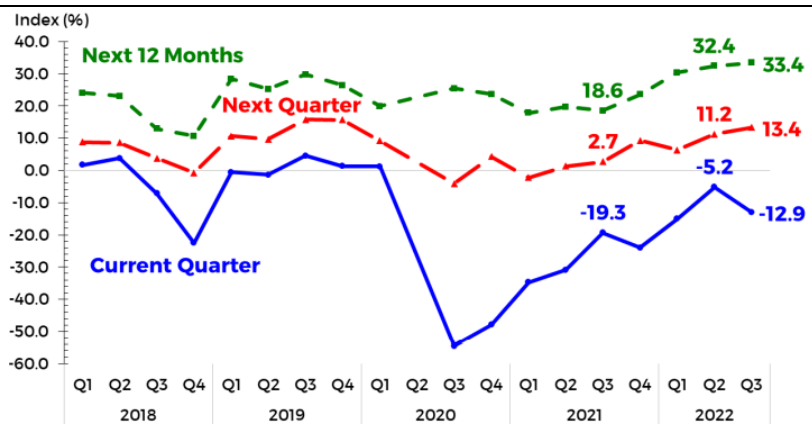
URC is the main beneficiary of the country's improving mobility and return-to-school spending. Moreover, the incremental household income attributable to a step-down in personal income tax rates in 2023E should provide an additional boost to consumer spending. Our rolled-over DCF-TP of PHP152 for URC implies 27.9x FY23E PER, in line with Philippine consumer peers. But we think this is justified by URC's established presence and leadership in both domestic and international markets.

Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)		P/B (x)		Div yld (%)	
							22E	23E	22E	23E	22E	23E
Universal Robina	URC PM	5,316	Buy	134.00	152.00	13	26.2	24.6	2.7	2.6	3.3	2.9
San Miguel F&B	FB PM	3,924	Hold	36.90	71.00	92	11.0	na	1.8	na	4.0	na
Monde Nissin	MONDE PM	3,654	Buy	11.30	15.00	33	27.1	23.5	2.7	2.6	0.9	2.2
Century Pacific	CNPF PM	1,549	Buy	24.30	28.00	15	16.8	14.8	3.0	2.6	1.8	2.0

18. Consumer sentiment worsening

In the latest Consumer Expectation Survey (Fig 1), consumer sentiment was more pessimistic in 3Q22 as the confidence index fell to -12.9% (from 2Q22's -5.2%), due to inflation worries, lower household income and limited job opportunities. This was mirrored by the household spending outlook for 4Q22, which also reported a less upbeat projection as confidence declined to 35.5% in 3Q22 from 38.3% in 2Q22, an indication of a slight slowdown in consumer spending ahead.

Fig 1: Consumer Expectation Survey (3Q22)

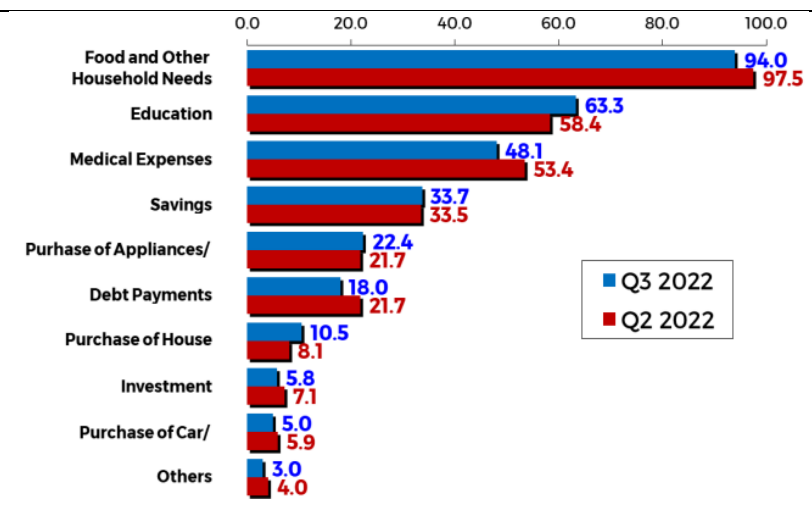


Source: BSP

Nonetheless, a silver lining is the Consumer Confidence Index for 4Q22 rose to 13.4%, with the improvement attributed to better jobs availability and additional income during the period.

Moreover, the latest breakdown of Overseas Filipino Worker (OFW) remittances still points to strong spending on staples, with the bulk of remittances being allotted to food and education (Fig 2).

Fig 2: Uses of OFW remittances (% to total OFW households)



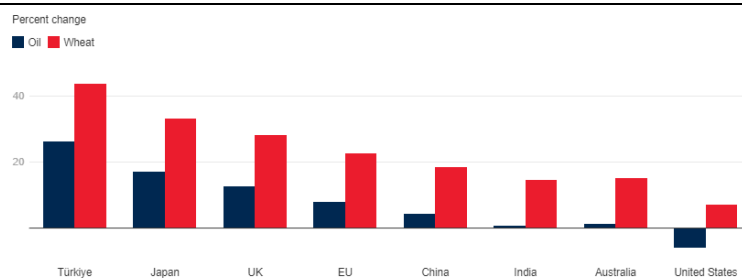
Source: BSP

19. Raw material prices still high in PHP terms

While most commodity prices have retreated from their peak levels in the aftermath of the post-pandemic demand surge and the start of the war in the Ukraine, the World Bank believes the decline is also attributable to slowing global growth and increasing concern about a looming global recession.

Moreover, we still see elevated commodity prices in domestic currency terms, despite softening prices, as most currencies have depreciated against the USD. An illustration is the Brent crude oil price in USD terms, which dropped 6% from Feb to Sep 2022, yet the figure below tells a different story, as c.60% of oil-importing developing economies saw a sharp increase in domestic oil prices during the period.

Fig 3: Oil and wheat price changes in local currencies



Source: Haver Analytics; World Bank;

Note: Percentage change in prices in local currency terms between February and September 2022.

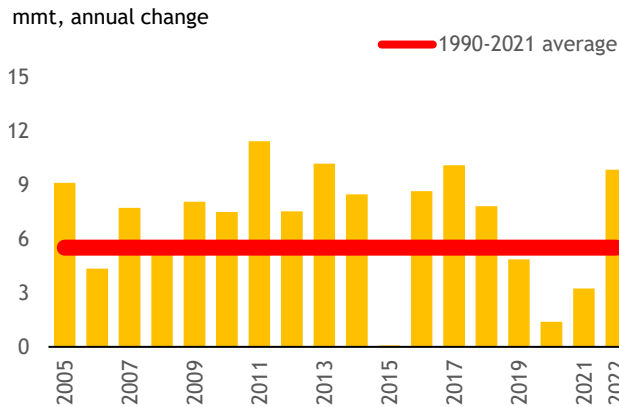
Major commodities that affect raw material inputs of local FMCGs:

Brent crude oil. The World Bank estimates Brent crude prices to average USD92/bbl in 2023E, similar to the current level with upside risk relating to supply issues and lower-than-expected US production or lower OPEC+ output.

Wheat. According to the Commodity Market Outlook (Oct 2022), wheat prices, which are projected to have increased 36% YoY in 2022E, are expected to decline modestly next year, on expectations of improved yield, continuation of Ukraine's return to the global markets and weakening global demand.

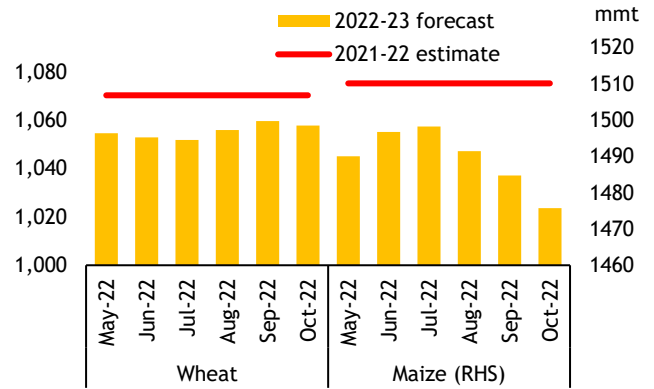
Edible oil. Global edible oil production is expected by the World Bank to rise by 4% YoY to 5.5mmt in 2023E; key increases are noted for palm and soybean oil +4.2%/8.2% YoY. Nonetheless, prices have remained stable due to improving supply sentiment, underpinned by: i) better crop prospects across most edible oil; ii) Indonesia's removal of its palm oil export ban; and iii) resumption of exports from Black Sea ports.

Fig 4: Edible oil supply growth



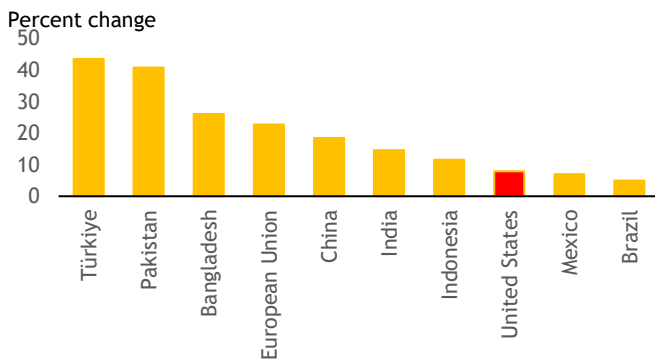
Source: U.S. Department of Agriculture; World Bank.
 Years represent crop season (for example, 2021 refers to 2021-22). Supply is the sum of beginning stocks and production. Data updated as of October 12, 2022.

Fig 5: Wheat and maize supplies



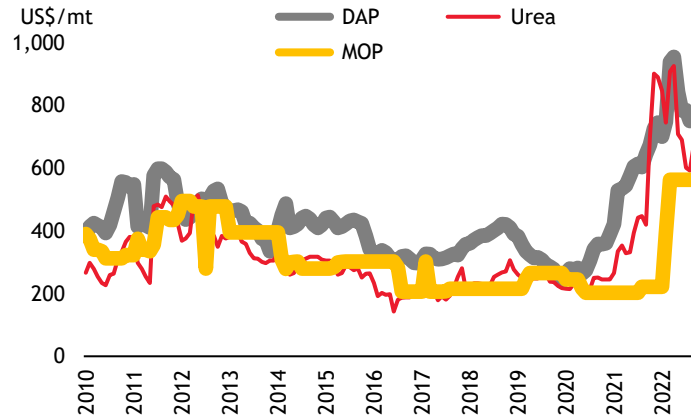
Source: U.S. Department of Agriculture; World Bank.

Fig 6: Wheat price in domestic currencies



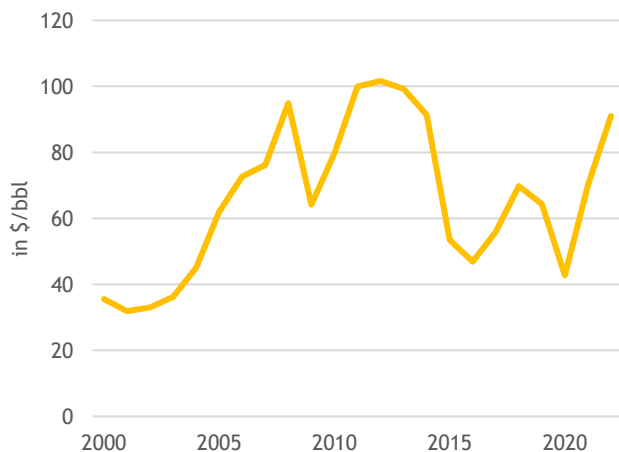
Source: Haver Analytics; World Bank.
 Note: Percent change from February to September 2022. Years represent crop season (for example, 2021 refers to 2021-22). Supply is the sum of beginning stocks and production. Data updated as of October 12, 2022.

Fig 7: Fertilizer prices, monthly



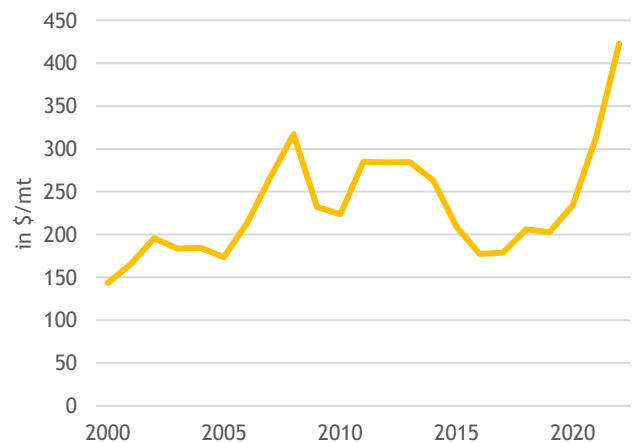
Source: Bloomberg; World Bank
 Note: DAP = diammonium phosphate. MOP = muriate of potash. mt = metric ton. Last observation is September 2022.

Fig 8: Brent crude oil prices



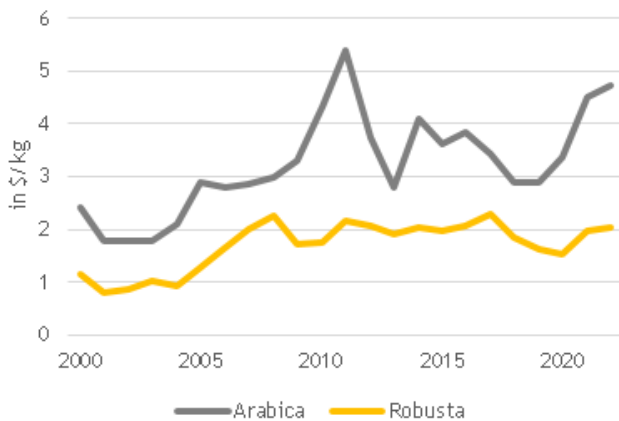
Source: World Bank

Fig 9: Wheat, US HRW



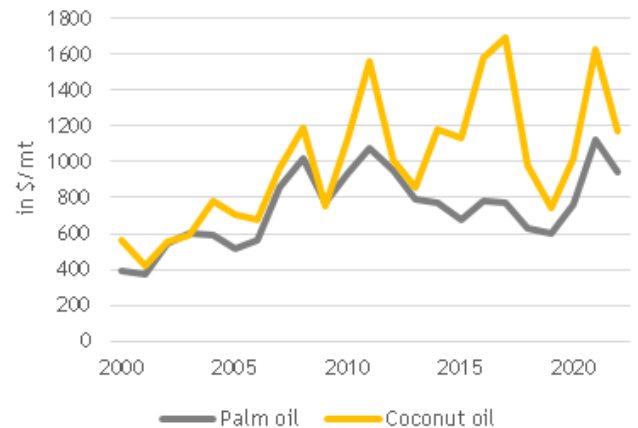
Source: World Bank

Fig 10: Coffee prices



Source: World Bank.

Fig 11: Wheat prices



Source: World Bank

In our consumer coverage, these commodities account for a chunk of URC, CNPF and MONDE's raw material cost. Raw materials account for 70-96% of COGS. While each FMCG player manages raw material price hikes differently, through inflation-driven price increases, locking in long-term contracts, favourable product mix or through hedging positions, we are cognizant spikes in key raw material prices could easily dampen their margin momentum.

We forecast the FMCGs under our coverage to post gross margins of between 24% and 34% for FY23E. MONDE, as expected, still has the highest gross margins among URC and CNPF, owing to its high margin-yielding meat alternative business. However, we expect URC to post faster GPM expansion of 80bps to 28.2% in FY23E, underpinned by GPM expansion in both its BCF-PH and BCF-Intl business, albeit softening of input prices for 2H23E.

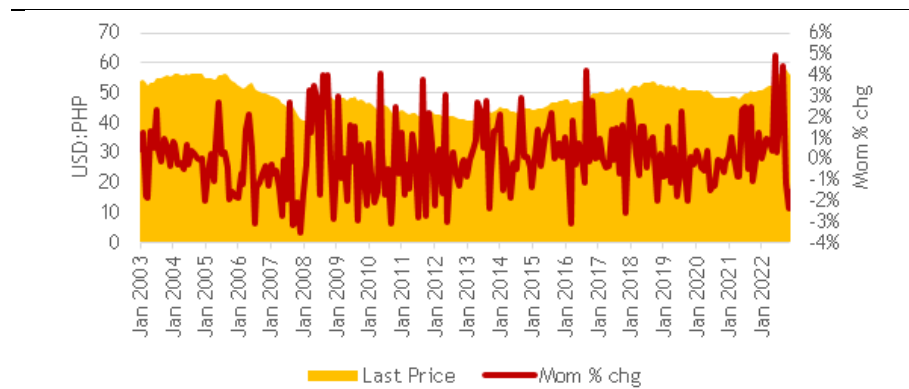
We likewise expect domestic food inflation to peak late in FY22E to early 1Q23. However, global commodity prices seem to be moving favourably in USD terms; a key downside risk would be forex movement that could dampen the recovery momentum of global commodity prices.

Nonetheless, we are not expecting any sharp ASP hikes for FY23E, even as FMCGs only factored in 70-80% of raw material price hikes this year; as they try to balance market share protection against margin expansion. We further expect price hikes to revert back to pre-pandemic mid-single digits, in line with domestic inflation, coming from FY22E's low double-digit ASP hikes. As such, our expectations of GPM expansion will largely be driven by declining raw material prices for FY23E.

20. Forecast PHP to rise to PHP54 by YE23

The USD:PHP closed at PHP55.90:USD1 on 13 Dec 2022, a c.10% depreciation vis-a-vis its 2021 closing level. Our regional economics team's PHP:USD forecast estimates the PHP to close at PHP56.50 YE22 and appreciate to PHP54.00 in YE23, assuming: i) the central bank raises interest rates by a cumulative +350bps in FY22E to end at 5.5% and hold at that level for 2023E; and ii) the Philippines maintains its twin-deficit position.

Fig 12: USD:PHP movement



Source: Bloomberg

Fig 13: USD:PHP quarterly forecast

Forecast	4Q 2022	1Q 2023	2Q 2023	3Q 2023	4Q2023
USD/PHP	56.50	56.00	55.50	55.00	54.00

Source: MIBG Research

Food manufacturers show the highest vulnerability to a weak PHP, largely because at least 50% of their raw material costs are imported, with limited ability to pass on higher costs to consumers as they need to protect their market share. While these FMCGs offer a natural hedge against forex vulnerabilities, this is insufficient to fully cover risks, as international operations are more often just 20-25% of revenues, while imported raw materials account for 50-60% of total raw material costs.

An appreciating PHP should contribute to food manufacturers’ margin expansion story in FY23E, with a more pronounced impact in 2H23.

21. Potential upside from lower PIT

The Department of Finance previously shared that taxpayers saved an estimated PHP111.7b in 2018, owing to the reduction in personal income taxes due to the implementation of the Tax Reform for Acceleration and Inclusion (TRAIN) Law (signed into Law last December 2017). TRAIN is the first package of the Comprehensive Tax Reform Programme. Consumer spending was then funneled into retail establishments (e.g. grocery, convenience stores), restaurants, and to some extent, real estate developers.

The second tranche of the step-down in personal income tax rates (PIT) will be implemented starting January 2023, and we view this as a catalyst that should support shrinking household income. The implementation of a further step-down in PIT should be positive for both the consumer and retail sectors as overall household income should increase, albeit in an inflationary environment. Both the staples and discretionary sectors are beneficiaries, but we see most upside for FMCG manufacturers URC, CNPF and MONDE, along with supermarket retailers, PGOLD and RRHI.

Fig 14: Income tax under the TRAIN Law

Annual Income Bracket		Tax Rate (2018-2022)		Tax Rate (2023 Onwards)	
Lower Limit	Upper Limit	Tax on Lower Limit	Tax on Excess over Lower Limit	Tax on Lower Limit	Tax on Excess over Lower Limit
0	250,000	-	0%	-	0%
250,000	400,000	-	20%	-	15%
400,000	800,000	30,000	25%	22,500	20%
800,000	2,000,000	130,000	30%	102,500	25%
2,000,000	8,000,000	490,000	32%	402,500	30%
8,000,000	Above	2,410,000	35%	2,202,500	35%

Source: TRAIN Law, RA No. 10963

22. URC is our Top Pick

We believe improving mobility and return-to-school spending should drive basket sizes and bode well for URC in FY23E. In our view, demand for URC's products will be resilient as food continues to account for c.40% of a typical Filipino household's budget. Moreover, the incremental household income due to the step-down in personal income tax rates in 2023E should provide an additional boost to consumer spending.

Fig 15: URC's product market share

BCF- PH	FY18	FY19	FY20	FY21	1Q22	2Q22	3Q22
Snacks	34.5%	35.8%	38.4%	37.2%	36.6%	36.3%	36.3%
Candies	26.7%	26.2%	27.4%	27.6%	27.0%	26.5%	26.1%
Chocolates	22.8%	20.9%	22.2%	24.4%	23.6%	23.2%	23.1%
Biscuits	16.6%	16.0%	16.2%	16.1%	15.8%	15.8%	15.8%
Cup noodles	49.9%	48.1%	48.9%	51.9%	51.9%	53.4%	54.2%
RTD tea	84.6%	84.6%	86.7%	89.0%	89.5%	88.8%	88.4%
Coffee	23.3%	22.2%	22.4%	21.7%	22.0%	21.7%	21.3%
Instant coffee	25.1%	22.5%	21.0%	21.9%	22.2%	22.1%	21.9%
Coffee mixes	23.0%	22.2%	22.7%	21.7%	22.0%	21.6%	21.2%
BCF-Intl							
Thailand							
Biscuits	24.9%	25.7%	18.2%	18.0%	17.7%	17.7%	17.7%
Wafers	25.2%	23.6%	22.4%	20.8%	20.7%	20.7%	20.5%
Vietnam							
RTD tea	14.7%	14.6%	16.7%	18.5%	18.9%	19.6%	20.0%
Malaysia							
Biscuits					23.9%	24.0%	24.1%

Source: Company disclosure

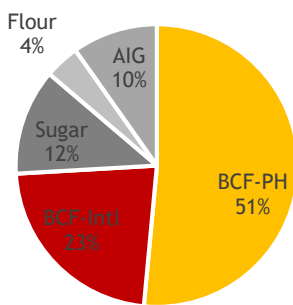
Fig 16: Target price computation

	FY22E (Old)	FY22E (New)	% change
Enterprise value (PHP m)	306,491	325,985	6%
Net (debt)/cash (PHP m)	9,978	7,560	-24%
Non-operating assets (PHP m)	514	514	0%
Value of equity (PHP m)	316,983	334,058	5%
# of outstanding shares (m)	2,204	2,204	0%
Rounded target price (PHP/sh)	144	152	5%

Source: Maybank IBG Research

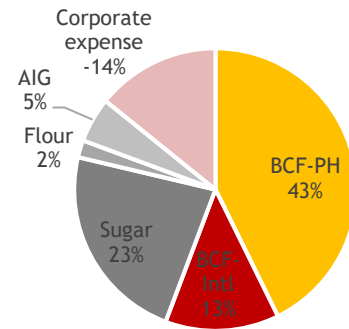
We roll over our DCF-TP to PHP152 (+5%), implying 27.9x FY23E PER, in line with Philippine consumer peers, but we think this is justified by URC’s established presence and key leadership position in both its domestic and international markets. Trading at 25.1x FY22E PER, the stock is still 1SD below its 5-year mean of 27.4x. We remain optimistic that URC’s earnings growth trajectory is sustainable, underpinned by its market leadership in key categories, prudent inventory hedging, and strong management team and execution abilities.

Fig 17: URC’s revenue breakdown (9M22)



Source: Company

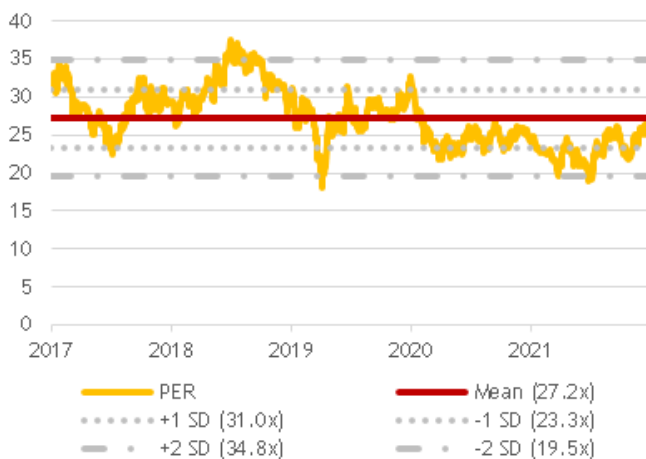
Fig 18: URC EBIT breakdown (9M22)



Source: Company

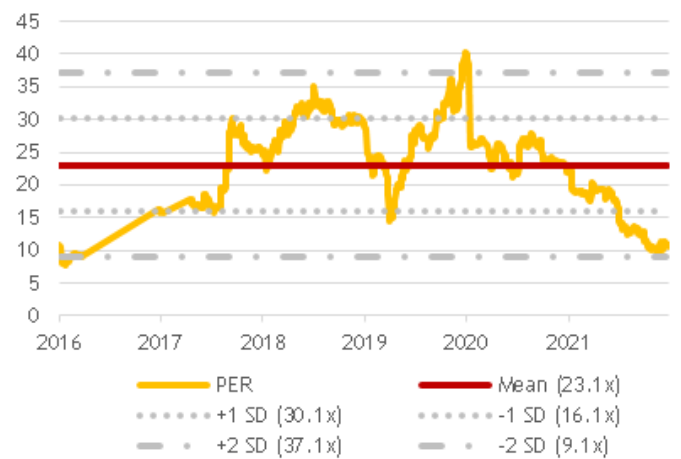
Key downside risks are elevated input costs (a function of both commodity prices and FX movement) and intensifying competition among FMCG players across different categories. However, we are confident URC’s market leadership, raw material sourcing, advertising and promotion activities and cost savings should directly address and mitigate these risks.

Fig 19: URC’s 5-year PER



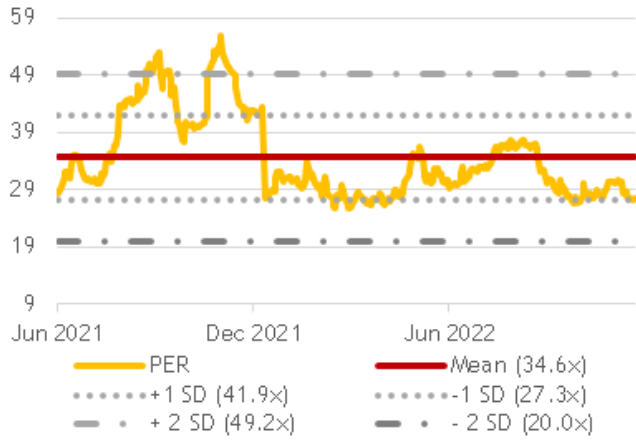
Source: Bloomberg

Fig 20: FB’s 5-year PER



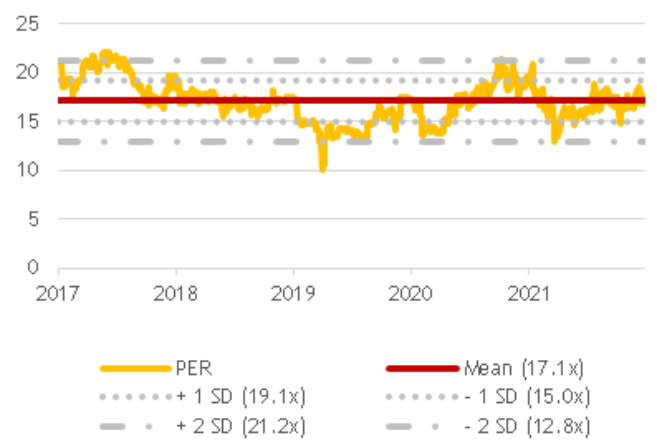
Source: Bloomberg

Fig 21: MONDE's 5-year PER



Source: Bloomberg

Fig 22: CNPF's 5-year PER



Source: Bloomberg

Philippines Telecoms

NEUTRAL

 [Unchanged]

Year Ahead 2023: Heightened competition

Pressure on prices and margins; TEL our Top Pick

Even at only c.25% penetration, growth in fixed-line customers significantly decelerated in Jan-Sep 2022 (see *Hitting the brakes* report). This has led to intensified competition among the telcos, which are fighting for market share through 'shifting promos' and offering higher speeds at unchanged price points. In its base plan of PHP1,500/mo., CNVRG now offers up to 200Mbps, outdoing GLO/TEL's 150/100Mbps offerings. All three telcos have introduced lower-priced plans at PHP1,250-1,299/mo. (at 25-50Mbps). CNVRG also entered the prepaid market, with an initial offer of PHP700/mo. while GLO is launching a prepaid fibre service, on top of its new prepaid wifi plan. While these initiatives are good for consumers and deepen the country's digital penetration, telcos may see declining ARPUs and margins; hence, we keep our NEUTRAL call on the sector.

Analyst

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Acronyms:

Mbps - Megabits per second
ARPU - Average revenue per user

Other stocks mentioned:

DITO Telecommunity Corp. (DITO PM, CP: PHP2.99, Not rated)

Wireless still growing; albeit at slower pace

Telcos are already feeling the pinch from inflation, with TEL and GLO both reporting declines in mobile top-ups and reloading frequency. For FY23E, we expect muted +2.9%/3.0% YoY recovery in mobile data demand for TEL/GLO. The presence of DITO should present little competition given its issues with signal reliability and negative equity. Further, the new law requiring prepaid SIM registration, with the deadline for compliance expected to be in Apr 2023 (180 days after the SIM card registration act was passed), could lead to a drop in mobile subscribers. But this should not be a cause for concern because these SIMs are not significant revenue drivers, and can even add significantly to telco costs as they need to implement security measures to block scam messages.

Focusing on new business

The slowdown in core telco segments (i.e. mobile data and fixed broadband) has compelled telcos to focus on new businesses, such as data centers, fintech, media, and even online healthcare. While new ventures take time to scale and achieve profitability, data centers are already driving enterprise revenues and GLO's fintech unit GCash achieved profitability in 3Q21. TEL's Maya is only expected to turn profitable in 2024. We believe telco capex peaked in 2021 on aggressive fibre expansion, and should start to decline from 2023. This should help the telcos keep gearing ratios low and sustain their high dividend payout ratios.

TEL our Top Pick; GLO new TP at PHP2,695

TEL remains our Top Pick in the sector for its fixed-line and enterprise leadership, and continued efforts to provide fast reliable internet connection. We are also positive on GLO given its leadership in mobile. With the competitive threat from DITO now subdued, GLO can continue growing steadily in mobile. We also like that its fintech venture GCash is now profitable, and new business ventures appear promising. Our new rolled-forward TP for GLO is PHP2,695 (+1.7%) taking into account +3.2/3.0% core income adjustments and a lower 2023 capex forecast.

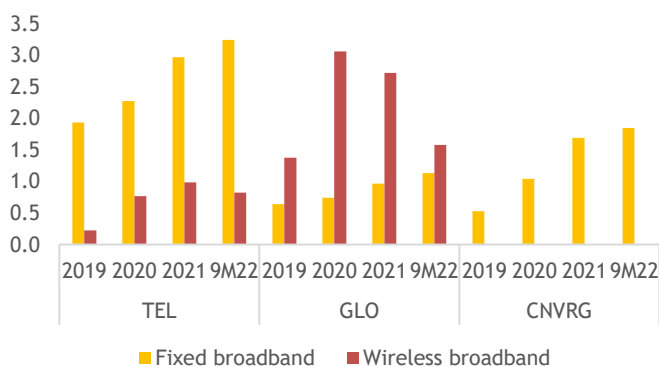
Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)		P/B (x)		Div yld (%)	
							22E	23E	22E	23E	22E	23E
PLDT Inc.	TEL PM	6,476	Buy	1,668.00	2,075.00	30	9.4	12.3	2.8	2.6	8.6	6.6
Globe Telecom	GLO PM	5,551	Buy	2,150.00	2,695.00	30	9.2	10.3	4.1	3.7	5.0	5.0
Converge ICT	CNVRG PM	1,985	Hold	15.20	12.90	(15)	13.3	9.8	2.6	2.0	0.0	0.0

23. Stiff fixed-line competition; prepaid broadband still in soft launch

Even at only c.25% penetration, the rise in fixed-line customers has sharply slowed since the beginning of the year with the trend persisting in 9M22. This spurred telcos to be more competitive, with growth strategies now including winning market share from rivals through ‘shifting promos’ and high speed offerings for the same price points.

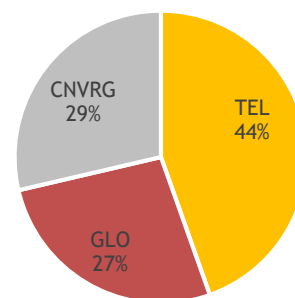
In 9M22, net adds for the three telcos reached only 594k, down 50.6% YoY. TEL still has largest share of net adds at 44%, allowing it to retain the highest percentage of subscriber share at 52.1%.

Fig 1: Fixed and wireless broadband subscribers (in millions)



Source: Company

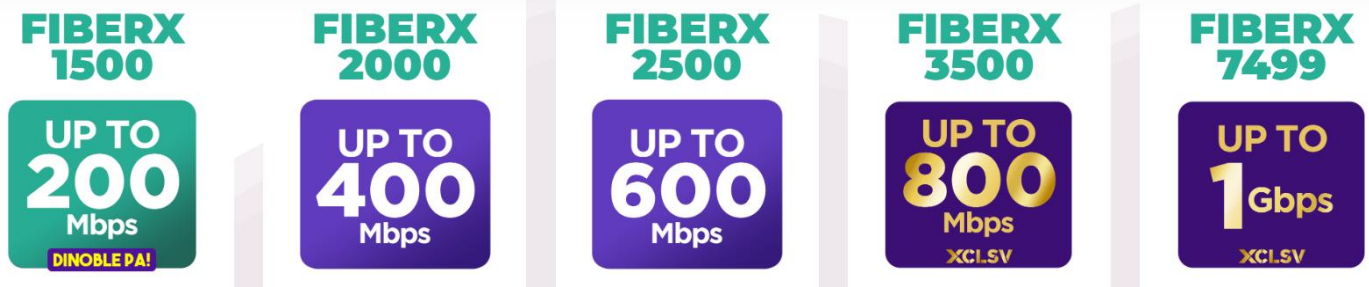
Fig 2: Share of net adds for fixed broadband for 9M22



Source: Company, Maybank IBG Research

CNVRG’s base plan of PHP1,500/mo. now offers up to 200Mbps of speed, topping that of GLO/TEL at 150/100Mbps.

Fig 3: CNVRG’s new data plans



Source: Company website

The three telcos introduced lower-priced broadband plans at PHP1,250-1,299/mo., with speeds of between 25-50Mbps. CNVRG’s initial prepaid offer costs PHP700/mo., with an installation cost of PHP1,000. GLO, meanwhile, is launching a prepaid fibre service (similar to CNVRG) on top of its newly launched prepaid Wifi. While these initiatives are good for consumers and deepen the country’s digital penetration, telcos may see a drop in ARPU and margins due to cannibalisation (i.e. higher-plan clients could downgrade to lower plans).

Fig 4: Comparison of fibre broadband plans

Plan (PHP/mo.)	GLO	TEL	CNVRG
1,250			50Mbps
1,299	50Mbps	25Mbps	
1,500			200Mbps
1,699	150Mbps	100Mbps	
1,749		150Mbps	
2,000			400Mbps
2,099	300Mbps	200Mbps	
2,499	500Mbps		600Mbps
2,699		400Mbps	
3,499	800Mbps		800Mbps

Source: Company websites

Fig 5: TEL switching promotion



Source: Company

24. Softer mobile data growth due to inflation impact

Telcos are already feeling the pinch from inflation, with TEL and GLO both seeing declines in mobile top-ups and reloading frequency. For 2023E, we expect 2.9%/3.0% recovery in mobile data demand for TEL/GLO, mainly driven by increased mobility.

We don't expect too much competition from DITO, due to concerns on signal reliability, and going concern issue as evidenced by its negative equity of PHP28.7b as at end-9M22.

Republic Act No. 11934, or the SIM Card Registration Act, was signed into law on 10 Oct 2022, with the Implementing rules and regulations (IRR) released on 12 Dec. The deadline for prepaid sim registration is expected to be in Apr 2023; a move seen to purge text/call scams, potentially leading to a drop in mobile subscribers. We, however, are not concerned since these sims are not significant revenue drivers, and can even be expensive to operate as telcos need to implement security measures to block scam messages.

Based on the IRR, the following information are needed for registration.

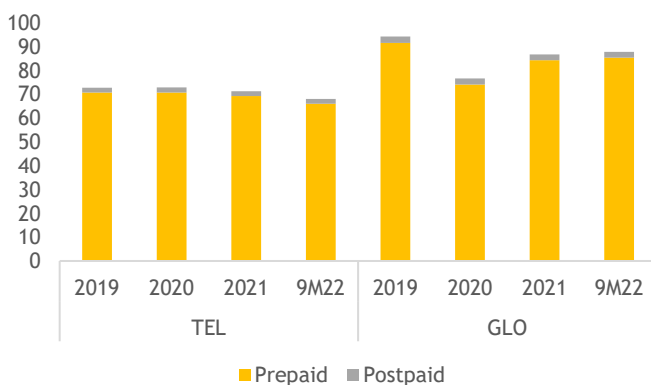
For individuals:

- Full Name
- Date of birth
- Sex
- Present/official address
- Type of ID presented
- ID number presented

For juridical entity:

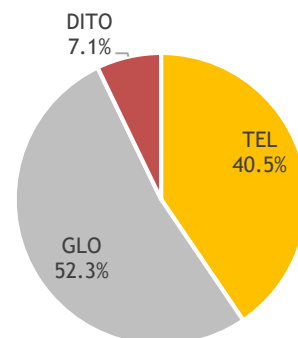
- Business name
- Business address
- Full name of authorized signatory

Fig 6: Mobile subscribers (in millions)



Source: Company

Fig 7: Share of subscribers



Source: Company, Maybank IBG Research

25. Forecast changes for GLO

We tweak our net income forecasts as we adjust for the timing of the recognition of tower sales. Our core income forecast is adjusted by +3.2%/3.0% on account of the following:

Fig 8: Summary of forecast changes

	FY22 (old)	FY22 (new)	% Change	FY23 (old)	FY23 (new)	% Change	Remarks
Service revenues	161,568	161,860	0.2%	164,811	163,977	-0.5%	Slight reduction in service revenue forecast for FY23E due to slower broadband net adds.
Nonservice revenues	16,335	16,335	0.0%	16,509	16,509	0.0%	
TOTAL REVENUES	177,904	178,195	0.2%	181,320	180,486	-0.5%	
INCOME							
Interest income	211	189	-10.6%	161	189	17.7%	We adjusted the timing of gain on sale recognition given the longer-than-expected period of closing the sale.
Gain on disposal of property and equipment - net	16,212	7,774	-52.0%	1,556	11,451	635.9%	
Equity in net income of joint ventures	1,795	1,218	-32.1%	2,388	2,357	-1.3%	We cut our equity income forecast on account of lower income booked by Mynt in 3Q22, as well as the expectation of higher costs in 4Q given new product offerings.
Other income - net	11,390	11,569	1.6%	1,088	1,083	-0.5%	
	29,607	20,750	-29.9%	5,192	15,081	190.4%	
COSTS AND EXPENSES							
General, selling and administrative expenses	74,368	74,489	0.2%	76,492	76,150	-0.4%	We cut our depreciation forecast given GLO's lower capex guidance of USD1.3b for 2023.
Depreciation and amortization	49,744	48,335	-2.8%	54,673	47,541	-13.0%	
Cost of sales	17,790	17,820	0.2%	18,132	18,049	-0.5%	
Interconnect costs	1,112	1,114	0.2%	1,134	1,128	-0.5%	
Financing costs	8,652	8,652	0.0%	8,906	8,906	0.0%	-
Impairment losses and others	3,558	3,564	0.2%	3,626	3,610	-0.5%	
	153,795	153,973	0.1%	157,314	155,384	-1.2%	
INCOME BEFORE TAX	53,716	44,972	-16.3%	29,198	40,183	37.6%	
PROVISIONS FOR TAX							
Current	12,835	10,315	-19.6%	6,976	9,217	32.1%	
Deferred	594	478	-19.6%	323	427	32.1%	
	13,429	10,793	-19.6%	7,300	9,644	32.1%	
NET INCOME	40,287	34,179	-15.2%	21,899	30,539	39.5%	
Net income to:							
Parent	40,190	34,097	-15.2%	21,846	30,465	39.5%	
NCI	97	82	-15.2%	53	73	39.5%	
EBITDA	81,076	81,209	0.2%	81,935	81,549	-0.5%	
Core income	19,572	20,193	3.2%	21,846	22,491	3.0%	

Source: Maybank IBG Research

GLO's 9M22 earnings snippets:

- **GLO posted 3Q22 net income of PHP6.8b**, up 38.5% YoY (+18.3% QoQ) as a result of recognition of partial gain from the tower sale amounting to PHP1.4b net. 9M22 net income is at PHP26.5b, up 47.8% YoY. Core income at PHP16.0b is ahead our FY22 estimate at 81.8% as a result of a lower effective tax rate of 21% vs our 25% forecast.
- **EBITDA** is up 6% YoY to PHP60.3b, inline at 74.4% of our FY estimate. EBITDA margin stood at 51.1%.
- **Service revenues** rose 3.9% YoY, driven by mobile data which saw 8% YoY growth. Mobile data now accounts for 78% of mobile revenues versus 74% last year. Voice and SMS are down by 14% and 7% YoY, respectively.
- **Home broadband** dipped 8.5% YoY, driven by a drop in fixed wireless clients, bringing total broadband subscribers down 27% YoY. Net adds for fixed broadband amounted to 70.9k. Decline in wireless broadband was higher at 44.0% YoY vs the 24.6% YoY increase in fixed line.
- **Corporate data revenues** grew by 21% YoY, driven by an uptick in (Information and Communication Technology) ICT, particularly from business application services, cloud and data center.
- **Capex** totaled PHP74.4b in 9M22 (84% of PHP89b target), 84% of which was allocation for data requirements.
- **Gross debt-to-equity** is at 1.94x (max 3.1x) while gross-debt-to-EBITDA stood at 2.62x (max 3.5x); net debt-to-equity is at 1.86x while net debt-to-EBITDA is at 2.5x. Debt service cover ratio (DSCR) was at 3.79x (min 1.3x).

26. TEL our Top Pick; GLO new TP at PHP2,695

TEL remains our Top Pick in the sector given its leadership in fixed line and enterprise, and continued efforts to provide fast reliable internet connections to Filipinos. We are also positive on GLO for its leadership in mobile. With the competitive threat posed by DITO now subdued, GLO can continue growing steadily in the space. We also like that its fintech venture GCash is now profitable, and new business ventures appear promising.

Our income adjustments and lower capex forecast for 2023 for GLO lead to a slightly higher rolled-forward TP at PHP2,695 (+1.7%).

Fig 9: TEL target price computation

	Target price
NPV of FCFF (PHPm)	104,314.3
Voyager	59,628.8
Terminal value	447,569.3
Net debt	(163,251.1)
Equity value	448,261.4
# of shares (million)	216.1
Equity value per share (PHP)	2,075.0

Source: Maybank IBG Research

Fig 10: GLO target price computation

	Target price
NPV of FCFF (PHPm)	84,510.7
Terminal value	422,478.3
Mynt	53,250.0
Net debt	(173,061.3)
Equity value	387,177.7
# of shares (million)	143.7
Equity value per share (PHP)	2,695.0

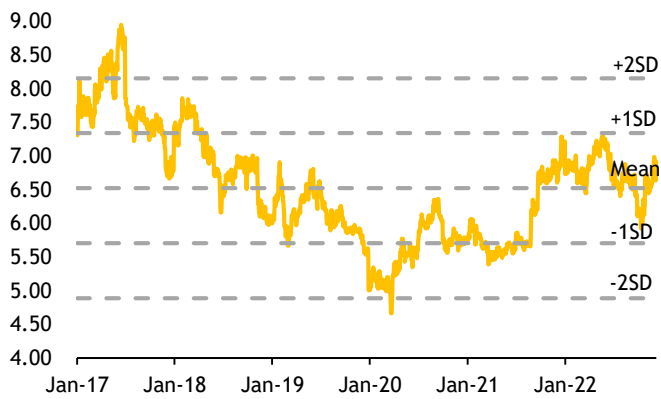
Source: Maybank IBG Research

Fig 11: CNVRG target price computation

	Target price
Enterprise value (PHPm)	144,481
Net debt	19,811
Equity value (PHPm)	124,669
Weighted ave. shares outstanding (m)	7,266
Target price before discount (PHP/sh)	17.2
CG discount (25%)	4.3
Target price (PHP/sh)	12.9

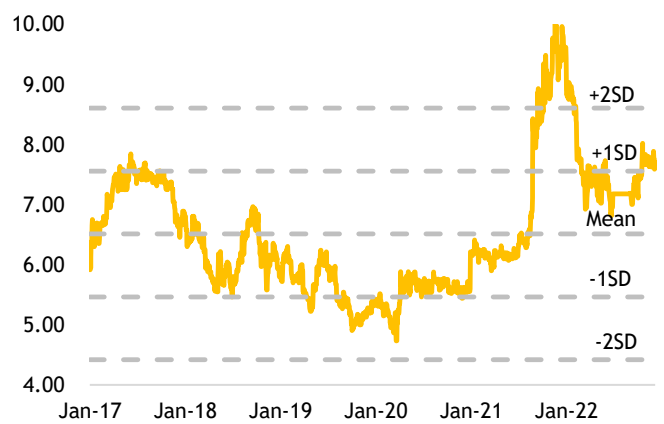
Source: Maybank IBG Research

Fig 12: TEL 5-yr EV/EBITDA



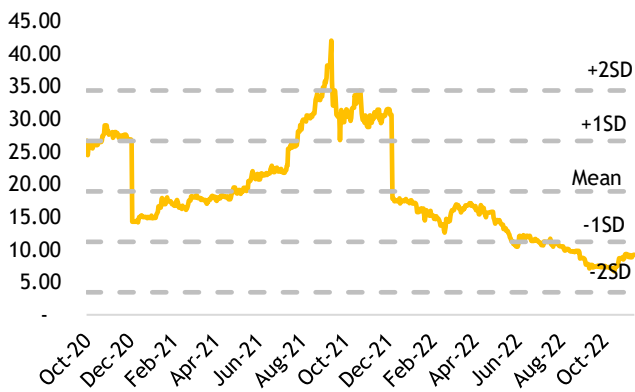
Source: Bloomberg

Fig 13: GLO 5-yr EV/EBITDA



Source: Bloomberg

Fig 14: CNVRG 1-yr EV/EBITDA



Source: Bloomberg

Fig 15: Income growth forecasts

	Net income (PHPm)			Core income (PHPm)			EBITDA (PHPm)		
	FY21A	FY22E	FY23E	FY21A	FY22E	FY23E	FY21A	FY22E	FY23E
TEL	26,367	38,597	29,652	30,233	32,433	33,066	96,169	97,711	102,883
GLO	23,653	34,097	30,465	23,653	20,193	22,491	74,922	81,209	81,549
CNVRG	7,156	8,319	11,281	7,156	8,319	11,281	14,801	18,037	22,757
<i>Growth</i>									
TEL	8.6%	46.4%	-23.2%	11.4%	7.3%	2.0%	2.5%	1.6%	5.3%
GLO	27.3%	44.2%	-10.6%	27.3%	-14.6%	11.4%	10.2%	8.4%	0.4%
CNVRG	111.2%	16.3%	35.6%	111.2%	16.3%	35.6%	80.1%	21.9%	26.2%

Source: Maybank IBG Research

Philippines Utilities

NEUTRAL

[Unchanged]

Year Ahead 2023: Filling the gap

AP and MER Top Picks; maintain NEUTRAL

While strong RE-based pipelines ensure long-term earnings growth, the looming supply tightness in the Luzon power grid presents near-term opportunities for firms with (i) MW additions in FY22/23E; and (ii) high spot market exposure. ACEN and AP have the most new MWs in their PH portfolios for FY22/23, at 585MW and 1,283MW (36% and 27% of their respective YE23E portfolios), translating to FY23E core earnings growth of 44%/9% YoY, respectively. Nevertheless, AP and MER are our top sector picks as they offer exposure to the domestic-driven volume growth story.

Luzon supply tightness until 2024

Although the new 2.4GW committed/indicative capacity covers our forecast peak demand growth of 1.7GW (+6.0% YoY) in FY23, the curtailment of Malampaya and derating of SMC's 1.2GW Ilijan plant could impinge power supply in 1H23. While we expect this to be resolved by COD of new LNG terminals in 2H23E, the supply tightness may provide further offtake opportunities for the new/uncontracted capacities of SCC, AP, and ACEN while spot prices may remain elevated at PHP6.5 per kWh in FY23E.

Manageable regulatory environment

We forecast MER's FY23-26E distribution tariffs to range from PHP1.2-1.3 per kWh, based on a 12% regulatory rate of return approved by 1Q23E, translating to FY23E earnings growth of 6.4% YoY and dividend yield of 5.9% (see [Reopening drives demand](#) report). We also expect competition in the domestic RE space to remain moderate, even as the DOE opens the sector to full foreign ownership, as foreigners still face other barriers to entry.

Top Picks: AP and MER

We believe the best ways to play FY23E's domestic demand driven uplift is through AP and MER. AP is currently undervalued at 10.1x PER, a 26% discount to its 5-year historical PER of 13.6x, as the market has yet to price in its near-term earnings growth and long-term upside from its 3.7GW RE pipeline. MER was an unloved stock due to regulatory overhangs, but we believe this will be resolved by 1Q23E. More than the near-term earnings upside of 6% YoY, supported by FY23E electricity sales growth of 5%, MER's 6.0% FY23E yield also provides a downside hedge.

Analyst

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Acronyms used:

AG&P- Atlantic Gulf and Pacific International Holdings
COD- Commercial operating date
DOE- Department of Energy
DU- Distribution utility
GNPD- GNPowr Dinginin (1,336MW; coal)
IAR- Interim average rate
KWH- Kilowatt hour
LWAP- Load weighted average price
MGen-Meralco Powergen Corp.
MT_ Metric ton
MTPA- Metric tons per annum
PLP- PacificLight Power (800MW; natural gas)
PPA/PSA- Power purchase agreement/ power supply agreement
RE- Renewable energy
RP- Regulatory period
SBPL- San Buenaventura Power (455MW; coal)
SPPC- South Premier Power Corp. (1,200MW; natural gas)
SMEC- San Miguel Energy Corp. (1,000MW; coal)
WACC- Weighted average cost of capital

Stocks mentioned:

Globe Telecom, Inc. (GLO PM, CP: PHP2,182.00, BUY, TP: PHP2,650.00)
San Miguel Corp. (SMC PM, CP: PHP93.00, Not Rated)
SP New Energy Corp. (SPNEC PM, CP: PHP1.30, Not Rated)

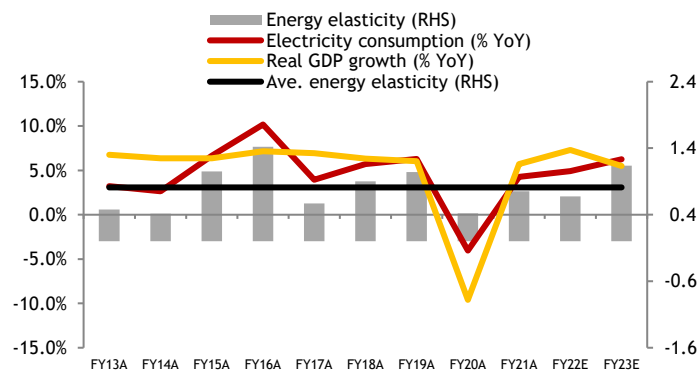
Stock	Bloomberg code	Mkt cap (USD'm)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x)		P/B (x)		Div yld (%)	
							22E	23E	22E	23E	22E	23E
Manila Electric C	MER PM	5,667	Buy	278.40	370.00	38	11.7	11.0	3.0	2.7	5.8	6.0
AC Energy Phils	ACEN PM	5,119	Hold	7.15	8.00	12	45.9	32.0	2.8	2.6	0.8	0.4
Aboitiz Power	AP PM	4,479	Buy	33.70	40.00	24	10.1	9.2	1.5	1.4	4.3	5.0
Semirara Mining	SCC PM	2,549	Buy	33.20	42.00	40	3.0	4.0	1.9	1.6	15.1	12.0
First Gen	FGEN PM	1,061	Buy	16.34	28.00	76	3.9	3.8	0.4	0.4	4.8	5.2

27. Luzon supply tightness until 2024

27.1 Natural gas disruptions to tighten 1H23E supply margin

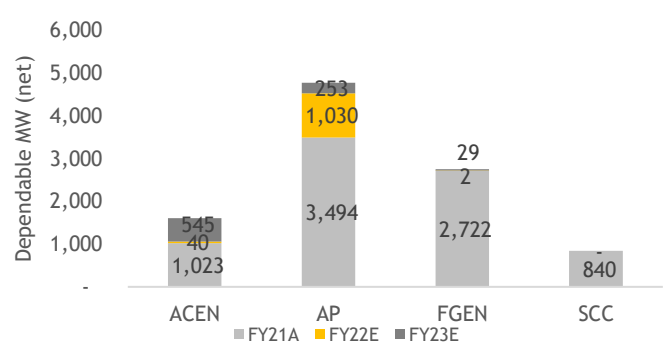
We forecast 2.4GW of fresh committed/indicative dependable generation capacity to COD in FY23E, anchored by expected COD of three units or 450MW of new coal capacity from SMC’s 4x150MW Mariveles coal power project as well as another 712MW of committed new renewables capacity. Of this 712MW of RE, the bulk is from ACEN, which should add 160MW of wind and 385MW of solar. This, together with AP’s 1.3GW GNPowr Dinginin supercritical coal plant, which will start full operation of its 668MW Unit 2 in 4Q22, should adequately cover our forecast nationwide peak demand growth of 6.0% YoY in FY23.

Fig 36: Positive relationship between electricity consumption and economic growth



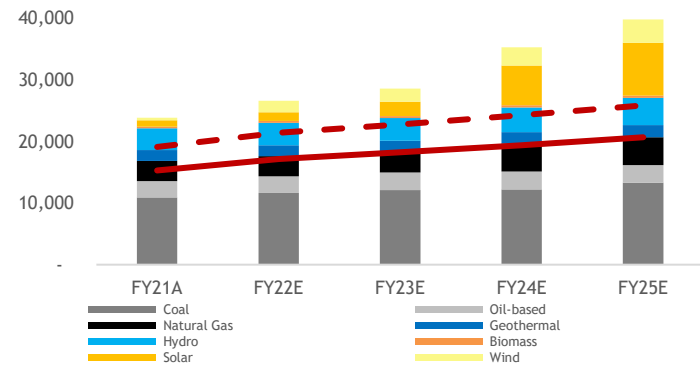
Source: DOE, NGCP, Maybank IBG Research

Fig 37: AP and ACEN adding the most new MWs in the PH



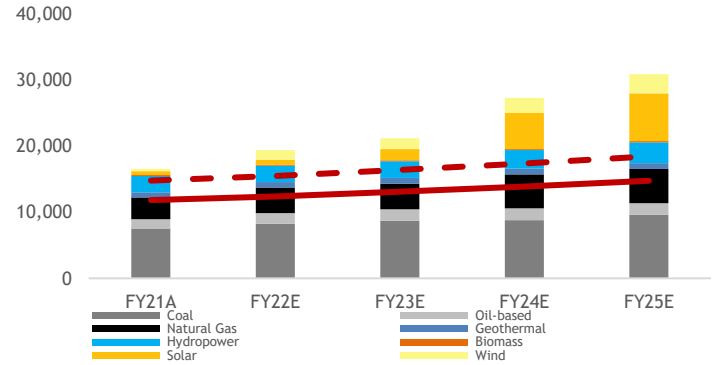
Source: Company, Maybank IBG Research

Fig 38: Dependable capacity vs supply forecast (MW) - Philippines



Source: DOE, NGCP, Maybank IBG Research

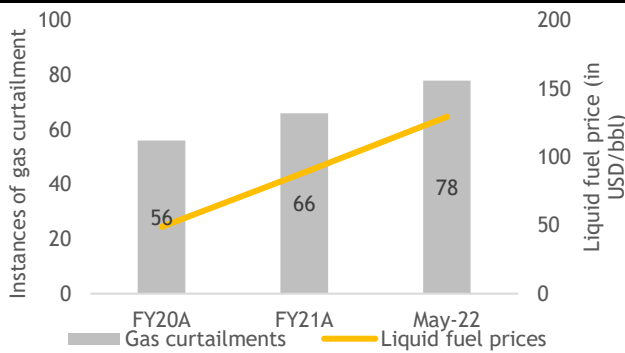
Fig 39: Dependable capacity vs supply forecast (MW) - Luzon grid only



Source: DOE, NGCP, Maybank IBG Research

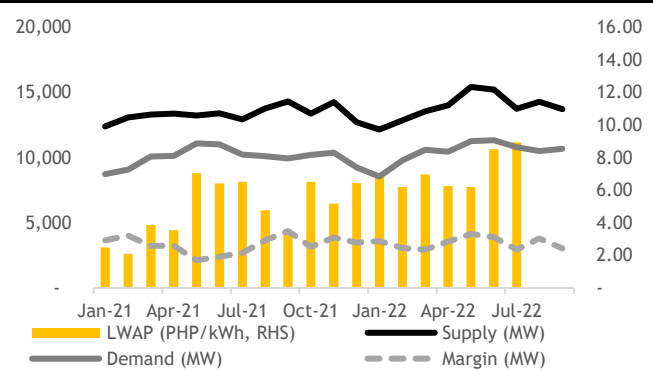
Despite the moderate additions to supply, we still see potential supply tightness ahead in 1H23E for the Luzon grid. Besides the expected demand growth due to continued economic reopening, we also expect various disruptions to its natural gas fired generation to impact power supply. This is not surprising considering 25% of FY21A Luzon grid generation was from natural gas.

Fig 40: Malampaya gas supply curtailments



Source: DOE, FGEN, Maybank IBG Research

Fig 41: Historical spot prices (FY21A)



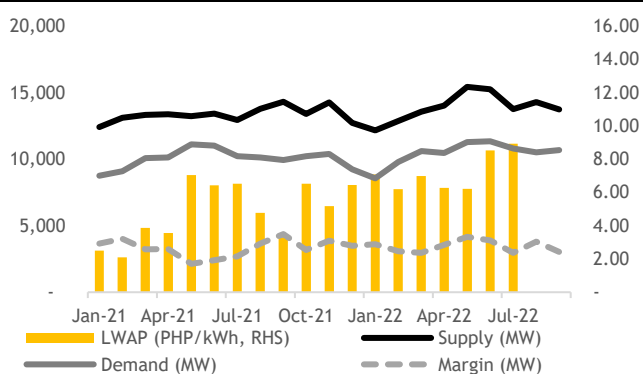
Source: IEMOP

The main issues natural gas-fired generators may face are: (i) risk of continued Malampaya gas curtailments, heading closer to its expected depletion by FY27E; (ii) the impact of the capacity derating of SMC’s 1.2GW Ilijan plant since Jun 2022 due to the expiration of its primary gas supply agreement with Malampaya. Excluding natural gas from the mix, we estimate a thin c.900MW buffer between peak demand (including the reserve requirement) and the grid’s dependable capacity.

We expect the supply tightness threat to abate after the expected COD of two new LNG terminals by 2H23E, including FGEN’s PHP13b LNG terminal project, which will offer the initial phase of its 5.26 metric tonnes per annum (MTPA) regasification capacity by Jul 2023, and the 5.0MTPA LNG terminal of Atlantic Gulf & Pacific (AGP, Unlisted), which will have SMC’s 1.2GW Ilijan as its planned anchor offtaker upon the terminals COD in 1H23E.

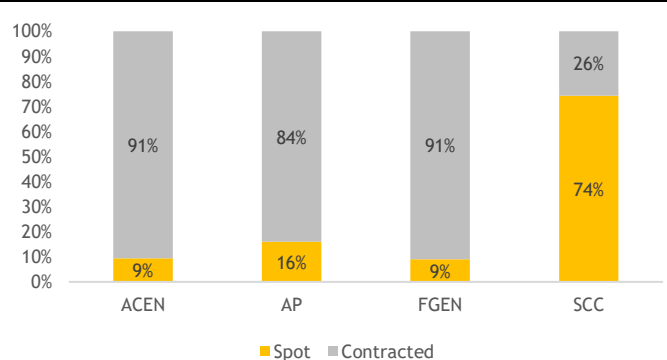
All things considered, the supply situation should provide further offtake opportunities for new/uncontracted capacities of ACEN, AP and SCC while continually elevated spot market prices at PHP6.5 per kWh in FY23E (FY22E: PHP7.0 per kWh) would benefit SCC and AP the most.

Fig 42: Luzon-Visayas margins and LWAP spot prices



Source: IEMOP

Fig 43: Spot exposure (% of capacity as of 9M22)



Source: Company, Maybank IBG Research

27.2 Clean energy comprises bulk of new MW over FY23-27E

As a significant proportion of PPA/PSA of traditional power companies in the Philippines still feature cost pass-through, we see capacity expansion to be a more meaningful driver of long-term earnings growth.

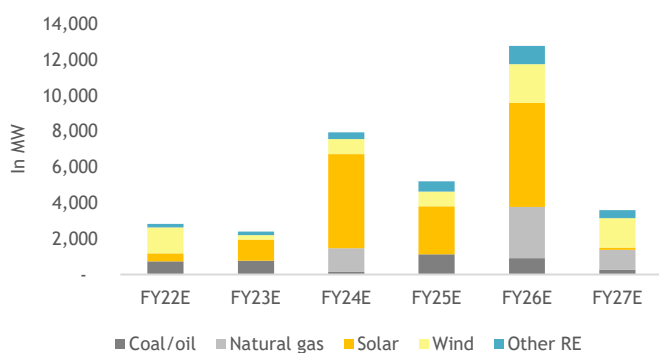
The recent supply additions have been headlined by traditional generation technologies, the most notable of which is the 1.3GW GNPowder Dingin

(GNPD) plant of AP, which is currently the largest stand-alone coal plant in the Philippines (See *Ramping up* report for more).

Nevertheless, despite the largest distribution utilities remaining compliant with their mandated renewables procurement until YE24E by virtue of their respective RPS, the DOE’s list of committed/indicative power projects as of Sep-2022 shows that 23.4GW, or c.73% of new supply in FY23-27E is from renewables. Natural gas, which is a cleaner alternative to coal-fired power for serving baseload power requirements, will comprise another 16% of new supply, and should serve to complement intermittency of solar and wind RE technologies.

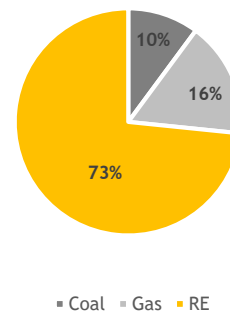
The balance or 10% will be accounted for by coal projects that underwent significant development already before the DOE’s moratorium on greenfield coal plants was imposed in Oct 2020.

Fig 44: Total committed/indicative new MW until FY27



Source: DOE

Fig 45: 10: New supply from FY23-27E by technology (in %)



Source: DOE

Even though the DOE’s updated Power Development Plan for FY23-28E has not yet been released, the new administration of President Bongbong Marcos has clearly aligned with the previous administration’s thrust to expand renewables sourcing. This has been highlighted by the initial policy actions of the DOE since Jun 2022, which so far include:

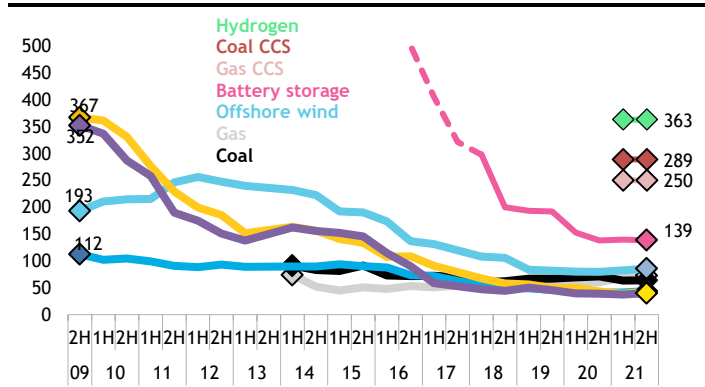
- i) retention of the coal plant moratorium policy throughout the Marcos administration (Jun 2022-Jun 2028);
- ii) holding of the first Green Energy Auction in Jun 2022 to support commerciality of 1.97GW of new RE capacity for COD between FY23-25E;
- iii) amendments to the Renewable Energy Act of 2008 implementing rules allowing 100% foreign capital investment in RE projects; and
- iv) issuance of department circular broadening preferential dispatch status in the spot market to all RE plants, including geothermal and impounding hydroelectric plant facilities.

Besides the favourable local regulatory backdrop, RE players are also racing to secure viable project sites amid the opportunistic window opened by the recent surge in coal/oil prices as well as the long-term expected downtrend in solar panel and wind turbine prices, which would further facilitate not just local but global adoption of renewables.

The major renewables investors in the sector are currently ACEN and AP, which have laid out the biggest renewables capacity targets in the country (See *Renewables demand firming up* report for more). ACEN is by far the most aggressive renewables investor, targeting to grow its regional renewables portfolio to 20GW, 6.5GW of which will be for the Philippines only, by FY30E. However, given the run-up in ACEN’s valuations, we prefer

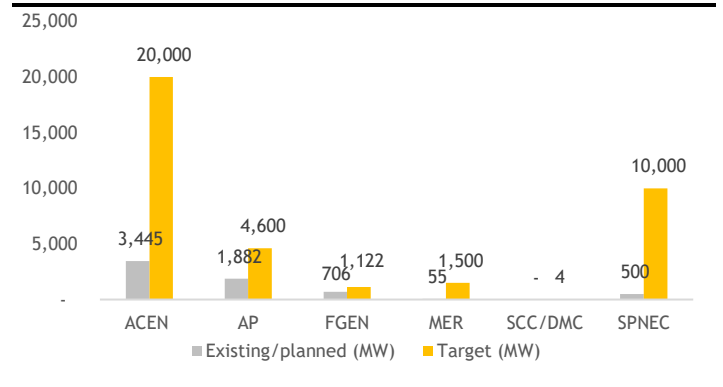
AP as it's also progressing well on target to grow its renewables capacity to 4.6GW, or 50% of its FY30E capacity (from 26% as of FY22E).

Fig 46: Global leveled electricity cost (USD/MWh)



Source: Bloomberg NEF

Fig 47: Renewables commitments of local power firms



Source: Maybank IBG Research

Fig 48: Global power capacity mix

	Global power generation capacity (GW)				CAGR (%) 2021 to:	
	FY10A	FY21A	FY30E	FY50E	FY30	FY50
Total capacity	5,198	8,185	12,932	26,541	5.2	4.1
Renewables	1,343	3,278	7,744	20,290	10.0	6.5
Solar PV	39	892	3,498	11,065	16.4	9.1
Wind	181	832	2,251	5,727	11.7	6.9
Hydro	1,027	1,358	1,609	2,325	1.9	1.9
Bioenergy	83	173	307	707	6.6	5.0
CSP	1	7	35	318	19.9	14.1
Geothermal	11	16	37	102	10.3	6.7
Marine	0	1	7	47	26.9	15.1
Nuclear	403	413	487	716	1.9	1.9
Hydrogen and ammonia	-	-	30	228	na	na
Fossil fuels with CCUS	-	0	18	288	74.3	30.8
Coal	1,621	2,184	1,988	942	-1.0	-2.9
Natural gas	1,389	1,850	1,949	1,623	0.6	-0.5
Oil	438	427	286	164	-4.4	-3.3
Battery storage	1	27	425	2,286	35.7	16.5

Source: IEA

Assuming a scenario whereby a major international clean energy commitments are met, the IEA forecasts double-digit CAGR for renewables and battery storage capacity between FY21-30E.

We are of the view that improving economies of scale due to wider global adoption of RE would lead to further cost competitiveness.

28. Regulatory risks are manageable or priced in

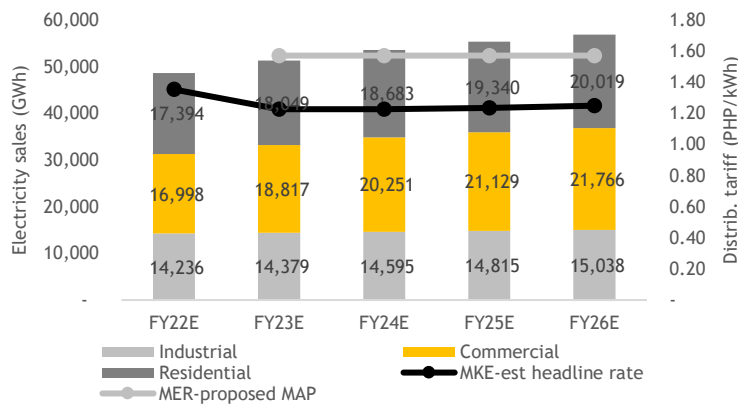
28.1 Impact of DU rate rebasing is manageable

Local power distributions firms have all experienced delays in their respective rate rebasing timings amid manpower restraints at the ERC. The largest electricity distributor, MER, is no exception to this as the regulator failed to account for its under- or over-collection for its 3rd regulatory period (RP), which covered Jul 2011 to Jun 2015, as well as the reset of the 4th RP distribution rate, which covered Jul 2015 to Jun 2019 (but subsequently extended to Jun 2022).

The ERC resolved this by: i) initially allowing MER to collect during the 4th RP using an interim average rate equivalent to PHP1.381 per kwh then; ii) finalizing by Jun 2022 the over-recoveries in the 3rd and lapsed 4th RP, which cumulatively amounted to PHP48.3b.

MER was able to anticipate and pre-provision for the PHP48.3b over-recoveries, limiting the cash impact. As of Sep 2022, MER's provisioning stood at PHP27.2b, sufficient to cover the PHP21.0b remaining over recoveries (See *Reopening drives demand* for more).

Fig 49: Distribution volume and tariff forecast (FY22-FY26E)



We forecast FY22/23E consolidated electricity sales growth of 6%/5% amid continued economic reopening, which lifted all segment volumes in 9M22 despite inflation headwinds.

Source: MER, Maybank IBG Research

Fig 50: Telco tower leaseback deal with Globe

Globe inks deal with MIDC for 2,180 towers with total proceeds of over Php26 billion

	MIDC PORTFOLIO
Portfolio	2,180 towers in Luzon
Offer Price	Php12.0 million/tower
Total Proceeds	Php26.2 billion
Lease Rate	Php100K/tower/month (PHP for Lease and Risk subject to capped escalation)
Initial Lease Term	15 years
Potential Gain to be Recognized	Php10.6 billion recognized in step with closing
BTS Commitment	750 Built-to-suit

Tower Type Profile

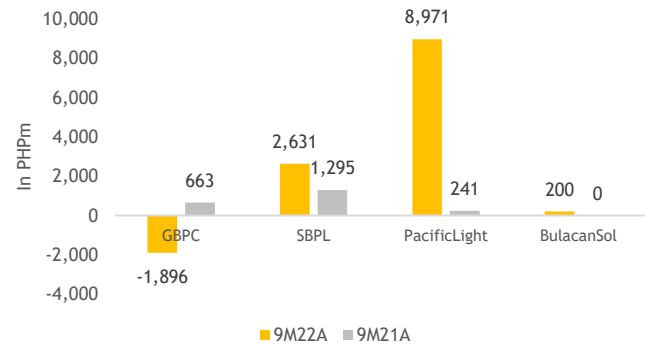
28% Ground-based

72% Rooftop

- MIESCOR Infrastructure Development Corporation (MIDC) is a Joint Venture between MIESCOR (a Subsidiary of Manila Electric Company), and Stonepeak
- Transaction documents signed on August 11, 2022
- First closing targeted in September 2022

Source: Globe

Fig 51: 9M21/9M22 power generation core net income



Source: MER, Maybank IBG Research

The ERC has yet to set the 5th RP distribution rate, but we estimate that using a more conservative 12% regulatory rate of return would result in a PHP1.2-1.3 per kWh distribution tariff for MER. This is relative to the historical 3rd/4th RP regulatory WACC of 14.97% and MER’s own proposed 13.2% regulatory WACC, which it applied to its regulatory asset base in its 5th RP reset application filed with the ERC in Mar 2022.

Although these new distribution tariffs would be lower than the PHP1.3522 per kWh average rate of the 4th RP, post adjustment of the ERC in Jun 2022, the impact of this is offset by its +6%/+5% volume growth over FY22/23E and business diversification efforts into power generation and telco tower leasing, translating into FY22/FY23E earnings growth of 9%/5% YoY.

Given delays of ERC hearings on the matter, we assume that the new rates will be announced in 1Q23E although still retroactively applied starting Jul 2022.

28.2 Cessation of supply from SPPC PSA

The ERC disapproved SMC’s appeal for a temporary rate adjustment to recover running losses of PHP15b since 2021 to serve its PSAs with 670MW contracted capacity from South Premiere Power (SPPC, Unlisted) and 300MW contracted capacity from San Miguel Energy Corp. (SMEC, Unlisted). Consequently, SMC formally notified MER on 7 Dec that SPPC would stop supplying the 670MW under its PSA with MER drawn from its 1.2GW Ilijan gas-fired power plant. It would stop supplying the PSA for a 60-day duration, coinciding with the duration of a temporary restraining order granted by the

Court of Appeals on 7 Dec which allowed SPPC to temporarily halt supplying electricity for its PSA with MER.

MER is temporarily sourcing the 670MW from the spot market but it's looking to subsequently pursue alternative power sources such as:

- i) awarding an equivalent 670MW of emergency PSAs to various power generation firms (these are expedited by the DOE, which is exempting these PSAs from the usual requirement of a competitive selection process); and/or
- ii) taking SMC's offer to keep Ilijan's 1,200MW capacity running for MER in exchange for a PHP1 per kWh "capital recovery fee" on top of the fuel cost. MER is looking to source the gas supply from FGEN, which still has existing gas allocation from Malampaya until FY24E, by which time it should have already shifted to using imported LNG supply via its new LNG terminal.

Fig 52: Scenario analysis of alternative sourcing to cover SPPC PSA

Scenarios	PHP/kWh average impact to MER customers	Est. incremental cost versus orig. PSAs
A: 6-month rate adjustment for SPPC and SMEC PSAs granted	PHP1.57/kWh higher	PHP5.2b
B: PSAs terminated, covered by 1-year emergency PSAs	PHP1.92/kWh higher	PHP12.6b
C: PSAs terminated, replacement with new PSA via CSP	PHP0.56/kWh higher	PHP25.8b
D: PSAs terminated, cover with spot market	PHP2.87/kWh higher	PHP1.6b/month

MER estimated that granting the temporary rate adjustment to SMC was the cheapest option for consumers.

However, the temporary rate adjustment appeal of SMC was not granted by the ERC.

Nonetheless, all these scenarios are earnings-neutral for MER, which passes through generation costs to consumers

Source: ERC, MER

Although overall generation costs for MER's consumers may rise temporarily, we note that all generation costs, including spot market procurement costs, are passed through to its captive customers and earnings-neutral for MER.

The higher spot market purchases from MER, if prolonged, also pose upside risk to our FY22/23E spot market price forecast of PHP7/6.5 per kWh and would benefit SCC and AP, which should remain net sellers to the spot market in FY22/23E.

28.3 Amendment of foreign ownership cap

In Nov 2022, the DOE Energy Secretary, Mr. Raphael P.M. Lotilla, signed a circular amending the implementing rules and regulations of the Renewable Energy Act of 2008 to allow 100% foreign capital in renewable energy projects.

The previous implementing rules capped foreign participation in renewables to just 40%, although a recent ruling by the Department of Justice gave its legal opinion that renewable energy technologies that tap inexhaustible sources of energy should not be subjected to the 60:40 foreign equity limitation as set by the 1987 Philippine Constitution.

Despite this, we do not expect an immediate surge in competitive pressure from foreign investors as other barriers to entry such as land ownership limitations for foreigners still exist, meaning that foreign entrants would have to either partner with or lease land from local companies. The larger and more established local power companies also enjoy other advantages such as more established relationships with offtakers as well as more

familiarity with the Philippines’ geography and the local power industry regulatory framework.

29. Maintain NEUTRAL; Prefer AP and MER

29.1 Softer overall sector earnings in FY23E

We maintain our NEUTRAL view on the sector amid our outlook for softer overall earnings growth in FY23E. The largest drag on sector earnings is SCC as we forecast 25% FY23E net income contraction due to softer coal prices (See [Coal cooling](#) report for more). SCC’s earnings are sensitive to changes in coal prices, which have remained volatile throughout FY22E due to rising demand amid global economic recovery, geopolitical tensions between Europe and Russia, and unexpected supply disruptions of major coal exporters such as Australia.

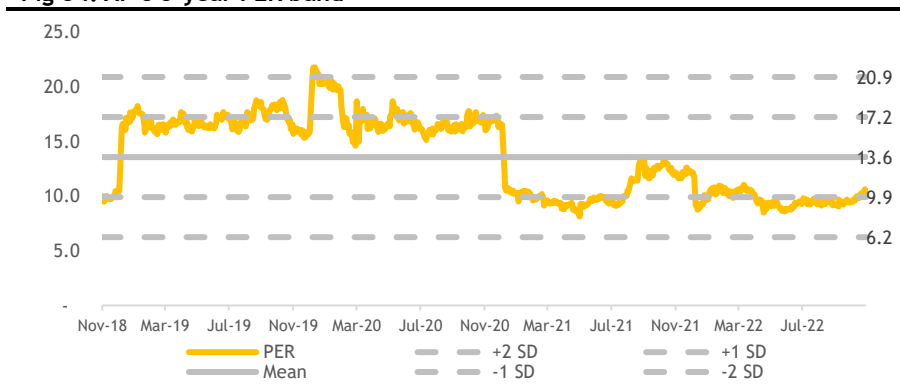
Even excluding SCC, the sector’s FY23E earnings growth of 13.0% does not outperform versus the estimated 14.8% earnings growth of the PSEi basket. Although we recommend BUY on most of the sector components, we prefer to be selective in the space and prefer AP and MER.

Fig 53: Peer comparison (as of 9 Dec 2022)

Name	Ticker	CP (PHP)	TP (PHP)	Upside (%)	Rec	EPSg (%)		PER (x)		ROE (%)		Div. Yield (%)
						FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	
<i>Median</i>												
AC Energy Corp.	ACEN PM	7.25	8.00	10.3	HOLD	-12.7	43.5	46.5	32.4	4.9	8.1	0.4
Aboitiz Power Corp.	AP PM	33.80	40.00	18.3	BUY	33.0	9.3	10.1	9.2	15.2	15.3	5.0
First Gen Corp.	FGEN PM	16.24	28.00	72.4	BUY	13.0	8.1	4.0	3.7	10.3	10.0	5.3
Manila Electric Co.	MER PM	280.00	370.00	32.1	BUY	9.3	6.4	11.7	11.0	26.3	25.0	6.0
Semirara Mining	SCC PM	33.20	42.00	26.5	BUY	192.9	-24.9	3.0	4.0	66.6	38.6	12.0

Source: Bloomberg, Maybank IBG Research

Fig 54: AP’s 5-year PER band

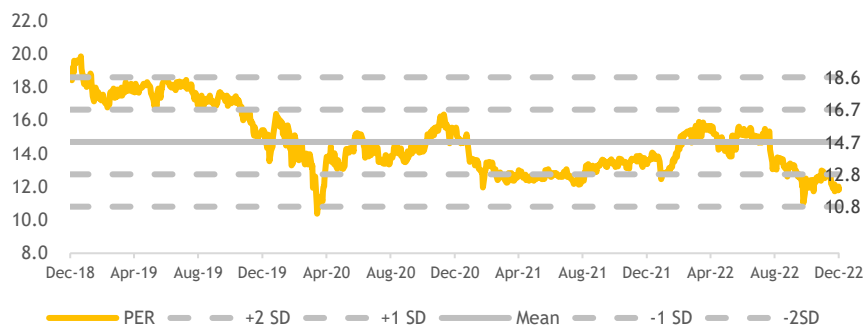


AP is still trading at 1 standard deviation below its 5-year average PER.

In our view, continued ramp-up of new GNPD earnings and better project visibility towards its 4.7GW RE target would support re-rating of the stock

Source: Bloomberg, Maybank IBG Research

Fig 55: MER's 5-year PER band



Source: Bloomberg, Maybank IBG Research

We find MER undervalued as its PER is also 1 standard deviation below its 5-year average.

In our view, overhang on the stock is related to: i) a Jul 2022 private placement between two major shareholders, which priced MER at PHP344, below the market price at the time; as well as ii) uncertainty over direction of 5th RP rate rebasing.

We estimate even a 12% regulatory WACC will still result in FY22/23E earnings growth and TP of PHP370.

29.2 Aggressive capacity expansion-driven upside for AP

We reiterate BUY on AP. AP has the largest commercially operational power generation capacity in our Philippine utilities basket, currently standing at 3,940MW, and it primarily contracts its capacity with either matching cost-pass through or commodity hedging to protect its margins. Moreover, its operating capacity has also grown significantly due to the addition of its new 1.3GW GNPD coal plant, which will contribute PHP6.1b or 22% of its FY23E net income. (See [Ramping up](#) report for more).

These are allowing it to take advantage of rising bilateral and spot power prices over FY22/23E. These all translate to our forecast of FY23/23E earnings growth of 33%/9% and our rolled-forward DCF-based TP of PHP40.0, implying 12-month returns of 18%. AP is currently undervalued at 10.1x PER, a 26% discount to its 5-year historical PER of 13.6x, as the market has yet to price in its near-term earnings growth and long-term upside from its 3.7GW RE pipeline.

Although SCC has the highest spot exposure at 74% of capacity, it may see an earnings-driven de-rating due to our softer outlook for coal prices (FY22E: USD349 per MT vs FY23E: USD300 per MT).

29.3 MER is discounted yet offers sustainable yield

MER reported 9M22 core net income rose 9% to PHP19.6b, in line with MIBG/consensus FY22E of PHP26.7b/PHP25.6b, reinforcing our BUY call (See [Reopening drives demand](#) for more).

MER remains among the most defensive-oriented stocks in the PSE today as the bulk of its income is from its utilities distribution business while both returns and its costs are regulated, which limits upside but also provides a degree of predictability to its cash flows. It has historically been a reliable source of dividend yield over the last 10 years.

Despite our outlook of lower 5RP distribution tariffs, we still forecast FY22/23E earnings growth of +9%/+6% as supported by robust distribution volumes growth of 6%/5% over the same period as well as further windfall from higher Mgen equity earnings, in turn due to better contributions of its power generation business. These translate into our largely DCF-based TP of PHP370.00, implying 12-month forward returns of 32%. The stabilizing interest rate environment may also make MER's FY23E 6.0% yield more attractive, although the 10-year bond yield currently remains higher at 6.88%.

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