

The Moat Report plus more!

- CLSA recently published The Moat Report. Report highlights 246 companies in Asia that generated return ratios above cost of capital, sustained earnings growth, and were at undemanding valuations. "Economic moats" are the basis for this durable competitive advantage.
- Warren Buffet coined the term "economic moat" to refer to the ability to sustain such an advantage. Companies that have a moat around their operation can be said to have a business franchise. They generally have pricing power that leads to wide margins and good return ratios.
- Out of the 246 companies mentioned, 4 are from the Philippines and these are PLDT, SM Investments, ICTSI, and Jollibee.
- Aside from the 4 companies mentioned, we believe that there are still other moats in the Philippines and these are Aboitiz Power, DMCI Holdings, Univeral Robina, Alliance Global, and Phoenix. Though still EVA negative, Metro Pacific could also be considered a moat in the coming years.

The experts say...

In CLSA's latest thematic piece entitled The Moat Report, Amar Gill and Anirudha Dutta highlight 246 companies in Asia that generated return ratios above cost of capital, sustained earnings growth, and were at undemanding valuations. Investment guru Warren Buffet coined the term "economic moat" to refer to the ability to sustain such a competitive advantage. To quote Buffet specifically:

'...[the] most important thing to me is figuring out how big a moat there is around the business. What I love, of course, is a big castle and a big moat with piranhas and crocodiles.'

Firms that have a moat around their operation can be said to have a business franchise. They have pricing power that leads to wide margins and excellent return ratios. We define a "franchise" as a business that has a comparative advantage which over time will lead to return ratios staying above cost of capital which in turn will result in economic value creation or a positive EVA.

There are various ways a company might be able to sustain a long-term advantage, or business franchise. The analysis of Pat Dorsey in The little book that builds wealth suggests they can create economic moats from one of the following main channels:

- **Intangible assets**, eg, brands, patents, or regulatory licenses that allow a business to sell products or services that can't be matched by competitors;
- **Customer switching costs** that give the firm pricing power as it is hard for customers to move away from the product/services offered;
- **Network economics** where the value of the product or service increases with the number of users; and

- **Cost advantages** stemming from process, location, scale or access to a unique asset, which allows the company to offer goods or services at a lower cost than competitors.

In practice, most of the corporations that build a franchise do so through developing a brand.

A tale of four moats...

Out of the 246 moats mentioned in the report, 4 come from the Philippines and these are PLDT, SM Investments, ICTSI, and Jollibee. Key takeaways for each are as follows:

PLDT – Leading telco play in the Philippines with bundling/convergence possibilities over the longer term through affiliates, eg, Meralco and hospitals that will allow it to offer services (eg, paying electric bills on the phone) that competitors will not be able to match.

Figure 1

PLDT’s 12-month forward PER

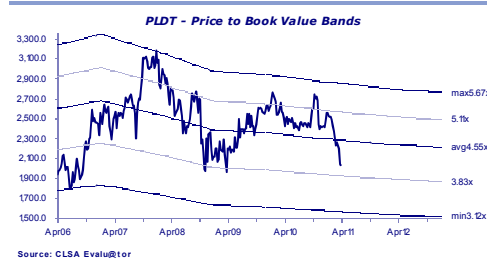


Source: CLSA Evalu@tor

Source: CLSA Asia-Pacific Markets

Figure 2

PLDT’s 12-month forward PBV



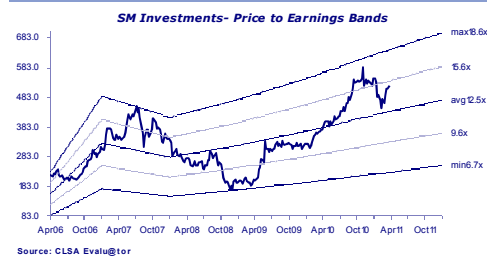
Source: CLSA Evalu@tor

Source: CLSA Asia-Pacific Markets

SM Investments – Largest conglomerate in the Philippines with leading market positions in retail, shopping malls, supermarkets, cinemas and banking. Has been savvy in capitalizing on the buying habits of the middle and mass markets.

Figure 3

SM’s 12-month forward PER

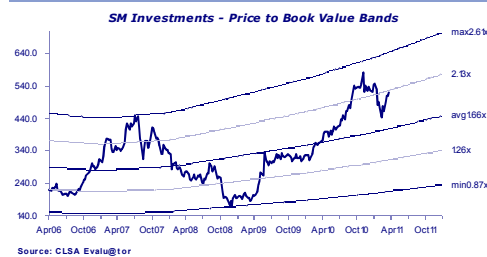


Source: CLSA Evalu@tor

Source: CLSA Asia-Pacific Markets

Figure 4

SM’s 12-month forward PBV



Source: CLSA Evalu@tor

Source: CLSA Asia-Pacific Markets

ICTSI – Fast emerging as a key player in medium-sized ports globally. Management team is strong and is continuously looking for M&A opportunities globally.

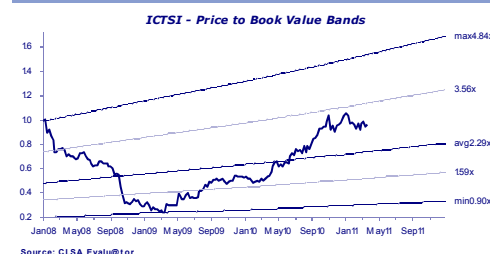
Figure 5

ICTSI's 12-month forward PER



Figure 6

ICTSI's 12-month forward PBV



Source: CLSA Asia-Pacific Markets

Source: CLSA Asia-Pacific Markets

Jollibee – The biggest fastfood chain in the Philippines. Nearest competitor McDonald's Philippines is less than half the scale of Jollibee. With strong balance sheet (net cash) the company is beginning to penetrate the vast China market.

Figure 7

JFC's 12-month forward PER

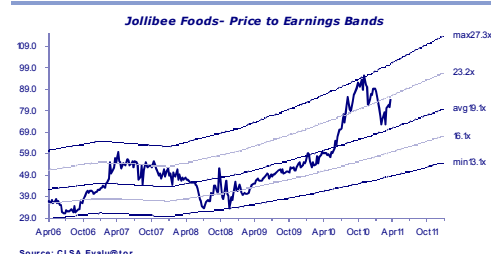
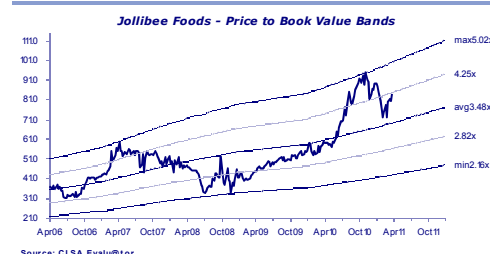


Figure 8

JFC's 12-month forward PBV



Source: CLSA Asia-Pacific Markets

Source: CLSA Asia-Pacific Markets

Figure 9

Philippine companies highlighted in THE MOAT REPORT

Company	ROIC/ROE	EVA/IC
Jollibee Foods	30.6	20.8
PLDT	21.3	12.5
SM Investments	15.9	3.9
ICTSO	13	1.1

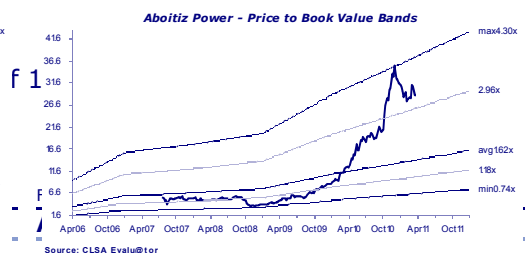
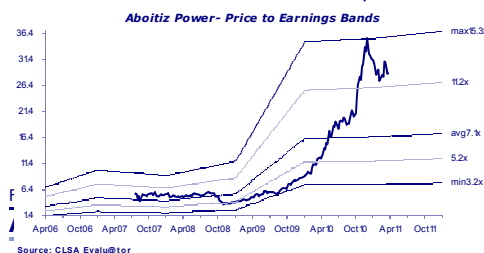
Source: CLSA Asia-Pacific Markets

Plus more...

Aside from the 4 companies mentioned in The Moat Report, we believe that there are still other moats in the Philippines and these are Aboitiz Power, DMCI Holdings, Universal Robina, Alliance Global, and Phoenix Petroleum. All of these companies are generating positive EVA. Though still EVA negative, Metro Pacific could be considered a moat in the coming years. Key takeaways of each are as follows:

Aboitiz Power

- ❑ Aboitiz Power Corporation is a member of the Aboitiz Group of Companies. The Aboitiz Group is one of the oldest business groups in the Philippines with over 100 years of experience in doing business in the Philippines;
- ❑ Aboitiz Power is into power generation and power distribution. Aboitiz Power is one of the biggest power generation plays in the Philippines with capacity of 2,100 MW. In terms of power distribution, total capacity is at 800 MW spread into concession areas in Cebu, Davao, Cotabato, and San Fernando;
- ❑ In the medium term, Aboitiz Power intends to add an additional 400MW

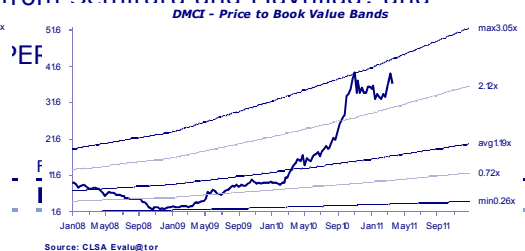
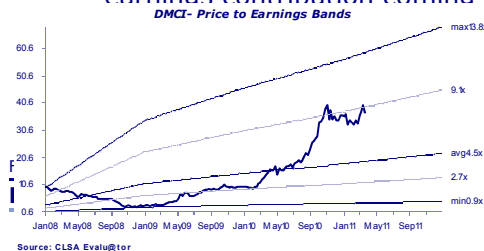


Source: CLSA Asia-Pacific Markets

Source: CLSA Asia-Pacific Markets

DMCI Holdings

- ❑ DMCI Holdings is one of the fastest growing conglomerates in the Philippines;
- ❑ Its stable of assets are (1) DMCI Construction; (2) DMCI Homes; (3) Maynilad Water; and (4) Semirara Coal. Through Semirara, DMCI is also in power generation;
- ❑ EPS growth is at 22.5% in 2011 and 21.6% in 2012 on the back robust earnings contribution coming from Semirara and Maynilad; and

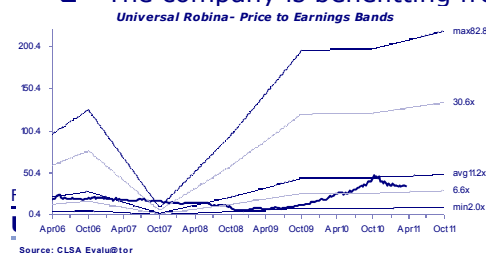


Source: CLSA Asia-Pacific Markets

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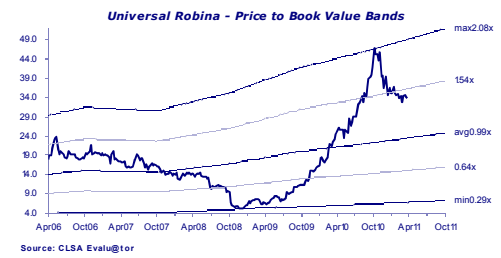
Universal Robina

- ❑ URC is the biggest snack food manufacturer in the Philippines with over 40 years of track record in this highly competitive industry;
- ❑ It has three core businesses: branded consumer foods group (78% of revenue), agro-industrial (11%), and commodities (11%);
- ❑ The company is benefitting from strong domestic consumption given a still growing population base; and



PER of 8.6x and 2012 PER of 7.7x.

Figure 15
URC's 12-month forward PBV



Source: CLSA Asia-Pacific Markets

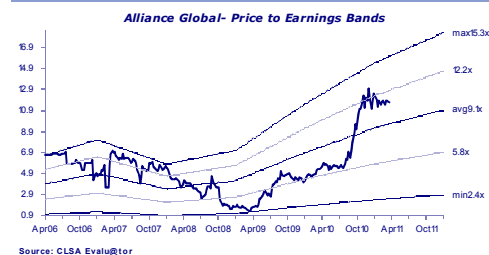
Source: CLSA Asia-Pacific Markets

Alliance Global

- ❑ Alliance Global is one of the most exciting and fastest growing conglomerates in the country;
- ❑ It has an interesting stable of assets namely (1) Megaworld; (2) McDonald's Philippines; (3) Emperador Distillers; and (4) Travellers International which houses its casino business;
- ❑ We expect EPS growth of 33.6% in 2011 and 18.9% in 2012 on the back of a recovering economy as well as robust growth in the casino business; and
- ❑ Stock is trading at 2010 PER of only 11.5x and 2011 PER of 9.7x.

Figure 16

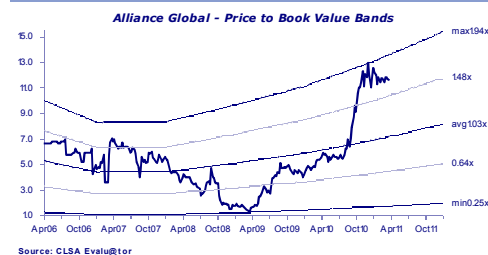
AGI's 12-month forward PER



Source: CLSA Asia-Pacific Markets

Figure 17

AGI's 12-month forward PBV



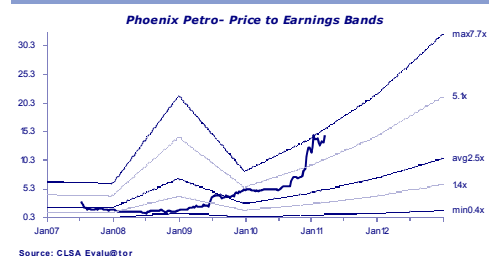
Source: CLSA Asia-Pacific Markets

Phoenix Petroleum

- ❑ 2nd largest independent downstream oil industry player with 2.5% market share seen to double to 5% by 2015 with a large 500 service station network;
- ❑ Strong 69% YoY earnings growth in 2011 underpinned by aggressive service station roll-out this year;
- ❑ Inexpensive valuations (mid-single-digit PEs) further highlighted by strong earnings growth and 24-29% ROEs; and
- ❑ 8.8x PE at target price is still at a substantial 40% discount to the market PE.

Figure 18

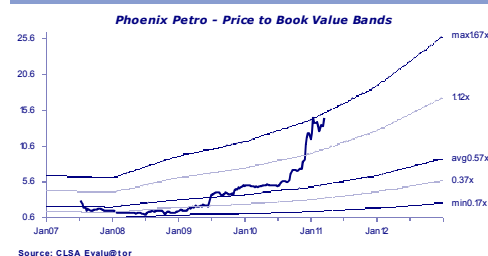
PNX's 12-month forward PER



Source: CLSA Asia-Pacific Markets

Figure 19

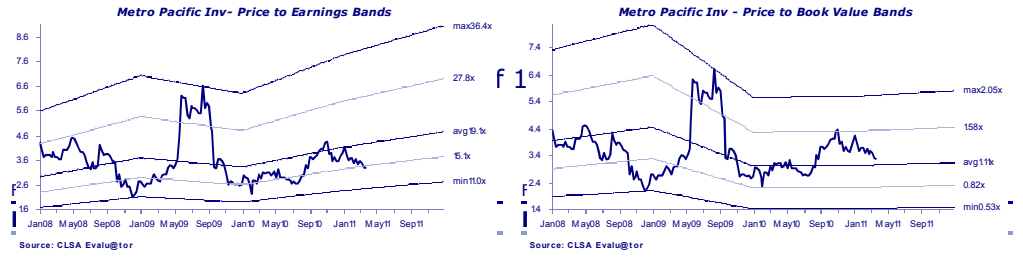
PNX's 12-month forward PBV



Source: CLSA Asia-Pacific Markets

Metro Pacific Investments

- ❑ MPI is one of the most aggressive and fastest growing conglomerates in the Philippines;
- ❑ MPI' stable of assets include stakes in Meralco, Maynilad Water, Metro Pacific Tollways and a couple of hospitals;
- ❑ We expect EPS growth of 33% in 2011. Key driver for earnings growth is Maynilad where we expect non-revenue water (NRW) to fall from 51% this year to 45% next year. Meralco and the tollways are also key assets with expected tariff hike implemented next year for Meralco and added vehicle traffic from new tollroads; and
- ❑ Fundamentals continue to strengthen with businesses that generate strong cash flows. Net gearing is seen to 65.4% next year from 75.4% this year.

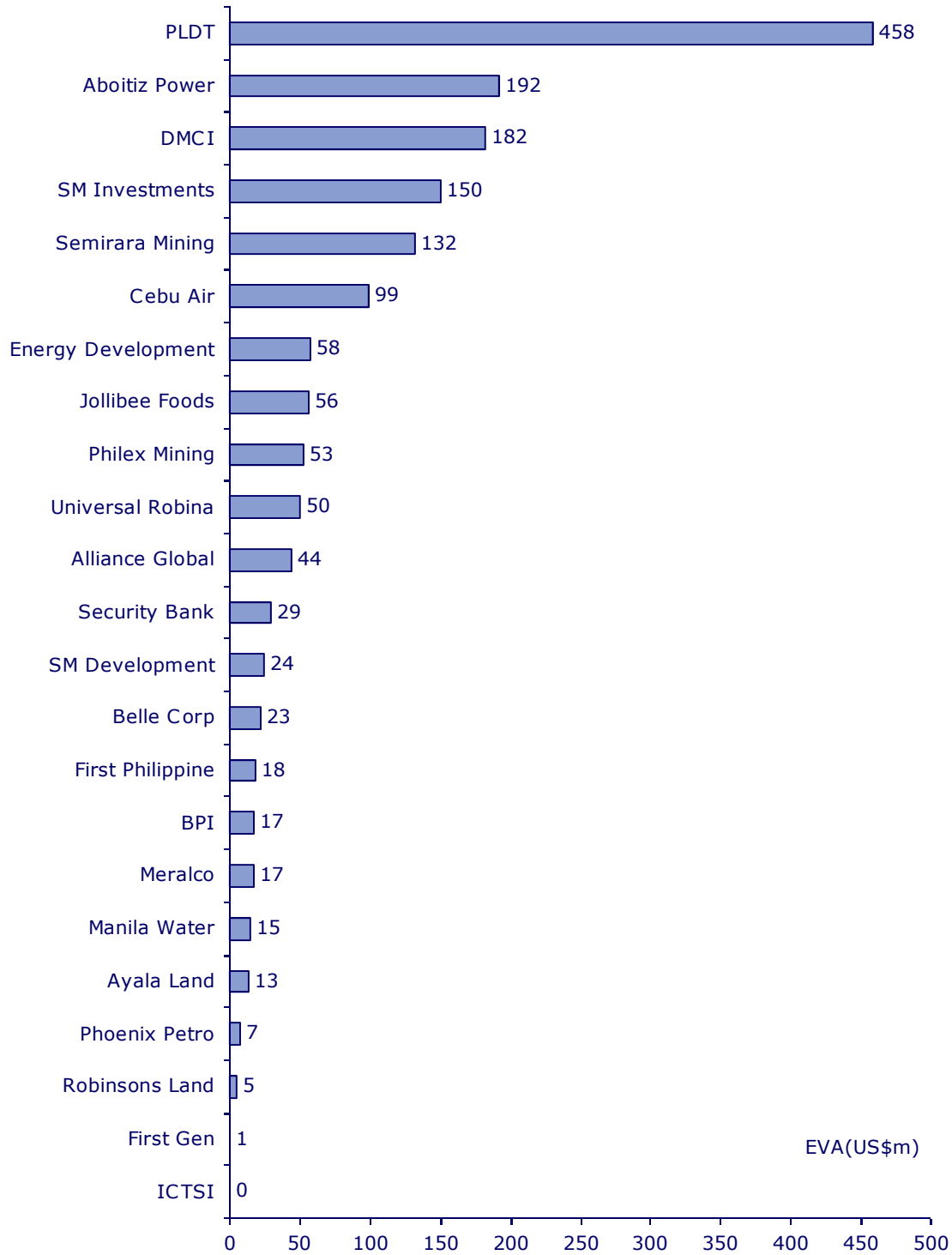


Source: CLSA Asia-Pacific Markets

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Figure 22

Philippine companies that are EVA positive

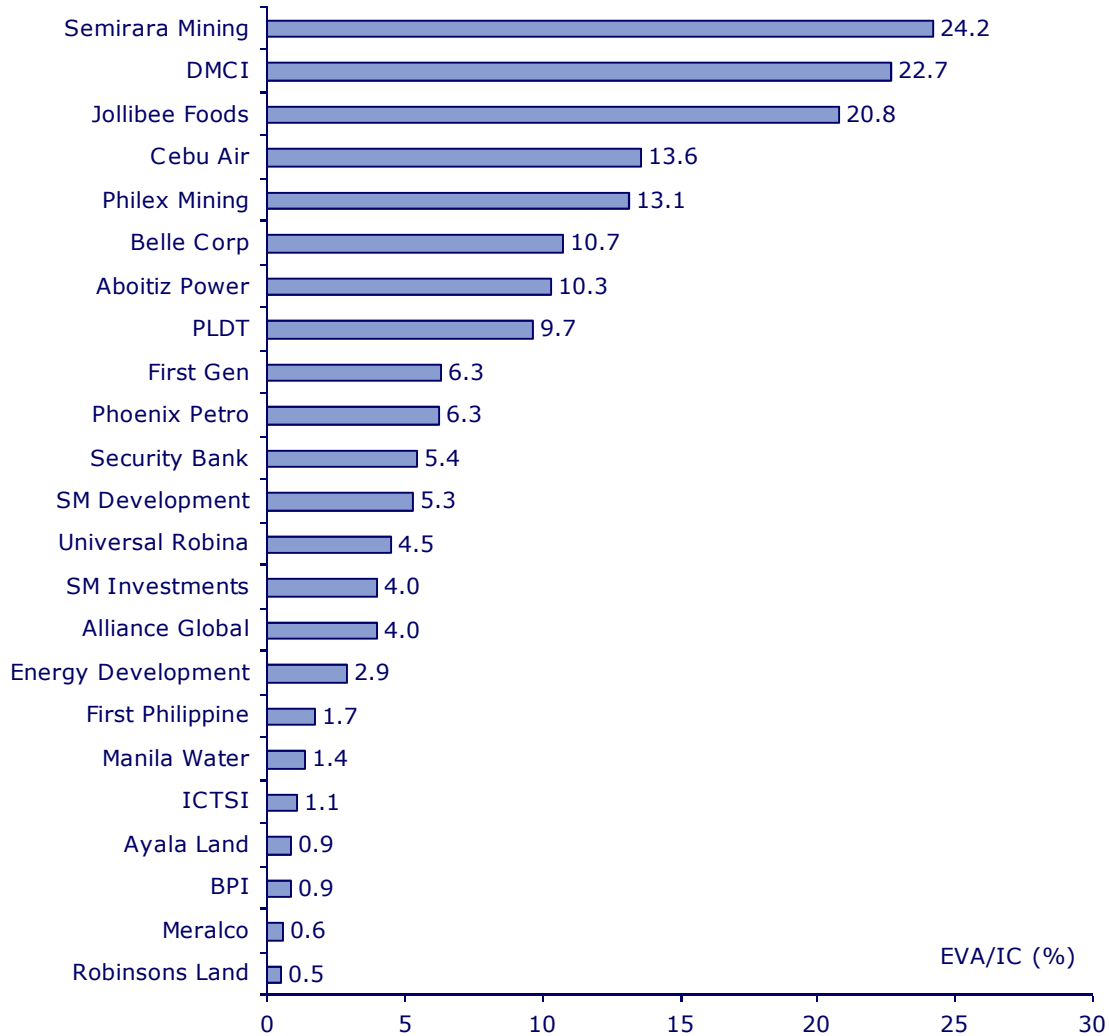


Source: CLSA Asia-Pacific Markets



Figure 23

EVA/IC (%)



Source: CLSA Asia-Pacific Markets

Figure 24

Valuation table of Philippine Moats

Company	Mcap	PE (x)		PB (x)		Rec
		11CL	12CL	11CL	12CL	
PLDT	439,997	11.0	11.0	4.7	4.8	U-PF
SM Investments Corp	315,477	15.3	13.7	2.1	1.9	BUY
ICTSI	80,602	19.4	17.3	3.1	2.8	BUY
Jollibee	90,199	24.4	20.8	4.5	3.9	BUY
Aboitiz Power	213,032	12.5	12.1	3.5	2.9	O-PF
DMCI	100,510	9.3	7.6	2.8	2.2	BUY
Universal Robina	69,679	8.6	7.7	1.5	1.4	BUY
Alliance Global	113,138	11.5	9.7	1.7	1.5	BUY
Phoenix Petroleum	5,607	8.2	5.3	1.7	1.3	BUY
Metro Pacific Investments	65,521	15.0	13.0	1.2	1.1	BUY

Source: CLSA Asia-Pacific Markets

Key to CLSA investment rankings: **BUY** = Expected to outperform the local market by >10%; **O-PF** = Expected to outperform the local market by 0-10%; **U-PF** = Expected to underperform the local market by 0-10%; **SELL** = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

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Note: In the interests of timeliness, this document has not been edited.

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