

THURSDAY, 31 OCTOBER 2013

Earnings Analysis

**Manila Electric Company:  
9M13 results miss forecast due to higher than expected expenses**

- 9M13 results miss forecast due to higher than expected expenses.** Meralco's 3Q13 core net profit rose 13.3% to Php4.38Bil. This brought 9M13 core earnings higher by 5.2% to Php13.56 Bil, representing 70% and 75.6% of COL and consensus full year forecasts respectively. Core earnings missed COL's forecast mainly due to higher than expected expenses. Cost and expenses excluding pass-on purchased power cost amounted to Php26.4Bil, representing 82.7% of our full year forecast. This was most likely due to higher provisions made during the period. Net distribution revenue increased by 12.86% y/y to Php42.3 Bil and was slightly better than expected as Meralco enjoyed higher than expected distribution tariff.
- Sales volume growth meets forecast due to strong residential segment growth.** 3Q13 sales volume grew by 6.4% to 8,720GWh. As a result, 9M13 sales volume grew by 4.8% to 25,518GWh, roughly in line with our growth forecast of 4.7%. For 9M13, sales volume of the residential segment was the strongest growing by 5.6%, followed by the commercial segment which saw volume grow by 5.5%. The industrial segment was the weakest, as sales volume grew by only 3.1% y/y. Average tariff for the period rose 7.1% to Php1.65/kwh, exceeding our forecast of Php1.58/kwh. Distribution tariff exceeded forecast as the sales volume growth for 9M13 was skewed towards the residential and commercial segments which pay higher rates.
- Expenses exceeded forecast likely due to provisions.** Cost and expenses excluding pass-on purchased power cost amounted to Php26.4Bil, representing 82.7% of our full year forecast. We believe that expenses exceed forecast mainly due to higher than expected provisions made.

**Forecast Summary (PhpMil)**

Year to Dec. 31	2010	2011	2012	2013E	2014E
<b>Sales</b>	<b>38,161</b>	<b>48,315</b>	<b>50,923</b>	<b>53,655</b>	<b>55,803</b>
% change y/y	37.5	26.6	5.4	5.4	4.0
<b>EBIT</b>	<b>12,240</b>	<b>17,880</b>	<b>20,836</b>	<b>27,068</b>	<b>28,208</b>
% change y/y	46.0	46.1	16.5	29.9	4.2
EBIT Margin (%)	32.1	37.0	40.9	50.4	50.5
<b>EBITDA</b>	<b>18,459</b>	<b>23,384</b>	<b>26,412</b>	<b>33,206</b>	<b>34,725</b>
% change y/y	37.3	26.7	12.9	25.7	4.6
EBITDA Margin (%)	48.4	48.4	51.9	61.9	62.2
<b>Net Profits</b>	<b>9,685</b>	<b>13,227</b>	<b>17,016</b>	<b>19,409</b>	<b>21,189</b>
% change y/y	61.3	36.6	28.6	14.1	9.2
NPM (%)	25.4	27.4	33.4	36.2	38.0
<b>EPS (Php)</b>	<b>8.75</b>	<b>11.95</b>	<b>15.37</b>	<b>17.53</b>	<b>19.14</b>
% change y/y	61.3	36.6	28.6	14.1	9.2
<b>RELATIVE VALUE</b>					
P/E(X)	35.2	25.8	20.0	17.6	16.1
P/BV(X)	5.4	5.0	5.0	4.5	4.0
ROE(%)	15.3	19.3	25.1	25.7	25.2
Dividend yield (%)	1.8	3.1	3.0	3.4	3.7

\*Source: COL estimates

**SHARE DATA**

<b>Rating</b>	<b>HOLD</b>
<b>Ticker</b>	MER
<b>Fair Value (Php)</b>	276.00
<b>Current Price</b>	306.00
<b>Upside (%)</b>	-9.80

**SHARE PRICE MOVEMENT**

**ABSOLUTE PERFORMANCE**

	1M	3M	YTD
<b>MER</b>	6.99	6.77	17.42
<b>PSEI</b>	6.55	-0.63	13.50

**MARKET DATA**

<b>Market Cap</b>	344,892.22Mil
<b>Outstanding Shares</b>	1,127.00Mil
<b>52 Wk Range</b>	248.00 - 397.00
<b>3Mo Ave Daily T/O</b>	269.02Mil

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## 9M13 results miss forecast due to higher than expected expenses

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### Exhibit 1: MER 3Q13 Results Summary

<i>in PhpMil</i>	3Q12	3Q13	% Change	9M13	% of FY COL Forecast
<b>Net distribution revenues</b>	13,077	14,375	9.9	42,285	79.1
<b>Net Income</b>	3,894	4,203	7.9	13,644	N/A
<b>Core net income</b>	3,869	4,384	13.3	13,558	69.9

Source: Meralco and COL estimates

## Sales volume growth meets forecast due to strong residential segment growth

3Q13 sales volume grew by 6.4% to 8,720GWh. As a result, 9M13 sales volume grew by 4.8% to 25,518GWh, roughly in line with our growth forecast of 4.7%. For 9M13, sales volume of the residential segment was the strongest growing by 5.6%, followed by the commercial segment which saw volume grow by 5.5%. The industrial segment was the weakest, as sales volume grew by only 3.1% y/y. The strong growth of the residential segment was driven by higher temperature this year. Meanwhile, the strong performance of the commercial segment was driven by the steady growth in real estate and private services sectors.

Average tariff for the period rose 7.1% to Php1.65/kwh, exceeding our forecast of Php1.58/kwh. Distribution tariff exceeded forecast as the sales volume growth for 9M13 was skewed towards the residential and commercial segments which pay higher rates. While this had a favorable impact on revenues, the impact might not be sustainable as the ERC could adjust tariffs lower going forward to reflect the change in the sales mix. Meralco said that it has already made provisions to account for possible downward adjustments in tariffs for the future in light of the change in sales mix.

### Exhibit 2: Volume Mix

<i>in kWh</i>	9M12	9M13	%Change	3Q12	3Q13	%Change
Residential	7,361	7,775	5.6	2,405	2,601	8.1
Commercial	9,442	9,965	5.5	3,181	3,408	7.1
Industrial	7,546	7,778	3.1	2,613	2,711	3.8
<b>Total</b>	<b>24,349</b>	<b>25,518</b>	<b>4.8</b>	<b>8,199</b>	<b>8,720</b>	<b>6.4</b>

Source: MER

## Expenses exceeded forecast likely due to provisions

Cost and expenses excluding pass-on purchased power cost amounted to Php26.4Bil, representing 82.7% of our full year forecast. We will get more details on MER's operating costs when the F/S is released. However, we believe that expenses exceed forecast mainly due to higher than expected provisions made. Recall that in 1H13, provisions for probable charges rose by 32.2% y/y to Php5.2Bil. The provisions alone accounted for 31.2% of MER's total expenses excluding purchased power cost.

**Maintain HOLD rating with FV estimate of Php276/sh**

We have a HOLD rating on MER with a FV estimate of Php276/sh. Although near term earnings growth remains positive, we are concerned with the expected drop in earnings beginning in July 2015 once the lower tariff in the next regulatory period takes effect. Furthermore, the stock's valuation is not attractive as there is no potential upside to our fair value estimate of Php276/sh.

## Investment Rating Definitions

BUY	HOLD	SELL
<p>Stocks that have a <b>BUY</b> rating have attractive fundamentals and valuations, based on our analysis. We expect the share price to outperform the market in the next six to twelve months.</p>	<p>Stocks that have a <b>HOLD</b> rating have either 1.) attractive fundamentals but expensive valuations; 2.) attractive valuations but near term earnings outlook might be poor or vulnerable to numerous risks. Given the said factors, the share price of the stock may perform merely inline or underperform the market in the next six to twelve months.</p>	<p>We dislike both the valuations and fundamentals of stocks with a <b>SELL</b> rating. We expect the share price to underperform in the next six to twelve months.</p>

## Important Disclaimers

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