COL FINANCIAL PHILIPPINES
PHILIPPINE EQUITY RESEARCH
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Philippine Market Strategy

# Removing MWC, MER and MPI from our COLing the Shots Model Portfolio due to heightened regulatory risk

**Regulators looking to reduce allowable return to utility companies:**

During our meeting last week with MPI, we learned that regulators want to significantly reduce Maynilad's Appropriate Discount Rate (ADR) for the next regulatory period (from 2013 to 2017) to only 6.16% from 9.3% currently. The said rate is also much lower than Maynilad's proposed ADR of 8.94%. The significant drop in the ADR would lead to lower water rates and consequently hurt the profits of Maynilad.

Being in the same business as Maynilad, Manila Water (MWC) which is also undergoing ADR negotiations would also most likely suffer. Meanwhile, although Meralco (MER) is a power distribution company, the decline in Maynilad and Manila Water's ADR would also most likely hurt the company once it negotiates for power distribution rates in 2015 (for 2015 to 2019) since returns of power distributors are also regulated.

**Removing MWC, MER and MPI from our COLing the Shots Model Portfolio:**

Utility companies will most likely go into arbitration with the government to increase allowable returns since the rate being proposed by regulators is too low. However, it is still too early to determine the outcome of the arbitration. Moreover, allowable returns will most likely be below the 8.94% ADR being proposed by Maynilad and MWC. Given the prevailing regulatory uncertainty, investor sentiment for utility companies will most likely be negatively affected leading to underperformance of utility stocks.

Due to the heightened regulatory risk, we are removing MWC, MER and MPI from our "COLing the Shots Model Portfolio." Although MPI is not a utility company, it owns 48% of MER and 52.8% of Maynilad. As a result, it will also be affect by the significant decline in allowable returns.

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## Investment Rating Definitions

| BUY | HOLD | SELL |
|---|---|---|
| Stocks that have a **BUY** 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. | Stocks that have a **HOLD** 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. | We dislike both the valuations and fundamentals of stocks with a **SELL** rating. We expect the share price to underperform in the next six to twelve months. |

## Important Disclaimers



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