

PLDT buys into Meralco

**TEL****PLTL****FPH****MER**

PLDT (TEL) is set to acquire 223 million common share of Meralco (MER) from the Lopez Group. The acquisition will be coursed through its subsidiary, Piltel (PLTL), for certain reasons. In return for the shares, the Lopez Group, through First Philippine Holdings (FPH), will get cash considerations of P20.07 billion, which is equivalent to P90.00 per share. The closing date of the transaction will be no later than August 31, 2009. Other conditions of the deal include the right of first refusal and certain governance matters.

As part of the deal, an Exchangeable note worth P2 billion will be purchased from First Philippine Utilities Corporation by Piltel. The note comes with an option to be converted into 22.22 million shares of MER, which will form part of the 20% that the PLDT group is acquiring. Although the transaction is still subject to shareholder approval, it should merely be a formality. The PLDT group has also stated that it will cap its investment in MER at 20%. The PLDT Beneficial Trust Fund currently owns 10.17% of Meralco.

Piltel was used for the transaction because of its articles of incorporation, which allows it to invest in businesses other than telecommunications, and the significant amount of cash it has. Piltel will sell its subscribers and GSM assets to Smart and will receive a royalty fee for the usage of the Talk N Text brand. After the transaction, Piltel's sole asset will be the shares in Meralco. Minority shareholders in Piltel will be given a tender offer as a means of exiting should one disagree with the direction Piltel is headed towards.

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This deal has significant impacts on the companies involved, particularly TEL, MER, FPH, and PLTL. PLDT will be entering a new sector that differs from the one that it dominates. The Lopezes are letting go of a large stake in an asset that it has long protected. Meanwhile, Piltel will drastically change from an operating company to a holding one. The ownership structure of MER is getting crowded and more developments are expected soon. The relevant effects of this transaction to the different companies are discussed below in detail.

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Philippine Long Distance Telephone Company (TEL)

Share prices plunged by P250.00 or 11.66% to P1,895.00 on the first day of trading after the announcement was made. Most probable reasons are the huge premium paid over the book value of MER shares and concern over the entry into a field outside the area of expertise (telecommunications). The premium will be booked as both intangible assets, which are amortized over the relevant life, and goodwill, which is tested for impairment at regular intervals.

Despite being a side effect of the acquisition of a 20% stake in MER, the consolidation of PLDT's mobile business under Smart will reap benefits for the company. Aside from streaming all revenues to a single entity, the consolidation offers both operational and regulatory efficiency. There will no longer be any concerns over how traffic between Smart and Talk N Text subscribers are treated. While the one time payment for the acquisition of Talk N Text subscribers and the GSM assets of Piltel will negatively affect this year's bottom line, the transfer should boost earnings in the long run since Piltel is only 92.81% owned while Smart is 100% owned.

Other potential sources of long term benefits are the identified synergies that PLDT believes it has with MER. Among the synergies are fiber optic backbone, electric power poles, radio frequencies, bill statement printing and enveloping, ICT/Data center, and others. These synergies, should they be realized, can possibly give huge benefits in the long run, not only to PLDT but also to MER. While no one synergy will provide a big boost, the collective effect will be recognizable.

Perhaps the most intriguing synergy between MER and TEL is the possibility of offering broadband internet through Meralco's existing power lines. San Miguel broached the idea that MER can boost its revenues by offering broadband over power lines. Now, TEL is in a better position to make such a project come through. There are, however, uncertainties with regard to its viability. An official of the NTC (National Telecommunications Commission) has stated that the time for broadband over powerline is not now but still sometime in the future. Nevertheless, the possibility of offering a coveted service through existing infrastructure may come in handy as the telecommunications industry moves towards expanding internet services.

Even with concerns over the deal between PLDT and the Lopezes, it is hard to justify a fall in TEL prices of P250.00. The drop to P1,895 wiped out almost P47 billion in market capitalization, much more than the P20 billion PLDT is spending for the transaction. Given the data and details that have been disclosed concerning the deal, the sell off has been overdone. This drop in TEL presents an opportunity to buy shares of the company at an attractive price.

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Pilipino Telephone Corporation (PLTL)

Share prices surged on the first day of trading after the announcement was made. PLTL rose to P8.00, a gain of P0.60 or 8.11%. The strong demand in PLTL is in anticipation of the tender offer that will be made after April.

Piltel will cease to be a player in the mobile business as it is selling its subscribers and GSM assets to Smart. Although Piltel will receive royalty fees based on a percentage of net service revenues, it will become a holding company with the 20% stake in Meralco as its primary asset. What will happen to Piltel in the long run is still unknown. PLDT can use it as a holding company for further acquisitions in the power sector or for other purposes. The tender offer scheduled for after April will only serve to decrease the already minimal freefloat.

Shareholders of Piltel would do well to hold on to the stock and await the tender offer. It can reasonably be expected that the tender offer would be priced in such a way that would entice the shareholders to part with their stock.

First Philippine Holdings (FPH)

The Lopez clan has been known for its decades-long control of Meralco, a known power utility company in the Metro. Despite efforts to remain mum on the latest developments, talks of a coming deal between the clan and Pangilinan's PLDT created much buzz in the market last week. The week ended with an announcement of a final sale of a 20% stake in Meralco to one of PLDT's units. This left the Lopezes, through First Philippine Holdings (FPH), with 13.39% ownership in the power distributing company. Mixed reactions came from all sides in the business community. Some remained positive and considered this as a good move not just for Meralco but for the Lopezes as well. This will likely shield the clan from more tension and bitter disputes with other reputable companies.

It may have seemed that the Lopezes lost one of their prized companies. But a closer look reveals a deal that is very much in favor of the family. With its struggles in its debts for the past months, such sale allows the Lopez Group to have enough cash to pay its maturing debts. Eventually, the risk involved in the Group and its units' cash position would be covered by the sale of a large part of their stake to Pangilinan's Piltel. In the said transaction, FPH will be getting a total of P20 billion, at P90 per share, for the 20% stake in Meralco. Payment is due on or before August 30 of this year.

Looking at it in a long term perspective, the sale allows the firm to somehow stabilize its cash position as it settles debts in the parent and in the units as well. The fresh flow of cash to the company would also address the risks and worries in the financial condition and liquidity of FPH. In view of this development, holding on to the the shares would be a wise move as of now since the sale will definitely benefit the company and its shareholders in the long term.

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Manila Electric Company – Meralco (MER)

The much-contested company has been eyed by a few conglomerates in the country for the past months. Upon the entry of San Miguel Corporation, several angles and stories rose on how the transaction came about. Though the fire was not yet completely doused, the entry of Manny Pangilinan's PLDT created another uproar in the market. After several deals and transactions with the known firms, Meralco ended with quite a diverse ownership structure. The sale of the Lopezes' 20% stake out of their 33.4% ownership in Meralco to Pangilinan's Piltel left the former with only a 13.4% share in the power utility. While 20% goes to Piltel, another 10.17% goes to PLDT's Beneficial Trust Fund whose acquisition through the open market resulted to a sharp rise in Meralco's price to as much as P127 per share. San Miguel Corporation on the other hand, owns about 27% of the utility while 29.44% is left to the public.

Though recent developments created much hype in the industry, the entry of various firms and the sale of shares were seen to benefit the parent company the most. The funds acquired through the sales will allow FPH to augment and boost its current cash position. Meanwhile, with such diversity in Meralco's Board, it is believed that the resources and skills of the new management will be used thoroughly in the ongoing operations of Meralco. With the PBR rates still pending for ERC's approval, the new management may be a strong pool that will push for an immediate approval of the rates.

The entry of two reputable companies in Meralco creates an air of worry and anticipation in the market. Though politics have long been thrown aside, the direction the power company will take remains unknown given such strong and opposing industries aboard the ship. With certain areas still unclear, shares of the power company may be kept as the new management delivers their plans in due time.