

Manila Water Company

BUY

Continuous Flow

Price (as of September 9)	17.25
Target Price	20.50
Shares Free Float (B)	1.46
Shares Outstanding (B)	2.0
Market Cap (Pb)	34.59
52 week High	19.25
52 week Low	13.50

Manila Water is a company partly owned by the Ayala Group which delivers potable water and wastewater services in several areas in Metro Manila. The company covers the East Zone for a total land area of 1,400 square kilometers. It currently serves 5.6 million people.

Highlights



* **LOWER NRW.** Non-Revenue Water (NRW) of MWC has declined to 20.2% for the first half of 2008 from 63% in 2007. This is attributable to better water supply management and more projects focused on pipe replacements. The target NRW level was set by the MWSS at 25%.

* **REACHING OUT.** Through the company's "Water for the Poor" program, more than a million customers had access to clean and affordable water. In reaching far-flung areas, low income communities benefited from the said program of the company.

* **BETTER ACCESS.** 99% of customers have 24-hour access to water.

* **WASTEWATER TREATMENT.** MWC has provided better wastewater coverage with the completion of septage treatment plants and with more investments on desludging trucks last year.

* **SUSTAINED DIVIDENDS.** The company's annual dividend has been steadily increasing since 2003. Last year, it paid out 35% of its net income as dividends.

* **RISK-MANAGEMENT.** Rate rebasing mechanism has provided the necessary adjustments depending upon the risks involved in the operations.

* **FUND MANAGEMENT.** Sufficient access to various financing means with plans of raising debt to equity share of 60% and 40%. More than half of loans acquired have fixed rates.

* **EXPANSION OPPORTUNITIES.** Proposed projects in Boracay, Ho Chi Minh City, and India.

* **GOING GREEN.** Environmental initiatives such as Grey Water Reuse and Waste-to-Energy projects.

* Market price as of September 9 was at P17.25, an 18.8% discount to the fair value of P20.50

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Manila Water Company (MWC)

BUY

Risks

* Inflation for 2008 jumped to 17-year high figures. The soar in prices of materials in the past months may have affected the expenses and earnings of the company this year. Though prices have already gone down, its effect may only be felt next year.

* Consumer spending may have tightened these past months to make way for other expenses. Though water consumption is least likely to decrease, billed volume may only have minimal growth.

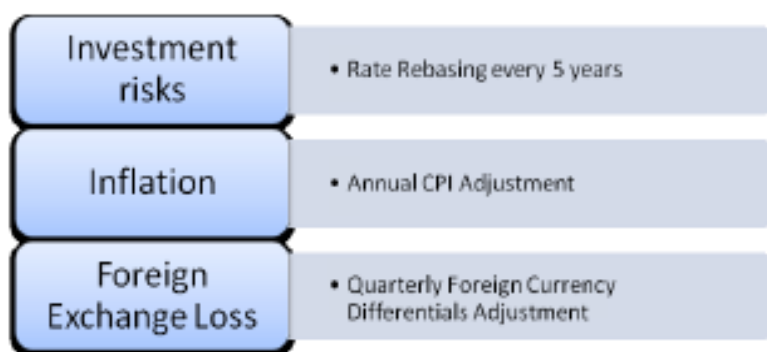
* With the early rainy season resulting to more muddy water, expenses on water treatment chemicals may significantly increase.

* Raising funds through equity may somewhat be difficult given market conditions. Better access to debt funding must be employed.

Protection from Risks

MWC is significantly protected from risks due to the Rate Rebasing Process implemented through the Concession Agreement. In this method, tariffs are adjusted according to the risks in the operations of the company. Last December 2007, MWSS approved a one time tariff adjustment of 75.07% which will then be added over the basic tariff. Since rate rebasing is applied every five years, the said adjustment will be spread out over the five-year period to cushion its impact on the consumers.

The increase in rates also accounts for inflation. A CPI adjustment is applied yearly in consideration to the general increase in prices. The company also makes use of foreign currency adjustment to shield itself from currency volatility and to recover possible losses. The adjustment in the foreign currency is done quarterly.



Manila Water Company (MWC)**BUY****Getting Ahead**

The utility company sees itself expanding its water supply service in the East Zone. Currently serving more than 5 million people, it seeks to increase its service to reach another one million people.

Having achieved a 12% increase in wastewater services, MWC expects to expand up to 30% by the end of five years. In the near future, it targets reaching more than 60% of the East Zone. MWC will be investing in more projects to support its growth as it widens its scope on its water and sewerage services.

Assumptions for the Model

For this model, we assumed that operations will cease upon the end of its concession period, which is on 2022. Depreciation of investments on plant and other equipment are expected to increase every year after 2008 until 2022. The increase in the company's asset base as it continues to invest in its operations contributes in the increase in depreciation value.

The tariff hike for both 2008 and 2009 include the adjustment for inflation. The succeeding values did not account for inflation risks yet. As such, values for the next three years may be different upon including the inflation adjustment for the said period.

Year	Tariff
2008	19% (with inflation)
2009	23% (with 9% average inflation)
2010	12.00%
2011	10.00%
2012	10.00%

The billed volume is expected to increase 5%-6% every year for the next five years.

Modest Growth

The company is expected to have a modest growth this year considering the impacts of high inflation figures. This may have a lag effect only until the early months of 2009. With the start of another five-year period this 2008, a conservative growth can be seen for the company. Investments are expected to pour in, financed mainly through debt. There are plans to raise its debt to equity ratio to 60% and 40% respectively from current values.

Using a WACC of 8.99%, the target price for MWC is P20.50 per share which is 18.8% premium. Its growth for 2009 is expected to double as the company continues to expand in the East Zone with opportunities for growth and expansion in Boracay, Vietnam, and India.

The computed P/E ratio for 2008 is 14x. As for 2009, we are seeing a P/E level of 10x.

The targeted billed volume growth of 5% is also close to being achieved in the next few years.

With these considerations, we rate Manila Water Company a "Buy".

Manila Water Company (MWC)**BUY****Company Description**

One of the largest conglomerates in the Philippines, the Ayala Group owns about 31.7% of Manila Water. Meanwhile a UK-based multi-utility company, United Utilities, holds 11.7% of MWC. There are two other companies which have their respective stakes in the company. Mitsubishi Corporation has a 7% stake while International Finance Corporation (IFC) has 6.8%. The remaining 42.8% is owned by the public.

Concession Agreement

The concession agreement covers a 25-year period from August 1, 1997 to May 6, 2022. It states that Metropolitan Waterworks and Sewerage System (MWSS) would act as the contractor to monitor and evaluate the performance of both East and West Concessionaires. The agreement allows the company, in this case MWC, to continue its operations in the East Zone, and to repair and restore assets for water delivery and sewerage services in the said area.

The agreement includes a Rate Rebasing Process wherein tariffs are adjusted at a specified period to address the risks involved in the company's operations. However certain conditions must be met for the company to apply the tariff hikes. One is that Non-Revenue Water must be reduced to 25%. The agreement also covers the reimbursement of costs and a guaranteed return on the company. For the next five years, the guaranteed return is at 9.3%.

Though the concession period lasts only until 2022, MWC is optimistic that it will renew the contract and extend the said agreement.