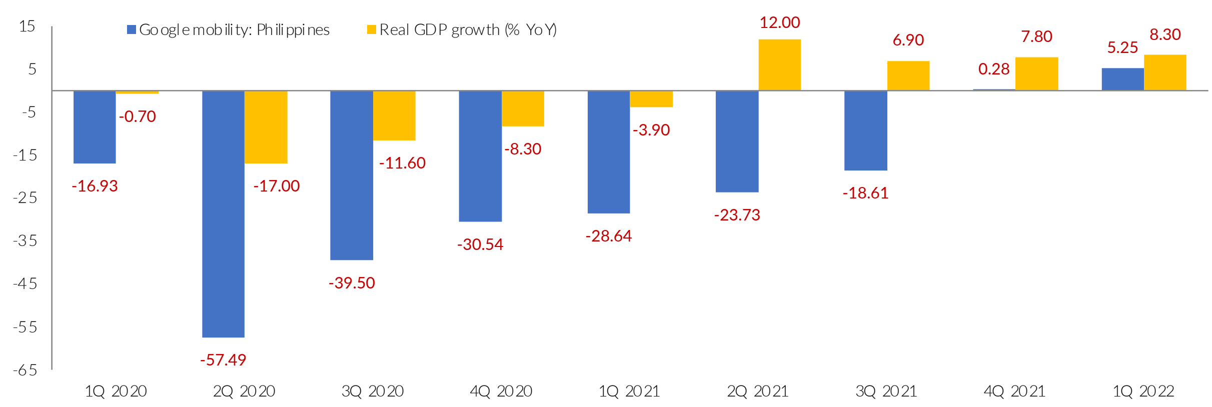
Philippines

MACRO

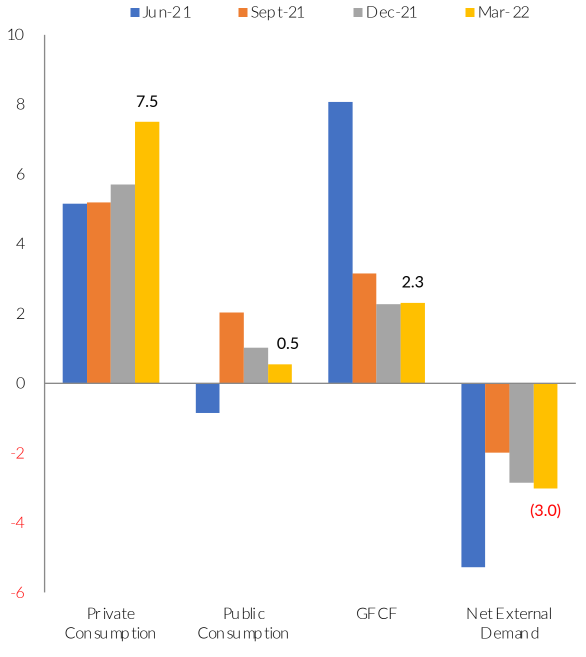
Mobility and real GDP growth



Source: Google LLC, CEIC

Movement restrictions due to lockdown measures by the authorities to curb the pandemic have been a drag on recovery during past quarters. Mobility is improving, translating into decelerating contractions in quarterly GDP culminating in the rebound that began in 2Q21. Progress in economic openings has helped to sustain the recovery momentum and resulted in the unemployment rate dropping to the pandemic-era low of 5.8% in March 2022, as well as reviving the services industry with +8.6% YoY growth in 1Q22 (4Q21: +8.0% YoY). We expect mobility to improve further as the number of new cases had started to show a significant drop from the recent peak in mid-January 2022, hence contributing to firmer economic growth this year at +6.5% vs. +5.7% in 2021.

Demand aggregates' contributions to real GDP growth (ppt) – rising private consumption

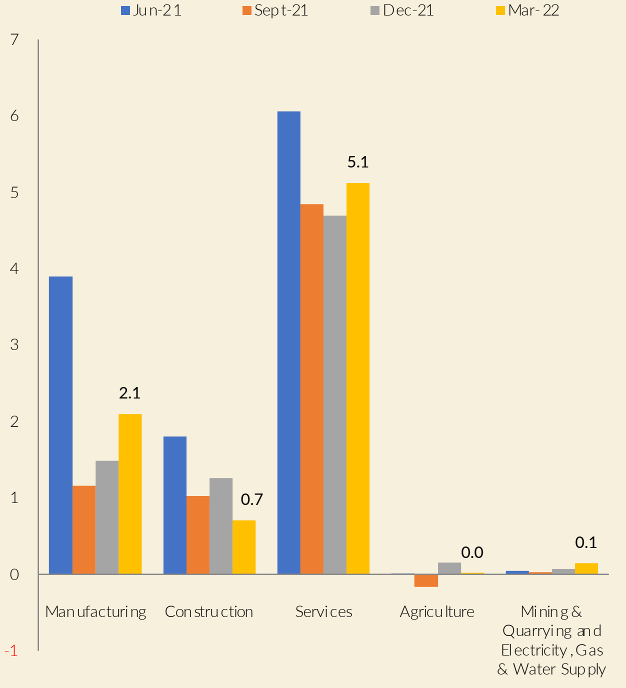


Source: PSA, CEIC

Domestic demand growth expanded by a faster +10.3% YoY in 1Q22 (4Q21: +9.8% YoY, revised from +9.4% YoY) on the pickup in both private consumption (1Q22: +10.1% YoY; 4Q21: +7.5 YoY) and gross fixed capital formation growth (1Q22: +11.0% YoY; 4Q21: +10.8% YoY, revised from +9.5% YoY) to offset the moderation in government consumption (1Q22: +3.6% YoY; 4Q21: +7.8% YoY;, revised from +7.4% YoY) due to the spending ban at the end of 1Q22 head of the election on 9 May 2022. On seasonally adjusted QoQ basis, GDP expanded +1.9% (4Q21: +3.5%, revised from +3.1%).

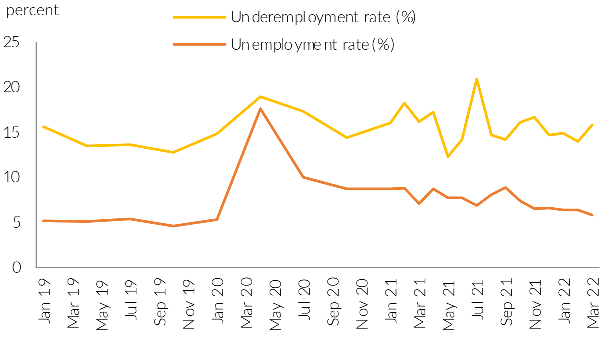
Economic sectors' contributions to real GDP growth (percentage points)

Services sector growth gained momentum (1Q22: +8.6% YoY; 4Q21: +8.0% YoY, revised from +7.9% YoY) amid steady recovery in "transportation & storage" and "accommodation & food services". With 61% share of GDP and the largest employer in the country (1Q22: 55.9% of total employment), recovery in the services sector will help to sustain economic growth.



Source: PSA, CEIC

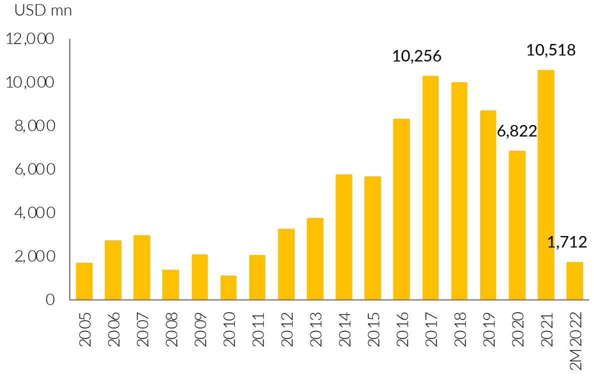
Sustained improvement in monthly unemployment rate is positive to private consumption



Source: PSA, CEIC

The unemployment rate fell to 5.8% in March 2022 (February 2022: 6.4%; 3M2022: 6.2%), the lowest since the start of the pandemic. Labour force participation rate rose to 65.4% (February 2022: 63.8%) with a total of 1.50m jobs created during the month, mainly in agriculture and services. But underemployment rate was higher (March 2022: 15.8%; February 2022: 14.0%). Revised our 2022 unemployment rate forecast to 6.0% from 6.3% previously (2021: 7.8%).

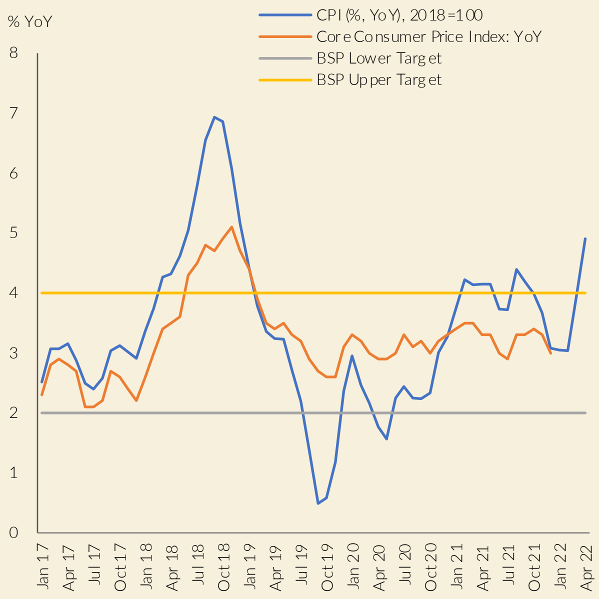
Record high net FDI in 2021 – reaping rewards of legislative reforms



Source: BSP, CEIC

We expect a series of legislative reforms (Financial Institutions Strategic Transfer (FIST), Corporate Recovery and Tax Incentives for Enterprises (CREATE), Retail Trade Liberalisation Act (RTL), Foreign Investment Act (FIA) and Public Service Act (PSA) to boost Philippines' long-term economic competitiveness and attractiveness to investors and spur private investment – including foreign direct investment (FDI) – which posted a record high of USD10.5b net FDI In 2021.

Headline inflation in Apr 2022 exceeded BSP's upper end target



Source: PSA, CEIC

Headline inflation rate accelerated to +4.9% YoY in April 2022 (March 2022: +4.0% YoY; 4M2022: +3.7% YoY), well above the upper end of BSP's target range of 2%-4%, mainly on higher FNAB, HWEGOF and transport costs. The risk to inflation outlook continues to lean to the upside as the biggest impact of the Russia-Ukraine conflict is the elevated global commodity prices, including crude oil (Brent) price which surged to well over USD100/bbl as well as food commodity prices such as grains (wheat, barley, maize) and vegetable oils (e.g. palm oil and sunflower oil). At the same time, easing of mobility restrictions leads to recovery in the domestic economy, which could add further inflationary pressure. We expect 2022 and 2023 headline inflation rate of +4.6% and +3.3% respectively (2021: +3.9%). BSP has responded to inflation with a 25bps hike in its policy rate to 2.25% on 19 May 2022, and we see further 25bps hikes in 3Q22 and 4Q22.

CONGLOMERATES

Stock performance is most correlated to NAV accretion

Unlike in other more developed economies, where conglomerates behave like private equities firms and position as strong yield plays, Philippine conglomerates act as incubators for new businesses in typically underserved, underdeveloped and unsupported sectors. This is the reason why Philippine conglomerates are always in cash conservation mode and have fixed dividend payouts and why this sector is best played by aligning with its sponsor's growth, which is most reflected the growth of its NAV.

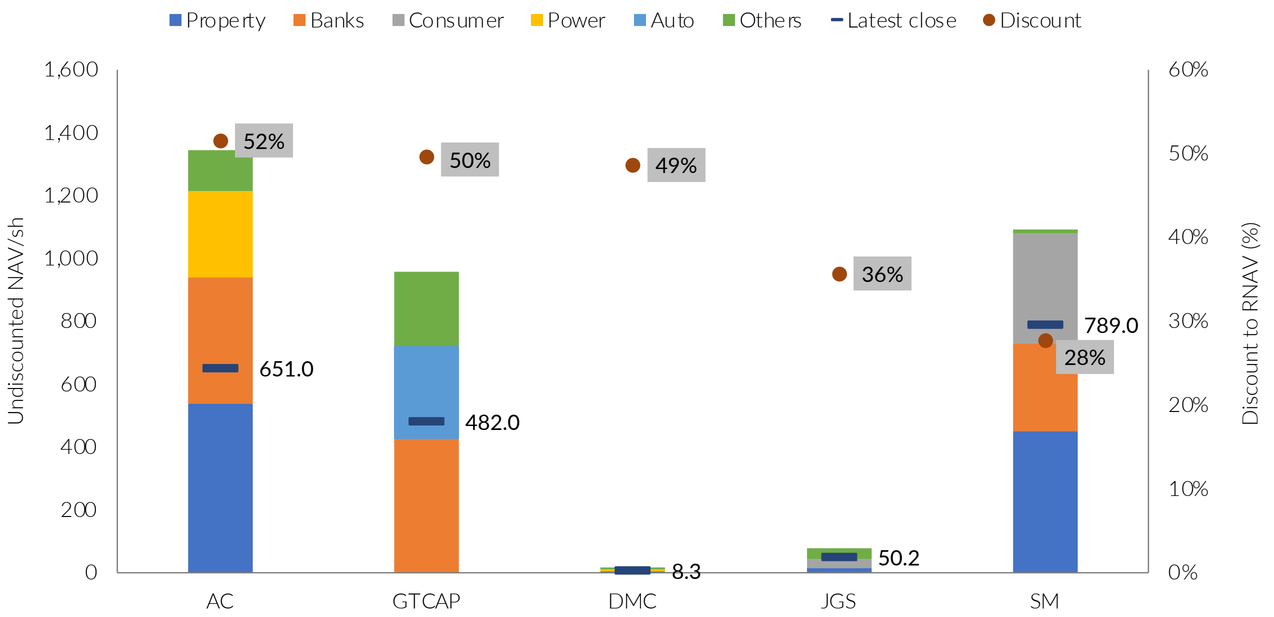
Some winners are positioned to win "better"

The reopening theme of FY22E should bode well for all conglomerates and should translate to NAV accretion. However, the magnitude of this NAV growth will largely depend on the conglomerate's sector key exposures and its own portfolio management strategy. We prefer groups that complement the expected macro-driven external uplift with opportunistic M&As and/or divestments, which would likely extend their NAV growth momentum well beyond the FY22 recovery year.

AC & SM are our top picks

In 2021, AC launched its value realization program, where it aims to divest out of its less profitable and non-core assets by YE23E and reinvest proceeds to its core subsidiaries and emerging healthcare and logistics businesses. This portfolio management strategy provides a boost to the group's property- and banking-led recovery trajectory. SM, on the other hand is our preferred reopening play. As the holder of country's consumption catch-basin, through the country's largest retailer, mall operator and bank, SM will be the first and biggest beneficiary of any and all macroeconomic improvement in the country.

NAV composition of Philippine conglomerates



Source: Maybank IBG Research, Bloomberg

BANKS

Sustained lending recovery

Philippine banks continued to post strong loan growth momentum in 4Q21 and 1Q22, since recording their first, post-pandemic loan growth in 3Q21 and is well positioned to post higher lending growths of 8-12% by YE22E (excluding UBP's +24% YoY FY22E lending growth, which is attributable to its acquisition of Citi's retail assets in the Philippines). We expect the rebound will be corporate-led (c.54-78% of total loan book) as the sustained economic reopening trajectory translates to higher working capital requirements and capex deployments.

Asset yield expansion

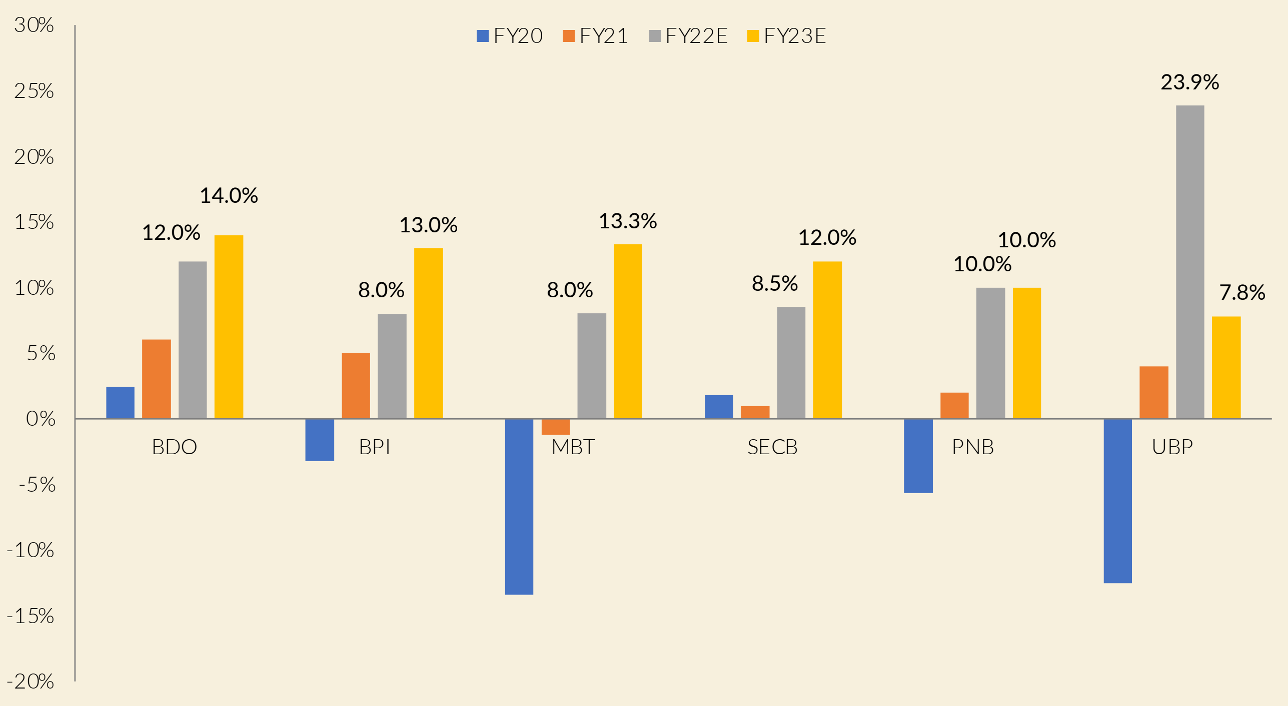
Bank's low funding costs from the significant rise in CA/SA deposits in FY20/21A (+15.8%/+16.7% YoY) will be further improved by a rising rate environment as banks are able to pass on higher rates to their floating rate corporate lenders, which, on average, account for 70% of their corporate loan books.

Maybank IBG forecasts policy rates to increase by +75bps in FY22E – one in June, one in 3Q22 and another in 4Q22. Our earnings sensitivity analysis shows that BDO will benefit most from this given that it has the highest proportion of CA/SA among the banks under our coverage, at 86.0% of total deposits. UBP and SECB, which have CA/SA to total deposits ratio of 60.0% and 62.5%, respectively, will be the least impacted.

BDO is our top pick

Aside from benefitting the most from the anticipated rise in policy rates, BDO is also best positioned to capture the upswing in loan demand given its size, lending appetite, access to the SM group's expansive network of clientele, and its dual digital and physical branch expansion strategy. PNB is our least preferred stock in the banking sector given its continually elevated NPL ratios and lack of visible catalysts, past the property dividend declaration last May 2021.

Lending Growth



Source: Maybank IBG Research, Company disclosures

PROPERTY / REITs

Malls continue to be a drag

Despite the sustained economic re-opening trajectory since 2H21, the 1Q22 results of Philippine property companies showed uneven, protracted recovery among the various segments. The residential segment is approaching c. 50-70% of pre-pandemic levels in terms of both sales reservations and recognized revenues. Office revenues did not contract amid the pandemic. Revenues from malls and hotels, however, continue to lag at less than half of FY19A levels. To illustrate, private consumption grew 10.1% YoY in 1Q22 but mall revenues have yet to return to pre-pandemic levels. Within our coverage, SMPH has the highest exposure to malls, at 54% of total revenues in FY19A, while MEG has the least, at 9% of pre-pandemic revenues.

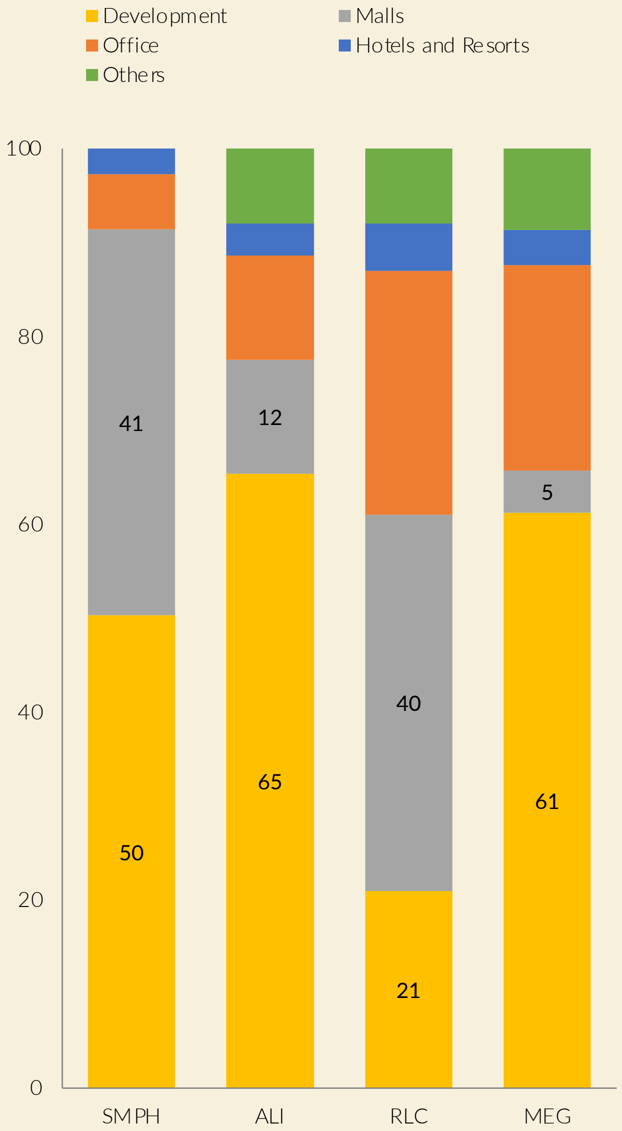
Reiterate preference for developers over landlords

The recovery of the residential segment, particularly for the upscale to the luxury segment, is underpinned by pent-up demand, which we view as a secular trend. The performance of malls, on the other hand, is heavily influenced by macroeconomic factors (such as mobility, growth in domestic consumption, inflation and employment), which currently limit the ability of mall operators to re-escalate rents back to pre-pandemic levels. Further, we believe residential development is less susceptible to geopolitically-driven, oil-based inflationary pressures than mall leasing given more resilient spending power for higher-income brackets and locked-in rates for construction contracts.

Pair trade: Buy ALI, sell SMPH

We recommend buying ALI while selling SMPH. This pair trade is consistent with our investment thesis for the sector. Valuations also reinforce our call. SMPH's current price implies a 3.0x P/BV and a 24% discount to RNAV, in line with 10Y averages (10Y ave. P/BV: 3.3x; 10Y ave. discount: 23%). On the other hand, ALI's current price implies a 1.8x P/BV and a 59% discount to RNAV, a steep discount to 10Y averages (10Y ave. P/BV: 3.8x; 10Y ave. discount: 32%).

1Q22 revenue mix (%)



Source: Maybank IBG Research, Company disclosures

TELCOMMUNICATIONS

Growth is broadband driven

The pandemic-induced mobility restrictions have led to an exponential increase in demand for fast and reliable home broadband service, which translated to the +16.5%/+20.4%, +23.2%/+9.7% and +98.7%/+83.1% YoY growth in the FY20/21A broadband revenues of TEL, GLO, and CNVRG, respectively. In terms of broadband subscriber growth, CNVRG outperformed TEL and GLO in FY20/21A, with total broadband subscribers growing by +96.0%/+62.9% YoY. CNVRG uses micro trenching technology, which deploys cables at <2 feet depths (vs. 1-2m using the old method), cutting the installation time for CNVRG's fast fibre ports and last-mile fibre lines. Given the country's low broadband penetration rates (FY21A: c.20%) and hybrid work- and learn-from-home setup, we expect TEL, GLO and CNVRG to continue their aggressive fibre expansion plans, which will largely drive revenue growth for the next 2-3 years. As such, we expect the Capex for TEL, GLO and CNVRG to remain elevated Capex in FY22 as they spend more on network upgrades to improve network speed and reliability, and fibre expansion.

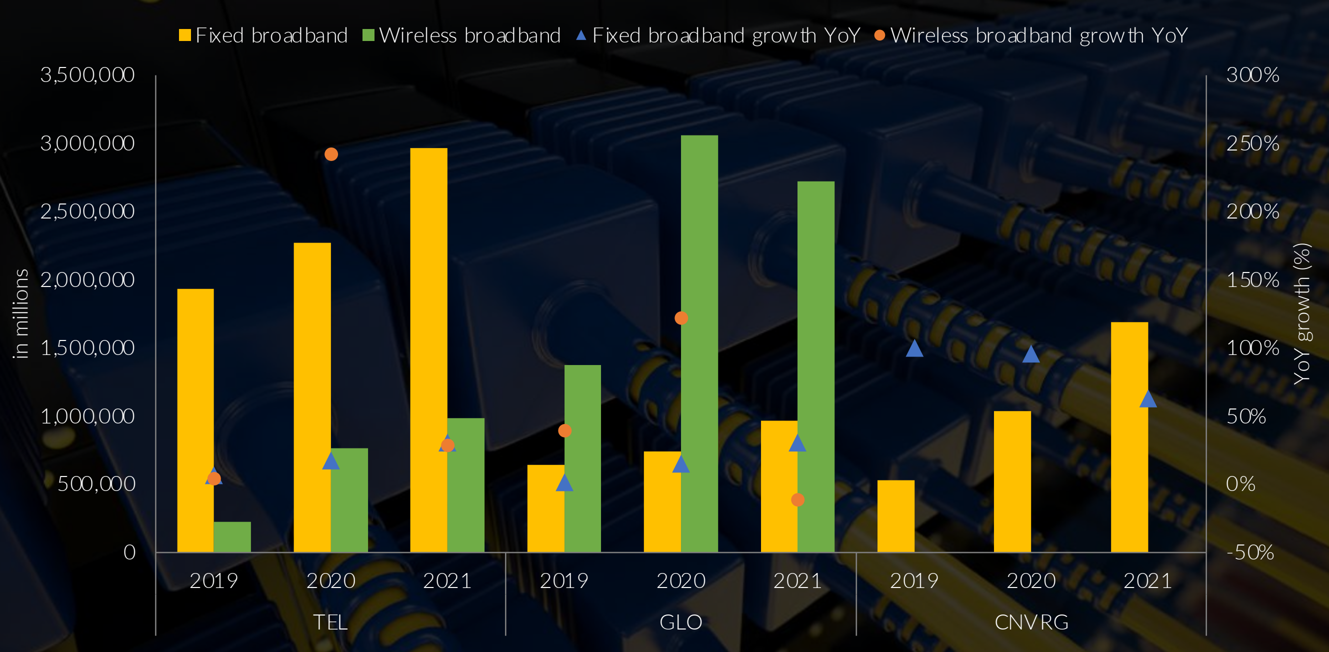
Increased mobility to spur the recovery of the mobile data segment

Mobile data revenue growth expectedly lagged in FY20/21A but the increased mobility should accelerate mobile revenue growth to +6-8% YoY in FY22E. Growth will be usage-driven as we expect only a slight +2-3% YoY uptick in mobile ARPUs, coming from mobile data top-ups. The flattish ARPU outlook is also a result of China Telecoms-backed DITO's aggressive data pricing. DITO, which launched in March 2021, now has over 7m subscribers or c.3% of the country's total mobile customers.

TEL is our top pick

We are generally positive on the sector given growth opportunities in the broadband space, but we prefer TEL over GLO and CNVRGE given its market leadership in fibre and enterprise, as well as in data centers, and relatively low exposure to the wireless mobile segment (53% of FY21A revenues vs GLO's 69%). Although we do not expect disruptions in the wireless business to be significant in the next 1-2 years, pricing pressures in the wireless mobile segment could still create a drag to earnings.

Fixed and Wireless broadband subscribers



Source: Company disclosures

TRANSPORT

Geopolitical tensions could be a drag on global trade volume recovery

Considering the base effects of the pandemic and the addition of the Port of Nigeria into ICT's portfolio, ICT's +9.5% YoY volume growth in FY21 was the highest growth ICT has posted in the past 5 years. However, the trade disruptions caused by the Russia-Ukraine war and the lockdowns in various parts of China will likely decelerate volume growth in FY22E to 3.5% YoY. This translates to revenue growth of +6.2% YoY, also a deceleration from FY21's +23.9% YoY. Even so, with the 8% tariff hike in the Manila port being effective on 15 May 2022, as well as higher yields in Mexico, Papua New Guinea and Melbourne from tariff adjustments and higher ancillary fees, there could be a potential upside to our forecast, which could mitigate the threat on volume growth.

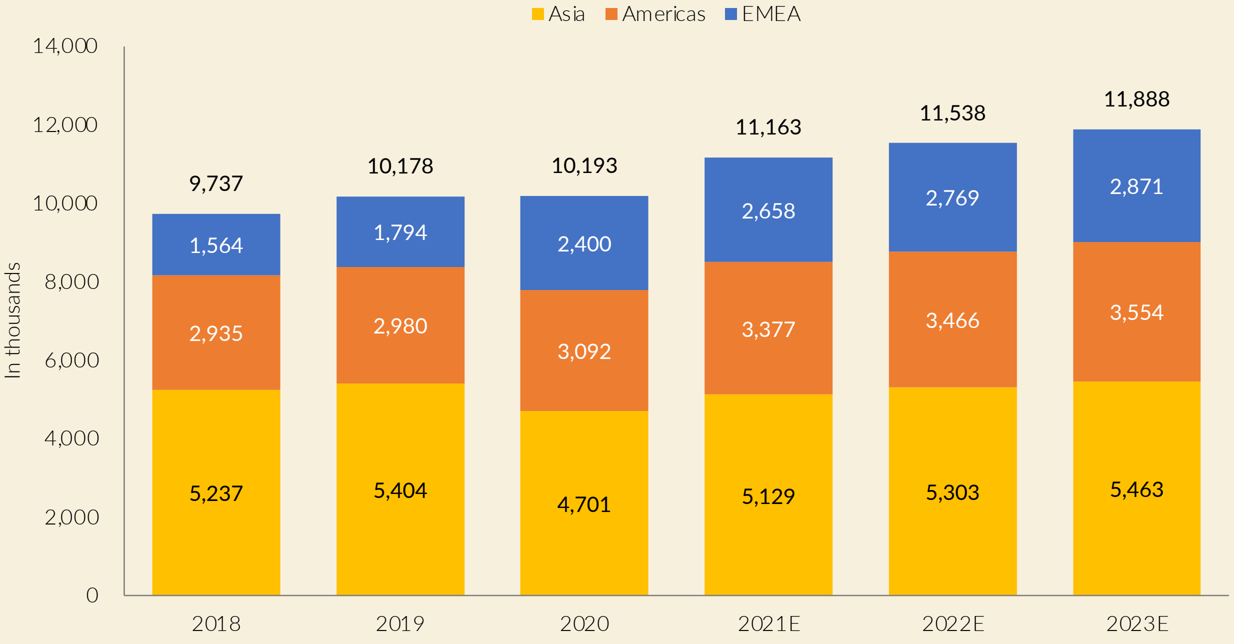
Potential boost from M&As

ICT is on the constant lookout for M&A opportunities and is currently negotiating with several ports in west and east Africa, Indonesia and India. Our FY22/23E forecasts factor in only the Indonesia port acquisition so any addition to ICT's port portfolio should be positive. Nevertheless, we expect these acquisitions to take time to be completed, given the varying lockdown situations across the globe and supply chain concerns.

We have a HOLD call on ICT

Our DCF-based TP of PHP224 implies 9.4x FY22E EV/EBITDA, 0.9SD above the 5Y mean, which we believe is justified given ICT's strong growth and continuous expansion efforts. However, with the stock's strong performance YTD capping the upside to our TP, coupled with risks to trade volumes due to geopolitical tensions and the lockdowns in China, we have a HOLD recommendation on ICT. ICT's long-term growth story remains attractive, and we believe it will continue to see volume and yield growth as economic tensions ease over the long term. There could be further upside on sustained higher yields and stronger-than-expected volume recovery, as seen in 1Q22.

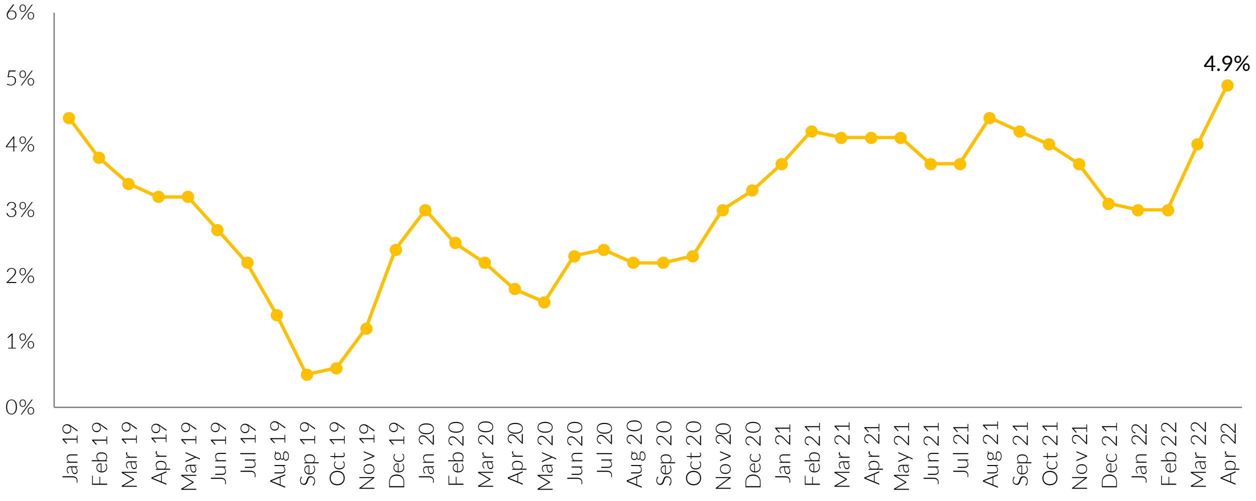
Segment volume growth



Source: Maybank IBG Research, Company disclosures

CONSUMER

Philippine Inflation Rate



Source: Philippine Statistical Authority

Supply-driven raw material price risk is a major headwind

The onset of the Russia-Ukraine war in late February 2022, along with the ban of Indonesian palm oil exports last April 2022, has caused the prices of key imported commodity items such as wheat, palm oil and crude oil to surge by 30-60% YTD. Despite implementing selling price adjustments, local consumer companies, which are catering to the broad C and D markets, are not able to pass this magnitude of input price surge on, causing gross profit margins to decline by 40-420 bps in 1Q22. Among the consumer companies under coverage, MONDE is most impacted (GPM decline of 420bps as of 1Q22) as c.40-45% of its raw materials are wheat and palm oil.

Downside risks trumps catalysts

The recovery of mobility within grocery and retail stores to pre-pandemic levels is offset by the inflation-driven contraction in basket sizes such that we expect FY22E earnings to contract by 4-21.6% YoY. Further, we also expect the inflationary environment to continue to protract dampening the recovery prospects for discretionary-driven name segments. Manageable inflation risk and improving employment figures, coupled with a declining trend in raw material input prices in 2H22, should be drivers of an inflection point in our view of the sector.

DNL is our top pick

Companies with pricing power offering products with inelastic demand should fare well in a cost-volatile environment. DNL is our top pick in the sector as its market leadership and R&D-based economic moat ensure that: i) DNL maintains pricing power; ii) its customers are sticky and price-insensitive; and iii) barriers to entry in its sector are kept high. We remain positive about DNL's two-pronged strategy to grow its high-margin specialty segment and its export business in the medium term. DNL currently trades at 17.6x FY22 PER, still below its 5-year mean PER of 22.1x.

POWER / UTILITIES

The Philippines' renewable energy (RE) targets are government-led

Amid the tightening Philippine power supply situation and rising calls to address climate change, the Department of Energy, in its Philippine Energy Plan 2020-40, remains intent on lifting the country's RE generation mix from 21% as of December 2020, to 35% by YE30E, 50% by YE40E. ACEN and AP have the most aggressive RE targets, aiming to add 5GW and 3.7GW RE capacities by YE25E and YE30E, respectively. Between the two, ACEN is further along, as it has achieved 65% of its target as of 1Q22A.

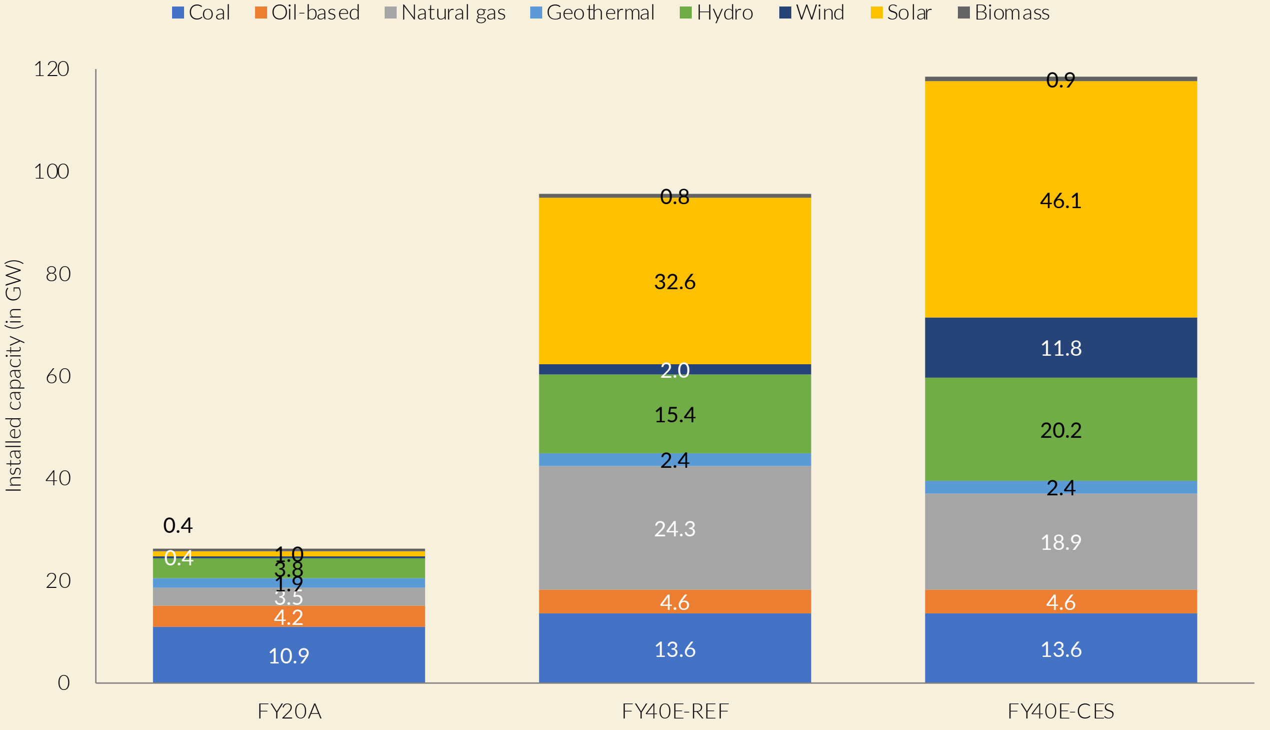
Banking on portfolio effect to bankroll aggressive RE pipeline in the absence of domestic feed-in-tariff (FIT) regimes

To fund their aggressive RE expansion, power generators are establishing baseline cashflows by: i) investing in offshore RE markets with viable FIT regimes; and/or ii) retaining thermal baseload power plants. This strategy will expose power generation companies to marginal generation cost volatility over the near term (given the uptrend in coal/fuel prices) but should enable their long-term energy transition programs in the absence of active solar or wind FIT regime in the Philippines.

AP is our top pick

AP is our top pick as the commencement of 2x668MW, coal-based GNPower Dinginin in January 2022 provides a near-term boost to earnings, contributing up to 20% of AP's FY22E earnings, while its PHP190b portfolio transformation investment for 3.7GW new RE projects by YE30E offer long-term catalysts.

Installed capacity by fuel (PEP FY20A-40E)



Source: Department of Energy