

Philippines

Economic growth has remained relatively strong, and transaction volumes have held up despite a decline in overall deal value. The energy sector should continue to provide deal activity in 2009



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Current Environment

GDP growth in the Philippines is expected to have been positive at 4.4% for 2008. Downward revisions from projections as high as 6.2%, are a direct result of the difficult external environment in the second half of the year.

Philippine exports have been hit by the global downturn. Electronic goods exports specifically, which comprise approximately 60% of export earnings, shrank 18.9% in October. Some segments of the service sector of the economy have also been affected. Contraction took place within the transportation, financial services, and trade services sectors during the third quarter of 2008. The slowdown in these sectors was mitigated by increased construction spending. This took the form of increases in spending for government priority infrastructure projects and private residential construction.

Inflation levels have eased since reaching a peak of 12.5% p.a. in August. Decreasing food and oil prices have contributed to inflation declining to 9.9% p.a. in November and further to 8% p.a. in December. Average annual inflation for 2008 is estimated to have been 9.3% compared to 2.8% in 2007.

Foreign Direct Investment (FDI) flows contracted for the first nine months of 2008. Despite strong inflows in the final month of September, January to September net flow totals amounted to \$1.4 billion, 45% less than the \$2.5 billion net inflows recorded last year.

The government's planned response to the global downturn includes increased infrastructure spending, financed by government borrowing. The budget deficit goal for 2009 has been increased to 1.2% of GDP, as opposed to the original ceiling of 0.5%.

A bright spot of the local service economy remains the Business Process Outsourcing ("BPO") industry.

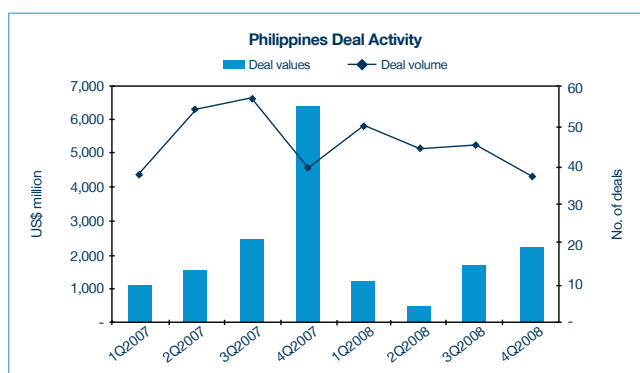
A November survey conducted by the Business Processing Association of the Philippines (BPAP) resulted in two-thirds of respondents reporting at least a neutral if not positive effect of the US financial crisis on their operations. The industry continues to develop more BPO sites, attract more foreign investors, and hire more workers.

Foreign exchange remittances from overseas Filipino workers continue to buoy the local economy. The Central Bank reported robust growth amid worsening global economic conditions. Inflows for the first ten months of 2008 grew 15.5% from the same period last year to US\$13.71 billion.

The Philippine Stock Exchange (PSE) tracked global exchanges and closed at 1,873 on 31 December 2008, a decrease of 48% from the 31st December 2007 close of 3,622. The Philippine Peso/US Dollar foreign exchange rate was at Php47.49/US\$ on 31 December 2008, a depreciation of 15% from last year's end close of Php41.28/US\$.

Listing activity dried up for 2008 as companies continued to hold out for better prospects. All listing activity took place in the first half of the year as San Miguel Brewery, Inc. and Pepsi-Cola Products Philippines, Inc. listed on the exchange, while Sultan Mining and Energy Development Corporation and Viva Communications, Inc. applied to list.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 31 December 2008

Total transaction value shrank to just US\$5.6 billion for the whole of 2008, as opposed to US\$11.5 billion for the whole of 2007. The total number of deals fell slightly from 188 for the whole of 2007 to 176 for the whole of 2008. Domestic and outbound deal activities led the decline, but were offset by a slight increase in inbound deal activity.



Government Divestment of Power Assets

The national government has been exiting the power sector via its policy of privatisation of generation assets and through divestment of its ownership in private distribution companies. Concurrent with the government's divestment efforts, large private holding companies are seeking to diversify their business by entering into this sector.

The Aboitiz Group has been involved in the largest deals for acquiring government power assets, increasing its footprint into power generation while moving away from its transportation services business.

- Aboitiz Power Corporation acquired the Tiwi-Makban Geothermal Power Plants from the Philippine state-owned Power Sector Assets & Liabilities Management Corporation as a result of the latter's mandate to privatise government power assets. These two geothermal plants had a combined value of Php19.7 billion (US\$447 million).
- SN Aboitiz Power acquired the Ambuklao-Binga Hydropower Plant for Php14.8 billion (US\$235 million).
- KGLI-NM Holdings agreed to acquire a 49% stake in Aboitiz Transport System Corp for Php1.8 billion (US\$47.3 million).
- In 2007, San Miguel Corporation divested large portions of its overseas drinks and beverage business in order to generate funds to enter into the power sector and other utilities.
- San Miguel Corporation agreed to acquire a 27% stake in the Manila Electric Company (Meralco), an electricity utility company, from Philippine state-owned Government Service Insurance System (GSIS), for Php27.1 billion (US\$552.8 million).

Ashmore Investment Management Ltd & Petron Corporation

In March, Ashmore Global Special Situations Fund 4 Ltd Partnership, a unit of Ashmore Investment Management Ltd, acquired a 40% stake in Petron Corp (PC), a petroleum products refiner, wholesaler and retailer, from Aramco Overseas Co BV for Php22.8 billion (US\$550 million).

In October Sea Refinery Holdings BV, a unit of Ashmore Investment Management Ltd acquired a further 40% stake in Petron Corporation from Philippine state-owned Philippine National Oil Co for Php25.7 billion (US\$544.2 million). In a separate transaction in June, Sea Refinery had previously acquired a 10.6% stake in Petron for Php6.5 billion (US\$146.6 million).

In December, San Miguel Corporation agreed to acquire Sea Refinery's entire 50.6% interest in Petron Corporation for Php32.5 billion pesos (US\$669.6 million).

Mining

Philex Mining Corp acquired Anglo American Exploration (Philippines) BV, a gold mining company, from Anglo American PLC, for Php2.5 billion (US\$55 million), while First Pacific Co Ltd agreed to acquire a 20.1% stake in Philex Mining for Php6.2 billion (US\$124.1 million).

Other Significant Deals

Metro Pacific Investments Corp acquired a 98.1% interest in First Philippine Infrastructure Inc, a toll road services provider, from First Philippine Holdings Corp and Benpres Holdings Corp for Php12.3 billion (US\$280.6 million).

EHS Acquisition Co LLC, a special purpose acquisition vehicle formed by Ayala Corp, launched a tender offer to acquire eTelecare Global Solutions Ltd, a call center services provider, for Php13.7 billion (US\$292.0 million).

EGCO International Ltd acquired a 90% interest in electric utility company GPI Quezon Ltd for Php6.1 billion (US\$124.2 million).

SM Prime Holdings Inc acquired the entire share capital of Mega Make Enterprises Ltd, a shopping malls owner and operator, from Oriental Land Development Ltd, in exchange for the issuance of 372.5 million new ordinary shares valued at HK\$661.9 million (US\$85.1 million).



Outlook

IPO activity will be dependent on the state of confidence in the local equities market, as many firms are uncertain as to whether the market has stabilised. Most firms who listed in 2007 have stocks trading below the original listing price. No firms have announced IPOs to take place in 2009. To stimulate activity in the equities market, the Philippine Stock Exchange is considering a proposal to give corporations who list the ability to benefit from income tax rates below current levels. Such a proposal is at the preliminary stage however, and would have to attract support from legislators and the government; this appears unlikely at this stage.

Privatisation of power generation assets by the state-owned Power Sector Assets & Liabilities Management Corporation will continue through early 2009. Due-diligence and pre bid conference stages have begun for the following power assets:

- 700 MW Contracted Capacity of Pagbilao Coal Fired Thermal Power Plant
- 1000 MW Contracted Capacity of Sual Coal Fired Thermal Power Plant
- Structures, Plant Equipment, Auxiliaries and Accessories of the 225 MW Bataan Thermal Power Plant

- Structures, Plant Equipment, Auxiliaries and Accessories of the 54 MW Cebu Diesel Power Plant
- 100 MW Power Barge 118 in Compostela Valley
- 100 MW Power Barge 117 in Agusan del Norte

Deadlines for final bid submissions fall in January and February 2009.

Activity in the alternative energy sector is expected to ramp up in 2009 as a result of the passage of the Renewable Energy Act. The Senate ratified the act in October and it was signed into law in December.

The legislation provides incentives for developers of alternative energy. This includes a seven year income tax holiday for renewable energy developers, and a 10% corporate income tax, as opposed to the standard 30% rate, once the income tax holiday expires. Further tax incentives granted are exemptions from carbon credits generated from renewable energy projects, a 1.5% realty tax cap on energy infrastructure, and import duty exemption for equipment and material used for renewable energy purposes. These measures are expected to generate significant investor interest in the sector, although this may be offset to some extent by recent declines in energy prices. ■