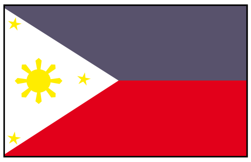


South and Southeast Asia

Philippines

The economy remains resilient; increased deal activity in the second half of 2010 is contingent on the results of the May 2010 national elections

Mary Jade T. Roxas-Divinagracia
Transactions Leader
Philippines

Current Environment

The Philippines' GDP growth for 2009 is forecast at 1.6%, slower than the economic expansion of previous years but nevertheless a marked improvement from the 0.4% growth reported in the first quarter of the year. The improvement is supported by the continued raised level of government spending, a slight growth in consumer spending, and overseas remittances projected to hit a record US$17.1 billion in 2009.

Increased spending has led the government to expect a deficit of Php300 billion or approximately 3.84% of GDP. The government-determined ceiling of Php250 billion was exceeded due to the delay in privatising government assets, such as Food Terminal Inc. (one of the largest industrial complexes in Metro Manila), and ownership stakes in Philippine National Oil Co. Exploration Corporation. The Arroyo administration has recently asked congress to prioritise the passing of revenue measures before its adjournment in the first week of February 2010. Two of the measures include a bill rationalising the granting of fiscal incentives to investors and a bill that seeks to limit the expenses that may be deducted from an individual's taxable net income.

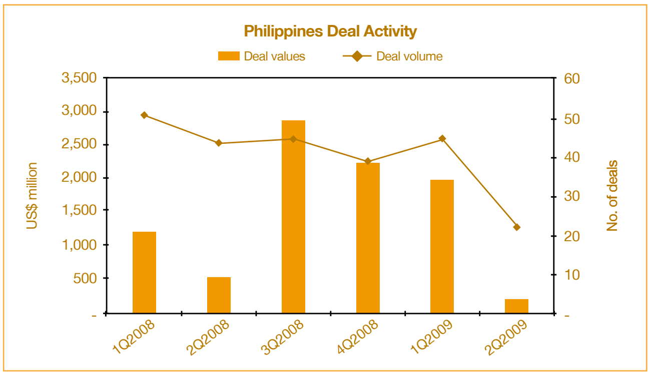
Exports and manufacturing continue to be weak points in the economy. Exports declined 15.5% in the first nine months of 2009 compared to the same period in 2008. The decline in exports was caused particularly by weakness in semiconductor exports. Imports, after falling by 20% in the first quarter, have managed to produce 0.2% growth for the first nine months. Historically, the stabilisation and growth of import expenditures heralded a recovery in export earnings. Industrial production is forecast to contract by 17% for the whole of 2009.

The bright spot in the economy continues to be the business process outsourcing (BPO) industry. In the contact center industry, the largest subset of the BPO industry, the forecast employment numbers are 300,000 workers, generating US$5 billion in revenue. The Philippines was recognised as the best outsourcing destination globally for 2009 at the National Outsourcing Association (NOA) Sourcing Summit, the UK's largest outsourcing conference. Based on government data, the other industries that have recently experienced improving growth figures are trade, finance, mining, and the services industries.

Consumer prices for 2009 were forecast to grow 3.1%. Prices towards the latter half of the year were particularly volatile due to massive flooding and natural calamities, which disrupted supply chains and affected agricultural production.

The composite index of the Philippine Stock Exchange (PSE) has improved to 3,053 as of 29 December 2009, an increase of 63% from the 29 December 2008 closing of 1,873. The Philippine peso appreciated 4.6% against the US dollar at Php46.1 to US$1 by the end of 2009 from Php48.371 to US$1 at the end of 2008.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 31 December 2009.

Deal values shrank 5% in 2009 to US$6.6 billion from US$6.9 billion in 2008. Domestic deals drove the market for 2009, as deal value increased 87% to US$6.1 billion. Inbound transactions, on the other hand, had a mirror-image performance and shrank 89% to US$398 million. The value of outbound transactions was stronger for the second half of the year, but nevertheless shrank 24% to US$130 million. The number of deals in 2009 shrank 9% to 162 deals from 179 deals in 2008.

Energy and Power

The largest deals in 2009 involved the government sale of the contracted capacities of major power plants:

- San Miguel Energy Corporation, a wholly-owned unit of San Miguel Corporation, acquired the contracted capacity of the 1000 MW coal-fired Sual Power Plant via an auction bid of US$1.07 billion;
- Strategic Power Development Corporation, a majority-owned unit of San Miguel Corporation, acquired the contracted capacity of the 345 MW San Roque Multipurpose Hydroelectric Power Plant via an auction bid of US$450 million; and
- Thermal Luzon, Inc., a wholly-owned unit of Aboitiz Power Corporation, acquired the contracted capacity of the 700 MW coal-fired Pagbilao Power Plant via an auction bid of US$691 million.

The privatisation of power-generation assets also led to deal activity in 2009:

- DMCI Holdings, Inc. acquired the 600 MW thermal coal-fired Calaca Power Plant with a winning bid price of US$362 million.
- Green Core Geothermal, Inc., a wholly-owned unit of First Luzon Geothermal Energy Corporation, acquired the combined 305 MW Palinpinon and Tongonan Geothermal Power Plants for US$220 million.

Ownership changes took place in the country's largest electricity distributor, Manila Electric Company (MERALCO):

- In July, Pilipino Telephone Corporation, a subsidiary of Smart Communications, Inc. acquired a 20% stake in MERALCO from First Philippine Holdings for US$415 million.
- Metro Pacific Investments Corp acquired a 12.95% stake in MERALCO from the PLDT Beneficial Trust Fund (10.17%) and Crogan, Ltd. (2.78%) for US$380 million.

Consumer staples

Most major transactions in the consumer staples sector involved the participation of beverage giant San Miguel Corporation (SMC).

- Q-Tech Alliance Holdings Inc. acquired a 19.91% stake in SMC from Kirin Holdings Co. Ltd. for US$823.4 million.
- An investor group led by Kirin Holdings Co. Ltd. and SMC, through their joint venture San Miguel Brewery Inc., agreed to acquire San Miguel Brewery International Ltd. for US$300 million.
- Coca-Cola Bottlers Philippines Inc. acquired a city-based beverage plant for approximately US$100 million.

Other major transactions include:

- Smart Communications Inc., a wholly-owned unit of Philippine Long Distance Telephone Company, acquired a 6.67% stake in Philippine Telephone Corp. for US$137 million via its tender offer to acquire the remaining 7.19% stake, which it did not already own.
- Two Rivers Pacific Holdings Corp. agreed to acquire a 9.23% stake in Philex Mining Corp. from Boerstar Corp. (3.57%), Goldenmedia Corp. (2.52%), Elkhound Resources Inc. (1.35%), state-owned Development Bank of the Philippines (1.21%), Walter W. Brown (0.51%), and Roberto V. Ongpin (0.07%), for US$206 million.

Outlook

Political landscape

The political landscape in 2010 will be dominated by the May presidential elections. The official campaign period for national candidates begins on 9 February and will last until 8 May. The elections are particularly significant as it has been nine years since the country has had a new president. We expect some deal activity to be front-loaded into the first quarter, and for the second quarter to be slow as market players await the election results.

The Secretary of the Department of Trade and Industry (DTI) has revealed that investors are expected to take into consideration the outcome and conduct of the elections before making a final decision on whether to infuse new investments into the country. Depending on the outcome of the elections, activity should once more pick up in the third quarter.

Expansionary liquidity measures

As a result of the election-related spending and some signs of a global economic recovery, market analysts expect the central bank or the Bangko Sentral ng Pilipinas (BSP) to review the necessity of keeping in place expansionary liquidity measures that were introduced to combat the effects of the global economic downturn. Key interest rates are anticipated to be adjusted, following the presidential elections, in order to head off inflationary pressure.

China-Asean Free Trade Agreement (CAFTA)

CAFTA took effect on 1 January 2010. Trade levels are expected to increase significantly between the Philippines and China as a result of the reduction of duties to zero for more than 7,000 trading items. Prior to the economic downturn in 2009, trade values had been rising 30% annually between the two countries. China is expected in the succeeding years to become the Philippines' second largest trading partner. ■