



Philequity Corner (May 29, 2017)
By Wilson Sy

Game of Thrones

Three weeks ago, we wrote an article about possible M&A in the banking sector (*Hunter Games*, May 8, 2017). As promised in that article, we now present the second part of our series on banking M&A.

RCBC's stock price action

Below, we show the price chart of RCBC, which illustrates the stock's move since talks of M&A surfaced.



Source: PSE

After consolidating for many months, RCBC's stock price was jolted by a gap-up move on April 17. This was triggered by speculation that the bank is a prime target for a possible acquisition. The stock then experienced a run-up which brought it to a high of 60.05 on May 8. However, RCBC corrected when the bank denied involvement in any M&A discussion. Its stock price surged again after a news article came out that China Bank is in talks to possibly acquire RCBC. Though both banks denied that there are M&A negotiations between them, RCBC moved higher and closed at 62.75 last Friday.

With last week's close, RCBC is now up 60.9% since its gap-up move on April 17. Note that RCBC's stock price is already near the purchase price of Cathay Life Insurance at 64, which was transacted on April 2015. Meanwhile, China Bank also moved higher and is now up 8.3% from its recent bottom.

Race to #1

Many of our readers might be wondering why bigger banks are so eager to acquire. One of the main reasons behind this is the race to become the country's top bank. More than just bragging rights, larger banks enjoy many advantages over their smaller peers. Bigger banks have wider branch networks and

benefit from economies of scale. Thus, bigger banks see M&As as attractive opportunities for them to further build on their competitive advantages by realizing synergies from successful acquisitions.

Game of thrones – by the numbers

In our recent article about banking M&A, we presented the rankings of the country's top banks. Below, we show the rankings again to illustrate how the game of thrones might play out based on the numbers.

Ranking of top local banks as of end-2016

Bank	Assets	Loans	Deposits	Capital	Branches
BDO Unibank	2,324,958	1,500,484	1,905,204	217,535	1,103
Metrobank	1,876,009	1,060,868	1,389,302	205,553	959
Bank of the Phil Islands	1,725,696	1,040,720	1,431,300	167,684	835
Phil National Bank	753,765	428,027	570,503	109,941	675
Security Bank	694,982	289,658	346,598	97,127	292
China Bank	633,198	386,827	541,583	63,386	541
Rizal Commercial Banking Corp	521,193	306,167	353,077	62,133	481
Union Bank of the Phil	524,432	235,386	376,485	67,587	304
United Coconut Planters Bank	310,099	143,999	265,653	17,665	190
EastWest Bank	291,818	198,876	240,222	34,449	445
Asia United Bank	165,501	98,092	129,705	23,770	239
PhilTrust Bank	153,386	55,108	130,030	22,796	60
Bank of Commerce	136,843	47,687	117,496	15,365	128
Phil Bank of Communications	86,499	46,089	63,146	10,782	82

Amounts in million pesos

Sources: Company data, Wealth Research

Game of thrones – M&A permutations

Below, we enumerate the possible game of thrones / M&A scenarios within the banking sector.

- BDO protects its throne.** If BDO ends up acquiring RCBC or another mid-sized bank, it will solidify its status as the country's top bank while also widening its lead vs. MBT and BPI.
- BPI challenges for the throne.** BPI is a potential hunter which has to be watched. Note that Gil Buenaventura, RCBC's current President, previously served as a senior officer in BPI. This establishes a connection between BPI and RCBC, which may pave the way for a possible M&A between the two banks. An acquisition by BPI will allow it to challenge BDO's #1 ranking and regain its throne.
- MBT resurfaces as a hunter.** After going through an M&A binge in the late 1990s to early 2000s, MBT has been absent from the M&A scene. If the bank resurfaces as an acquirer, an acquisition will allow MBT to reclaim its past position as the country's biggest bank.
- Mid-sized banks end up as acquirers.** If China Bank acquires RCBC, it will pull away from its mid-sized peers and become the 4th biggest bank in the country. Likewise, other mid-sized banks, such as Security Bank and Union Bank, might also end up as possible hunters. Yet, Union Bank still remains as a potential target. Last week, bank President Edwin Bautista was quoted as saying that there are some foreign banks who inquired about investing in Union Bank.
- Foreign banks end up as hunters.** The banking sector has received growing interest from foreign banks and financial institutions. Last week, BSP Deputy Governor Nestor Espenilla, Jr. said that there are eight foreign banks which have shown active interest in entering the Philippines. Some of these banks may end up acquiring local banks with solid client bases and extensive branch networks.

6. **Foreign banks end up as partners in the hunt.** Some foreign banks and financial institutions have chosen to forge partnerships with local banks. Japan's Bank of Tokyo-Mitsubishi UFJ bought a 20% stake in Security Bank while Taiwan's Cathay Life Insurance maintains a 22.7% stake in RCBC.

The price for the prize

In an article that we wrote years ago, we discussed the acquisition multiples of past banking M&As (*Banking M&A fever continues, Buy bank stocks*, March 20, 2006). We show these below and updated the table to include recent M&A transactions.

Acquisition multiples of past banking M&As

Acquirer	Acquiree	Valuation
BDO Unibank	Equitable-PCI Bank	3x adjusted book value
Bank of Tokyo-Mitsubishi UFJ	Security Bank (20% stake)	2.8x book value
Union Bank of the Philippines	iBank	2.5x book value
Bank of the Philippine Islands	Prudential Bank	2x adjusted book value
Bank of the Philippine Islands	Far East Bank	2.4x book value
Metrobank	Solid Bank	2.2x book value
Cathay Life Insurance	RCBC (20% stake)	2x book value
Equitable Bank	PCI Bank	1.8x book value

Sources: *Philequity*, *Wealth Research*

Another round of hunter games?

Takeovers and acquisitions are usually priced at a premium because they can afford the acquirers many benefits and advantages. In the table above, we show that bank acquisition multiples can go as high as 2.8 to 3x book value. Because of the high takeover and acquisition multiples, a round of bank M&As – or even mere speculation about it – generates a lot of interest and excitement in the stock market. Consequently, valuations for banking stocks improve.

PSE Index – higher despite martial law in Mindanao

Despite encountering many headwinds, the PSEi has been relatively resilient. The market has remained strong even as it dealt with weaker than expected 1Q17 GDP at 6.4%, the government's rejection of aid from the EU, the terrorist attack in Marawi and the declaration of martial law in Mindanao. This has been driven by the strength in global markets, with US indices making new all-time highs despite negative political headlines (*Politics vs. Economics*, May 22, 2017). In addition, excitement regarding possible banking M&As has buoyed banking stocks and has lifted the stock market as a whole.

Tax reform – next big catalyst for PSEi

The anticipation for tax reform is another reason behind the resilience of the PSEi despite negative news (*Tax Reform – The Next Big Catalyst*, February 20, 2017). Investors are looking forward to the passage of the first phase of the tax reform program, as this will pave the way for the much-awaited ramp-up in infrastructure spending (*Build, build, build!*, April 24, 2017). We thus believe that the timely passage of the tax reform package, as outlined by the Finance Department, will be a major catalyst for our stock market. This can propel the PSEi to retest or break its all-time high of 8,137.

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