

Philequity Corner (Mar 11, 2013)

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Black Swans, Broken Blades & Landslides

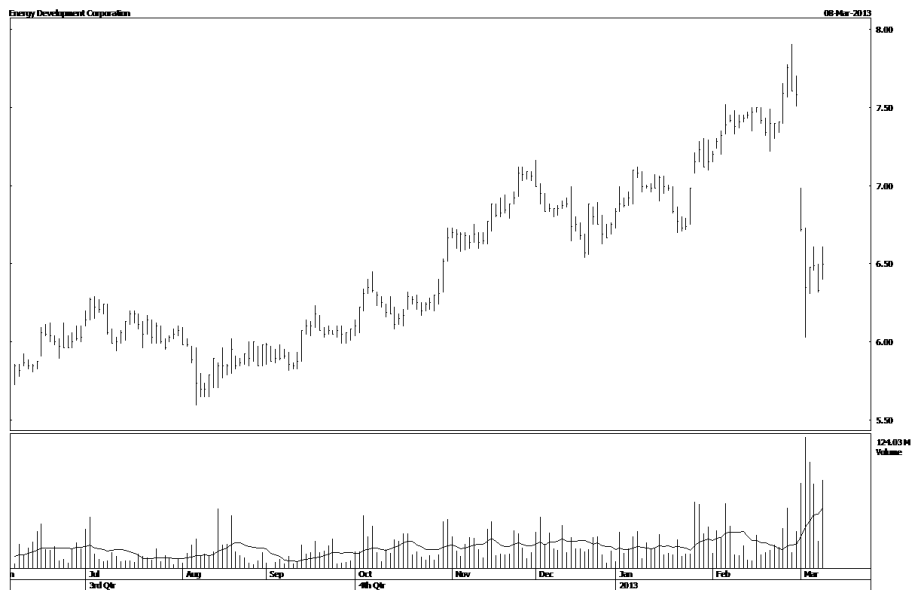
The DJIA made new all-time highs, convincingly breaching past the 14,000 level. Our own PSEi has also been making record highs and is fast approaching the 7,000 milestone. In fact, this is a global phenomenon where markets all over the world have been making all-time highs. We mentioned this in our investors briefing and in recent Philequity Corner articles. But despite all the record highs, the PSEi experienced the long-awaited correction towards the end of February triggered by a black swan event – a broken blade and a landslide happening one after another.

Bac-Man (didn't) Return

On February 28, EDC announced that it had shut down its BacMan Unit 2 (2x20 megawatts) in Bicol due to technical issues. An inspection showed that one turbine blade (out of the 519 blades on one end) was sheared off causing damage to the unit. As a precautionary measure, Unit 1 (2x55 megawatts) was likewise suspended for forensic inspection. The unexpected shutdown was announced a mere two days after declaring commercial operations and this caused severe frustration among investors, especially the foreign ones.

One may recall that about the same time last year, BacMan was all set for commissioning. Technical issues, however, arose and management decided to shut it down. The delay caused the market to react adversely and the share price plunged by about 20%. Nevertheless, management was keen on bringing BacMan to full operation and true to their word, they were able to do it. Unfortunately, BacMan is derailed again. Although management promised that they will do what it takes to bring BacMan online, uncertainty looms with respect to its restoration.

EDC's Price Chart



Source: Technistock

Double whammy

A day after EDC announced the suspension of BacMan's operations, another unforeseen event happened. This time, a landslide hit a section of the company's 125-megawatt Upper Mahiao geothermal project in Leyte. Intermittent rains have struck the area the past two weeks. A mild earthquake with a magnitude of 2.8 was likewise monitored a few hours before the mishap occurred. Forty three employees were injured and six perished. Management announced they would extend all efforts to help the families of the victims. And as a result of these twin unrelated events that occurred in separate places, EDC's share price plummeted 22% in only two trading days.

Parallel incidents

In the mining sector, both Semirara Mining (SCC) and Philex Mining (PX) have had their fair shares of misfortunes. Just last month, one of the walls of SCC's Panian pit in Semirara island in Antique gave way forcing the company to suspend coal mining operations. Similar to the incident in EDC's geothermal plant, a number of injuries and casualties were reported. Around August of last year, PX voluntarily shut its Padcal mine in Benguet following a leakage from its tailings pond due to the torrential rains brought about by back-to-back typhoons. This led to the onerous sanctions and fines imposed by the Mines and Geosciences Bureau, causing the company to seek financial assistance. These series of unfortunate events led to a cataclysmic drop in the share prices of SCC and PX. Both have bounced since then but neither stock has yet to fully regain lost share price value even if the PSEi has made new highs.

Impact of Unfortunate Events on Share Prices				
	Price before Shutdown	Trough	% Decline	Duration
Semirara (SCC)	257.80	220.00	14.6%	2 days
Philex (PX)	23.10	12.52	45.8%	4 months

Source: Technistock, Wealth Securities estimates

All in the family

The bullish prospects of EDC at the start of the year naturally pulled up the share prices of companies layered above it. EDC's immediate parent company, First Gen, the power holding company owning it, First Philippine Holdings, and the ultimate parent firm, Lopez Holdings, have all benefitted from the promise of BacMan's return. EDC's catastrophic decline has also caused the downward spiral of these Lopez-owned names. As they all moved in unison, the said companies set a negative sentiment thus triggering the market's anticipated correction.

EDC President and COO Richard Tantoco's reassuring words during a conference call / briefing to analysts and investors gave a calming effect and put a halt to the stock's sharp decline. In spite of the false starts, he remains steadfast in bringing BacMan back to commercial operations. The share prices swiftly recovered following the briefing held last Monday.

Share Price Reaction following EDC's Briefing			
	Feb 28 (Hi)	Mar 4 (Lo)	Mar 8 (Close)
EDC	7.70	6.03	6.61
FGEN	26.70	22.40	24.10
FPH	113.80	99.25	107.40
LPZ	7.50	6.69	7.40

Source: Technistock

Lesson Learned

One thing investors can learn from these unfortunate circumstances like the one that happened with EDC is diversification. As black swan events come in the most unexpected ways – be it acts from other developed markets or in this case, even acts of God – what is important is that the investors are prepared in the event these things happen. Within one's stock portfolio, diversifying into various sectors is critical. An investor should buy stocks in different industries (e.g., consumer, banking, power, etc.) rather than focus on a particular one. In this manner, the risk is spread out and volatility is minimized. If one cannot buy into multiple stocks in different sectors, we always say, especially to new investors, that investing in a mutual fund provides instant diversification. All these can be achieved by buying a mutual fund that can invest in 30 to 50 stocks. For as little as P5,000 investment in a mutual fund like our Philequity Fund, an investor can achieve diversification and invest in fundamentally sound and dividend paying companies.

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