

Sector: Power

13 November 2019

Manila Electric Company (MER)

HOLD

Maneuvers growth strategy amid regulatory compliance

Share Price: PHP347.00
Target Price: PHP348.60
Potential Upside: 0.0%

PSE Code
Bloomberg Code
Outstanding Shares (mn)
52-week High / Low (Php)
Market Cap Php mn

MER
MER PM
1,127.10
398.00 / 338.40
391,103.70

Cristian R. Miguel
BA Research
+63 2 8722 0132
research@basecuritiesinc.com.ph

➤ **San Buenaventura started commercial operation**

455MW San Buenaventura started its commercial operation in October after securing provisional authority to operate from the Energy Regulatory Commission or ERC. The power plant will supply MER with 455 MW within the period of 20 years. Prior to its COD, San Buenaventura was able to dispatch 93 MW (814 gWh) to MER during the 3rd quarter as reported by the distribution utility. Based on estimates, revenue generated from the power plant may reach around P6.2 billion this year considering our projected sold capacity of 207 MW and an average price per kWh of P4.2810/kWh. In 2020, we expect higher sold capacity factor and revenue contributions from its full year operation. In terms of earnings contribution attributable to MER, our estimate is around P1.25 billion next year. MER has a 51% indirect interest in 500MW San Buenaventura through MGen.

➤ **Delay in the rate rebasing for the 5th RP**

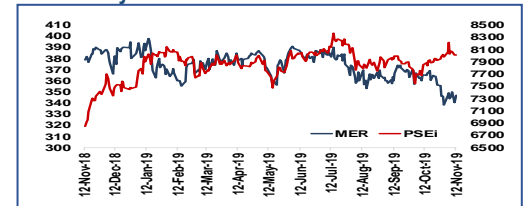
We think the distribution utility could only apply for the rate rebasing for the 5th RP in the second half of next year once the ERC finalizes the rules on the "Rate for the Setting of Distribution Wheeling Rates or RDWR." In the rate rebasing, primary considerations of the regulator will be the appropriate weighted average cost of capital, current asset base, and capital expenditures. Currently, there is a lower WACC environment and this may pull down distribution tariff for the 5th regulatory period. However, the case might be the opposite if the distribution utility is able to boost its capital expenditure considering the increasing demand on power.

MER is now operating in the 1st year of the 5th regulatory period but still applying the previous interim average distribution tariff of P1.3810 per kWh. Considering such provision, the distribution utility continues to post growth in distribution revenues driven by higher energy sales volume. This year, we expect distribution charges to grow between 6.0 and 7.0 percent YoY.

➤ **Rebound in 3rd quarter GDP supports energy sales volume growth**

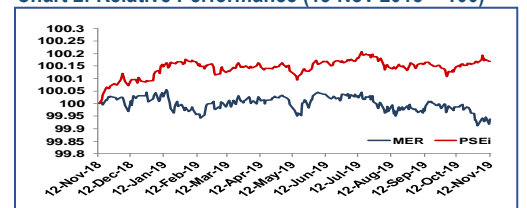
GDP growth recovered in 3rd quarter at 6.2 percent, above the 6.0 percent median estimate of economists and higher than the 5.6 percent average growth recorded during the 1st half of this year. Likewise, we also see above 6.0 percent growth in the 4th quarter from stable growth in household spending and rebound in fiscal spending. In effect, we maintain our energy sales volume growth expectation supported by increase in customer base and power consumption for MER. During the 3rd quarter, energy sales volume jumped significantly to 8.0 percent YoY driven by strong growth in consumption in the residential segment.

Chart 1: 1-year Share Price and PSEI



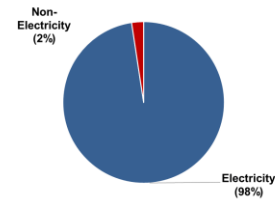
Source: Wall Street, BA Research

Chart 2: Relative Performance (13 Nov 2018 = 100)



Source: Wall Street, BA Research

Chart 3: 9M 2019 Revenue Mix



Source: MER

Table 1: Valuation		Table 2: Estimates (Year-End Dec)				
	2019E-2028E	2017A	2018A	2019E	2020E	
Sum-Of-The-Parts		Core EPS (PHP)	17.93	19.88	22.74	24.87
Period Covered	2019E-2028E	Core EPS Growth (%)	3.2	10.9	14.4	9.4
Power Distribution	303,214	PER (x)	19.35	17.45	15.26	13.95
Power Generation	20,221	DPS (PHP)	16.99	15.91	18.19	19.90
Retail Electricity Supply	75,955	Dividend Yield (%)	4.9	4.6	5.2	5.7
SOTP NAV	399,390	Dividend Payout (%)	95	80	80	80
Parent net debt	(6,502)					
SOTP NAV after debt/cash	392,888					
SOTP NAV/sh.	348.58					
Target Price (PHP)	348.58					

Power Generation

Table 3: San Buenaventura Power Plant	2019E	2020E	2021E
Rated capacity (MW)	500	500	500
Contracted capacity (MW)	455	455	455
Capacity factor	80%	80%	80%
Average price per kWh (base price)	4.2801	4.2801	4.2801
Est. revenues (PhP mn)	6,209	13,648	13,648
Est. net income (PhP mn)	1,118	2,457	2,457
Est. earnings (attributable to MER, 51% ownership, Php mn)	570	1,253	1,253

Source: ERC, BA Research estimates

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Latest Earnings Result

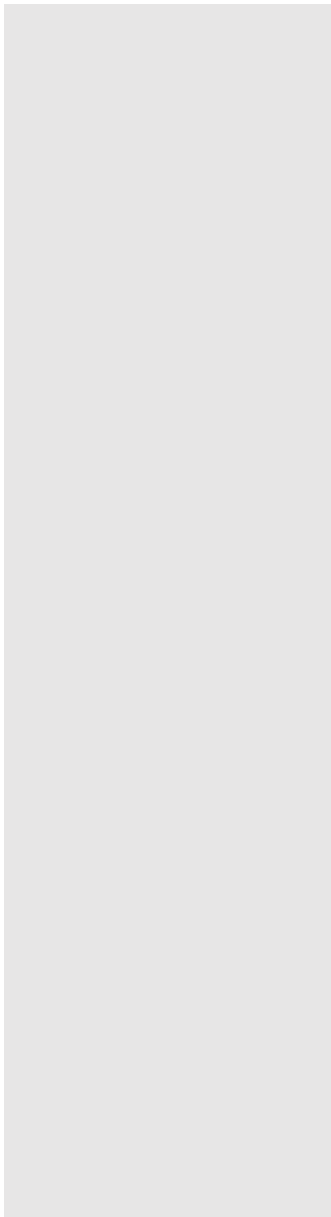
Table 4: Interim Results PHP mn unless stated otherwise	Third Quarter			Nine Months		
	3Q'19	3Q'18	YoY chg	9M'19	9M'18	YoY chg
Total revenues	76,173	76,867	-1%	241,126	227,411	6%
Revenues from electricity services	74,109	74,363	0%	235,376	221,266	6%
Pass-through charges	57,340	58,817	-3%	186,152	175,057	6%
Distribution charges	16,769	15,546	8%	49,224	46,209	7%
Revenues from non-electricity	2,064	2,504	-18%	5,750	6,145	-6%
Cost and expenses	68,581	70,099	-2%	218,193	206,960	5%
Operating income	7,592	6,768	12%	22,933	20,451	12%
Reported net income	6,245	6,268	0%	18,321	18,265	0%
Core net income	6,136	5,835	5%	18,453	16,686	11%
Reported EPS	5.54	5.54	0%	16.25	16.16	0%
Core EPS	5.44	5.18	5%	16.37	14.80	11%

Source: MER, BA Research estimates

Income Statement

Table 5: Income Statement PHP mn unless stated otherwise	2016A	2017A	2018A	2019E	2020E	2021E
Total service revenues	257,181	282,556	304,454	317,531	336,539	356,753
Revenues from electricity services	249,206	275,172	295,389	309,717	328,647	348,781
Pass-through charges	192,336	215,572	233,373	243,366	258,491	274,327
Distribution charges	56,870	59,600	62,016	66,352	70,157	74,455
Revenues from non-electricity	7,975	7,384	9,065	7,814	7,892	7,971
Cost and expenses	231,473	256,178	276,012	285,884	300,345	316,694
Operating Income	25,708	26,378	28,442	31,647	36,194	40,058
Reported Net Income	19,340	20,499	23,102	25,502	28,794	31,692
Core Net Income	19,583	20,213	22,408	25,634	28,033	30,931
Reported EPS	17.01	18.09	20.42	22.53	25.42	27.99
Core EPS	17.37	17.93	19.88	22.74	24.87	27.44

Source: MER, BA Research estimates


Rating Definition

BUY - Estimated potential return of > 10% in 12 months
 HOLD - Estimated potential return of 0 - 10% in 12 months
 SELL - Estimated potential return of < 0% in 12 months

Rating History

Date	Share Price (PHP)	Rating	TP (PHP)
04 July 2017	263.00	Buy	288.20
15 September 2017	269.60	Buy	299.70
29 January 2018	337.80	Hold	348.10
15 May 2018	322.00	Sell	292.40
28 August 2018	380.00	Hold	330.80
02 August 2019	373.80	Hold	348.40
13 November 2019	347.00	Hold	348.60