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STOCK WATCH

▶ JAZZ RESIDENCES LEADS SMDC EXPANSION

Philippine Gaming Sector:
Resilient to Economic Slowdown

The Crackdown. High rollers from mainland China, which account almost two-third of the Macau gaming market, are being lured by junket operators to Macau for more than a decade. An average of USD202.0bn worth of gambling money was being laundered each year through Macau. As a result, President Xi Jinping has implemented anti-corruption campaigns such as tighter bank transfer restrictions between Macau and mainland China and transparency of junket operators in relation to their clients' income sources. Note that an individual can only bring a maximum of 20,000 yuan (approx. USD3,227) to Macau and withdraw 10,000 yuan/day from ATMs. Since then, Macau gaming revenues declined for six months in a row. In the latest gaming data, December gross gaming revenues dropped by 30% to approximately USD2.9bn, the lowest level for the entire 2014. This brings 2014 gross gaming revenues to USD44.0bn, 3% lower than last year's USD45.2bn. Note that VIP baccarat accounted for 61% of Macau's gambling receipts, while mass market baccarat represents 39% in 2014. Las Vegas was also badly affected as baccarat revenues in October dropped by 36% to USD97.0mn due to a decline in Chinese high rollers. Even non-government rich Chinese gambling players cut spending due to the impact of the anti-corruption programs.

Macau Slowdown Persists Through 2015. Fitch Ratings estimates negative growth in Macau gaming revenues for 2015 as it produces no gaming supply until the latter part of the year as well

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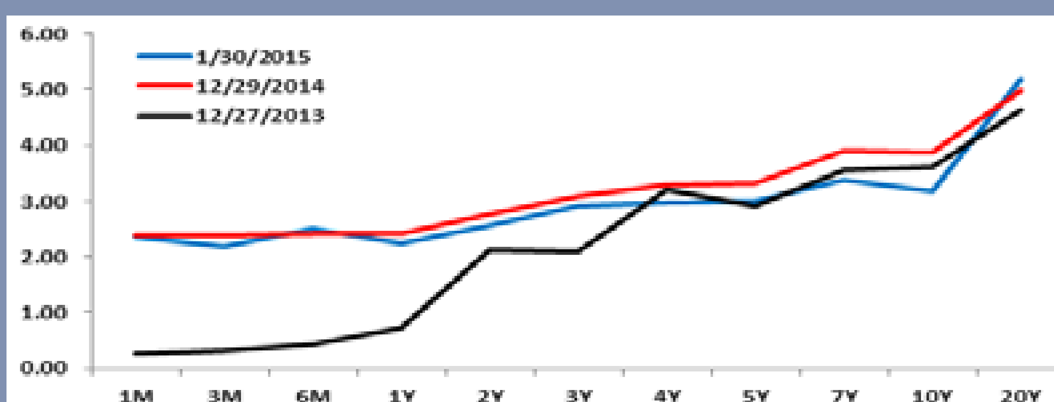
Treasury Gains on Oil Price Drop and Global Demand for Safety

Peso Yield Curve



Domestic and global indicators converged to support solid treasury gains at the start of 2015. Yields dropped across the curve at an average of 21.8bps (vs end-2014) led by the long-end, which fell by an average of 34.5 bps (vs end-2014). January total trade was at Php854.15bn, highest since March 2013, while daily trade volume hit Php50.244bn, 3.45x of the daily volume last Dec 2014. Domestic players maintained low inflation outlook, as oil prices were slashed into half of 2014 average (WTI: Jan 30 @ 48.24/bbl vs 2014 ave @ 92.91/bbl; Brent: Jan 30 @ 52.99/bbl vs 2014 ave @ 99.45/bbl). BSP Deputy Gov. Guinigundo said that 2015 inflation could be lower than the

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as China's economic issues and anti-corruption programs. VIP players from mainland China are seen to shift to other gaming destinations, like the Philippines, as two junket operators have decided to shut down private VIP rooms in the casinos in the past week. Note that tourist arrivals from China remain to be the top four among all visitor markets as of 10M14. The Koreans are the biggest in terms of foreign players in both Solaire and Resorts World, followed by ASEAN players like Singaporeans and Malaysians. According to Fitch Ratings, the crackdown in China will affect markets that are dependent mostly in VIP players, such as Singapore.

Philippine Market More Diversified. Although the Philippine gaming market does not cater to the high rollers of Macau, we anticipate that other rich VIP players, particularly from the southern parts of China, will consider transferring to other destinations like the Philippines due to fewer restrictions. With this, we expect that Bloomberry Resorts Corporation (BLOOM), Melco Crown (Philippines) Resorts Corporation (MCP), Premium Leisure Corporation (PLC) and Belle Corporation (BEL) will benefit in the near term. Some analysts believe that the Macau slowdown would have a negative impact on the Philippine gaming market. However, note that VIP players in the country are not equivalent to the high rollers of Macau or Vegas market. The Philippine gaming market is diversified, which consists of 30-40% foreign players from China, Korea, South East Asia, etc. and 60-70% local players. Note that half of Vegas' gaming revenues from table games come from Asian customers, while Philippines' 60-70% of gaming revenues comes from a highly diversified foreign market. Therefore, China's anti-corruption programs should be neutral to other VIP players, especially the ones in the Philippines.

Supply-Driven Market. In spite of lower VIP volumes, Fitch Ratings and S&P note that gaming in the Asia-Pacific region will be more competitive and stable in the next two years as gaming supply increases, such as the ones in the Philippines' Entertainment City. Specifically, BLOOM launched its Phase 1-A called SkyTower for its high-roller players on November 22, 2015. Note that 62% of its VIP gamblers are from Greater China, which includes Hong Kong, Macau, and Mainland China, while Resorts World and City of Dreams cater to the mass markets. This shows that the Macau slowdown will be earnings neutral to RWM and MCP-BEL-PLC, while BLOOM may benefit to the shift of Chinese VIP players to the Philippines. The nature of the business is that the gaming market is not a zero-sum game; thus, it is supply-driven, i.e. build more casinos and more high-rollers will come.

City of Dreams Manila conducted a soft opening on December 14, 2014 and will be followed by a grand opening on February 2, 2015. This integrated resort is seen to take advantage of Melco Crown's Macau gaming experience and junket operations. Note that MCP operates the casino, while BEL's 80%-owned PLC holds the gaming license. Based on S&P's credit outlook for 2015, earnings in the Philippine gaming market will rise faster than the economy mainly due to new supply and higher OFW remittances.

Gaming Markets Resilient to Global Slowdown. We compared Macau and Philippine gross gaming revenues from 2008 to 2013. We observed that despite the global financial crisis in 2009 and Macau slowdown in 2012, the gaming markets are still growing in terms of gross gaming revenues. Therefore, global issues are neutral to revenues as long as supply is increasing. However, we saw the gross gaming revenues growth follows the trend of its country GDP growth. But in the case of the Philippines and South Korea, we don't see any correlation between the two indicators. According to PAGCOR VP Francis Hernando, tourist arrivals growth is a better indicator for the gaming market.

In the case of Las Vegas, gaming revenues have not returned to its peak of USD12.8bn in 2007 or before the financial crisis. Las Vegas gross gaming revenues amounted to USD11.1bn by end-2013, same with the figures reported in 11M14. This shows that despite economic downturns, gaming revenues still spring back slowly to growth. Macau, on the other hand, rebounded back strongly with a double-digit growth in gaming revenues after the financial crisis. The revenue patterns differ between these two markets as gaming revenues in Macau account 90% of total revenues, while Las Vegas only make up 40%. Las Vegas visitors usually spend half of their budget in non-gaming activities such as entertainment and shopping.

One main reason why Las Vegas' gaming revenues are more affected by economic slowdown is because players are more diversified when choosing gaming activities. Note that baccarat revenues only represent 20% of all gaming revenues in Las Vegas. In the case of Macau, majority of the gaming revenues is coming from high-stake table players. During the 2007 financial crisis, quarterly growth of gaming revenues in Macau dropped to its lowest level of -12.7% in 2009. However, it bounced back in 2009 with a 50% growth driven by high-rollers.

Other gaming destinations like South Korea, Singapore and the Philippines operate similar to the Las Vegas model in terms of slot machines/gaming table ratio and contribution of non-gaming activities to total revenues.

PAGCOR, Integrated Resorts Benefit from "Theoretical House Advantage." Based on our talk with PAGCOR VP Francis Hernando, casinos get a margin (or theoretical house advantage) between 5% to 10% from slot machines and 3% to 5% from table games. Although, these numbers may seem low, these translate to billions of dollars.

AMLC Targets Casinos. The Anti-Money Laundering Council (AMLC) requires casino operators to report transactions worth Php4mn from one player in a day. This trig-

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SM PRIME HOLDINGS

SM Prime Holdings, Inc. (SMPH):
Jazz Residences leads SMDC expansion

SMPH Stock Data	
Price (PHP)	18.68
Market Cap (PHP Bn)	539.46
Outstanding shares (Bn)	28.88
2015E PE (X)	23.90
Price to Book (X)	2.99

Source: Bloomberg

SMDC's "Vertical Village" in Makati. We recently joined a tour of SMDC's SM Jazz Residences, located in Bel-Air, Makati. Launched in 3Q13, SM Jazz Residences is a high-rise residential project of SM Development Corp. (SMDC), SM Prime's (SMPH) real estate development arm. The project covers 2.5 ha.; 0.8 ha. is to be used for residential and commercial purposes, while the rest will be for amenities. All amenities will be completed by 2Q15.

SM Jazz Residences has four towers with 36 floors each and a total of 5,367 units. The average unit size is 26.8sqm and each is priced at an average of PHP121,500/sqm. As of January 2015, 84% of all units have been sold.

Tower A (Violin), which has 783 units and around 22 units/floor, was the first to be launched and was turned over in 3Q13. Tower C (Piano), with 1,077 units and around 34 units/floor, followed and was turned over in 3Q14. Tower C is the only tower to have residential units on only 35 floors, as the 6th floor was used solely for amenities. Both towers are completely sold out.

The remaining towers, Towers B (Cello) and D (Clarinet) each with 48 units/floor, will be turned over in 2015. Tower B, the largest tower with 1,758 units, will be turned over by end-1Q15, while Tower D, the second-largest with 1,749 units will be turned over in 3Q15.

At PHP121,500/sqm, unit sales from Towers B and D would yield revenues of PHP5.7bn each for a total of PHP11.4bn. This is already 55% of full-year 2013 real estate revenues of PHP20.8bn.

Real Estate Expansion. SMDC has set a capex budget of PHP15-18bn for 2015. The company will launch 10 projects including Shore Residences at the Mall of Asia Grounds, Air Residences and Jazz Residences in Makati, Fame Residences in Mandaluyong, and Trees Residences in Fairview.

Approximately 12,000-14,000 units will be completed in 2015, priced at an average of PHP3mn/unit. This implies real estate revenues of PHP36-42bn, 73-102% higher than in 2013.

The company is also looking to acquire property in either the north or south of Metro Manila. The location will be the site of SMDC's first horizontal residential project. The project will feature low-cost units (PHP800k-1.2mn) catering to the OFW market. Further details have yet to be disclosed.▲

SM Jazz Residences estimated sales

	Tower B	Tower D
Units	1,758	1,749
Average sqm/unit	26.8	26.8
Gross saleable area (sqm)	47,114	46,873
Average price/sqm (PHP)	121,500	121,500
Sales (PHP mn)	5,724.40	5,695.09
Total sales (PHP mn)		11,419.49

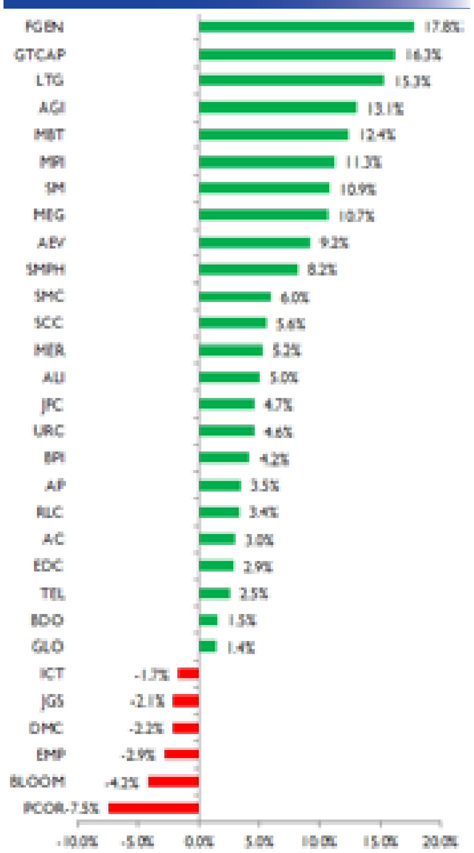
Sources: Company data, FMIC-Research estimates

SM Jazz Residences Exterior

Source: smdcresidence.com

PSEi Price Performance:
Conglomerate Leading the Pack

PSEi Members YTD Price Performance, Jan 30



Source: Bloomberg

Index Breaking New Highs. The PSEi rose 5.3% YTD to 7,613.15 as of February 3, 2015. Out of 30 index members, 24 rose while 6 fell with 14 stocks gained more than 5% led by FGEN at +17.8%. The conglomerate members of PSEi lifted the whole index with an average growth of 8.1%.

Valuation Play. MBT's price performance for 2014 lagged behind the other top banks as it only grew 9.9% vs BDO's +60.0% and BPI's +12.7%. This brought MBT's 2015 P/E using 2014 closing prices at 12.44x, way below BDO's 15.59x and BPI's 17.40x. The price gain was also fuelled by the then rumors that MBT will issue rights offering. In January 22, the bank disclosed that it will conduct stock rights offering amounting to Php32.0bn.

In spite of MEG's 2014 +44.4% price gain, the market views that it still has upside potential. MEG's 2015 P/E using 2014 closing prices at 13.41x, way below ALI's 28.78x, SMPH's 21.71x and RLC's 17.54x, resulting in higher demand for the property giant and gaining 10.7% YTD.

LTG's 2015 P/E using 2014 closing price was still high at 17.39x vs industry average (conglomerate PSEi members) of 16.12x. Nonetheless, the market is buying it (+15.3% YTD) with the hopes rebounding from poor 2014 price performance of -21.4%.

Corporate News Play. MPI (+11.3%) was the second top gainer as its subsidiary, Maynilad Water Services Inc., was awarded by the appeals panel an average tariff increase of Php3.06/cu.m.

SMPH rose by 8.2% on the back of more aggressive capital spending of Php60.0bn this year. The company also said that the company will have four to five project launches this year totalling 12,000-14,000 units.

Macro Shift Play. PCOR (-7.5% YTD) was badly hit by falling oil prices (WTI -6.9% YTD). On the other hand, JGS (-2.1%) is the primary beneficiary of this global commodity shift. With aviation fuel as CEB's main expense (51% of 2013 operating expenses), we expect it to benefit from lower oil prices. URC will also benefit as part of its raw materials are imported from North America, Europe and Asia. JGS' price declined, however, on the back of the Php8.8bn placement of 145.7mn primary common shares.

Fundamental Play. Despite raising Php7.5bn through an accelerated overnight placement of unissued and treasury shares, FGEN was the top price gainer at 17.8%. Due to power supply shortage, the market is bullish on the power sector. Proceeds of this offering will fund the on-going civil and mechanical works of both the 414MW San Gabriel (est. completion by late 2016) and the 828MW Sta. Maria (est. completion by 2019).

GTCAP (+16.3%) was the second top performer among PSEi conglomerates due to its sustainable earnings. Aside from MBT's expected recovery, Toyota Motor Philippines (TMP) is the primary driver of the GTCAP's 9M2014 earnings as it accounts for 42% of the total Php10.6bn. The total units sales of TMP for 2014 grew 40% YoY (vs industry's +27%) to 105k and the demand is expected to be sustainable given that oil prices are falling. In 2014, Global Business Power (GBP) expanded its total capacity by 82MW (commissioned in December 26, 2014) to a total of 622MW and the full year effect of this expansion will be felt this year.

Aside from the valuation play of LTG, we view that it has good growth drivers. Asia Brewery's earnings were strong in 9M2014 and the beverage business will add another water line for Absolute and Summit brand that expand capacity by 40%. Eton Properties plans to increase office and retail space by constructing more BPO office buildings. This is a strategic move as its current lease rate is at Php450/sqm., way below than industry average office lease rate at Php580/sqm.▲

First Metro Investment Corporation
Metrobank Group

Foreign Direct Investment (FDI):
Hitting Historical High of USD5bn

Jan-Oct 2014 Net FDI touched all-time high of USD5.3bn, as both equities and debt instruments yielded above 50% growth in net inflows.

PH Net FDI posted 64% growth, highest in the region. The average growth in the region was at 3.75%, as the growth in the Philippines, Thailand (+58.2%), Singapore (+35.6%) and India (+18.6%) offset the contraction in South Korea (-21.5%), Malaysia (-2.3%), Taiwan (-13.9%) and China (-15.9%). Despite the strong growth it posted, the country still has the lowest net FDI in the region.

Looking at the different types of FDI:

- Net Debt Instrument @ USD3.26bn, +55%
- Reinvestment of Earnings @ USD0.71bn, +65%
- Net Equity @1.35bn, +89%

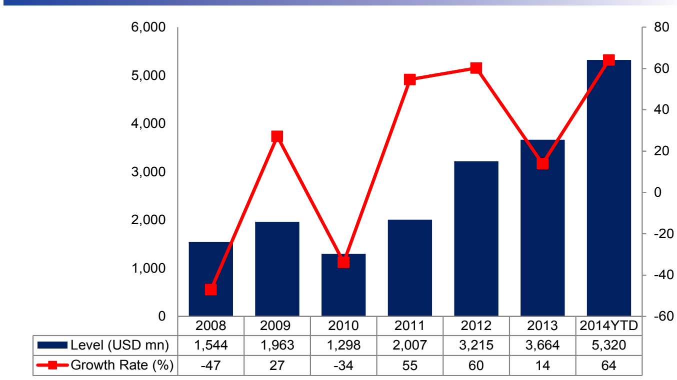
Debt instruments seemed to be the most attractive to foreign funds (about 61% of the net FDI). This counter benefitted the most after three institutions gave an investment grade rating for the Philippines (Fitch last March 2013; S&P last May 2013; Moody's last Oct 2013). These upgrades were due to the countries strong macroeconomic fundamentals and National Government's fiscal management program. Direct investors in emerging countries usually put their money first in debt instruments for secured interest gains.

As for the equity placements, Jan-Oct total was at Php1.35bn about 25% of total. About 90% of the total came from three sectors:

- Manufacturing @ USD244.93m, -4.78% growth, 18.1% of total
- Financial and Insurance Activities @ USD830mn, 379% growth, 61.4% of total
- Real Estate Activities @ USD140mn, 232% growth, 10.4% of total

It seems that foreign investors delayed their commitments to the Manufacturing Sector. Note that foreign investment commitments for the Manufacturing Sector in Jan-Oct doubled to Php55bn or USD1.23bn. Foreign investors remained bullish towards the Real Estate Sector as indicated by the 232% growth in FDI. This is despite the macro prudential measures of the BSP to avoid real estate asset bubble. Many listed real estate companies are still in expansion mode, especially for their retail and commercial segments. The Financial and Insurance Activities rebounded from a net outflow of USD298m (Jan-Oct 2013) to net inflow of USD830m in Jan-Oct 2014 amid the BSP's capital requirements and the enactment of the RA10641 (An Act Allowing the Full Entry of Foreign Banks in the Philippines). More so, many existing foreign banks hiked their capital in preparation for the entry of competitors from abroad. ▲

Philippine Foreign Direct Investment 2008-2014



Source: BSP
**2014 YTD: Jan-Oct 2014*

Change in Equity (net of retained earnings), Sept 2014

	Php Mn	USD Mn
ANZ Banking Group	1,076.06	24.02
Mizuho Corporate Bank Ltd.	1,438.39	32.11
Hongkong and Shanghai Banking Corporation	242.56	5.41
Bangkok Bank Public Co. Ltd.	1,935.44	43.20
Bank of America NA	1,156.20	25.81
Bank of China Limited	182.82	4.08
The Bank of Tokyo-Mitsubishi UFJ, Ltd.	2,402.43	53.63
Mega International Commercial Bank Co. Ltd.	1,220.53	27.24
Total	9,654.43	215.50

Source: BSP, Quarterly Banking Industry Report

(Philippine Gaming Sector.. continued from page 2)

ger is higher than Macau's 500,000 patacas (approx. Php2.7mn). According to PAGCOR, the high threshold will attract more foreign players. The move will be positive for the gaming sector, while preventing corrupt players from laundering money.

Outlook. Macau recovery is hard to anticipate in the near-term as President Xi Jinping is too keen in addressing the corruption in China. In addition, there are no new supplies expected until mid-2015, resulting in lack of catalysts for the Macau gaming sector. In spite of this, we anticipate a better year for the Philippine gaming sector as new capacities and a booming economy are highly anticipated in the next few years. In addition, casino players shift to other gaming destinations, which include the Philippines. The pessimism is overblown because the standpoints of regulation, geography and demographics of the Philippines will benefit from pent-up gaming demand from Macau's restrictions, e.g. disallowing travel to Macau by Chinese mainlanders by more than 2x in a quarter.

However, a 30% growth yearly is on the upper-end of the range and may be difficult to achieve due to its diversified market, which does not focus on high-rollers like Macau. Then again, higher gross gaming revenues may be attained if integrated resorts increase playing time and capital per player, maximizing the increasing consumer spending of the locals. On the other hand, the 30% corporate income tax implemented by the Bureau of Internal Revenue is earnings neutral. We are the catch-basin of the gaming spill over and not Singapore or Malaysia whose tax rates are 12% and 25%, respectively, for the VIP market compared to the Philippines' tax rate of 5%. This enables a more generous commission of 2% for junket operators, higher than the 1.2% of Macau. The Philippines is only a two-hour flight from Macau against four hours to Singapore and Malaysia. Without the Philippines, the next best alternative to Macau is Singapore, which is very expensive and requires USD20mn in gambling money as a minimum bet for VIP players. Note that half of that gambling money would suffice for a VIP status in the local gaming business. In other words, the Philippine market is never a direct competitor of Macau and Singapore and it is not dependent on Chinese VIPs. We are Asia's best niche market that is yet to be discovered.

Moreover, there is no cannibalization in the industry so far. Resorts World, which opened in 2009, never ate into PAGCOR's market share in terms of gross gaming revenues. The latter even went up by Php600mn. On the other hand, Solaire also added Php1bn to the Resorts World's existing Php1bn gross gaming revenues. Innovation Group and PAGCOR predict the local gaming revenues will grow from today's USD2.2bn to USD4.5bn, or a CAGR (2012-2017) of 27%.

Year-to-date Performance. Philippine gaming stocks slumped year-to-date as investors fear of a Macau gaming spill over. In spite of the PSEi's 6.1% growth year-to-date, BEL declined by -4.3%; BLOOM by -0.3%; MCP by -12.2%; and both PLC and RWM by -11.7%.

Valuation. PLC is estimated to have a 233% earnings growth in 2015 and is trading at 18.6x 2015E PE, still below local and global gaming average of 20.9x and 18.0x, respectively.▲

(Yield Curve.. continued from page 1)

initial 3% forecast, since the said forecast assumed oil trading at around USD80-100 per barrel. At the global front, demand for safety was triggered by deflation fears and uncertainties surrounding the Greece's snap election and potential exit from the EU. More so, the QE program of ECB and Bank of Japan pushed yields to record lows. The 10-yr rate ended at 3.1637%, down by 70 bps from end of 2014.

The National Government (NG) implemented two auctions this month: 1) T-Bill and 2) reissue of FXTN 20-20 (18 years to maturity). NG rejected all bids for the T-Bills auctioned last January 5, as bids were about 43.2bps higher (91-d @ 2.309%; 182-d @ 1.951%; 364-d @ 2.059%) than the December 1 auction. Market participants tried bidding higher yields due to tight liquidity of short-term (ST) papers at the secondary market. First week of Jan, demand from foreign clients was weak as the dollar continued to show strength. As for the re-issue of FXTN 20-20 (Jan 20), the bid/cover ratio hit 2.93x and average yield was at 3.855% (-6 bps lower than Jan 14 close). Demand was due to lower inflation expectations and supported by institutional clients. The last auction of GS with maturity of more than 10 years was last Sept 16, 2014.

Outlook: We believe that the low level of oil prices will continue to spur demand for government securities. Our house view of 2015 average inflation @ 2.7% will support low level of yields. For the next few days, there might a period of profit-taking after the announcement of the January 2015 inflation. The market will also be looking at the view or any change in language (if there is any) of the Monetary Board this coming Feb 16 meeting.▲

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