

TUESDAY, 22 JANUARY 2013

Sector Review

Property Sector Outlook: Demand is here to stay

Low interest rates to support continuous growth in housing demand. Aside from the country's favorable demographics, where the population is still growing by 1.9% annually and around 61.1% are aged between 16 and 65, low interest rates should help keep demand for residential properties strong.

We expect interest rates to remain low going forward. The BSP has little incentive to raise interest rates in the short term given the benign inflation outlook, the potential headwinds brought about by weakness in the global economy and the continuous strengthening of the peso. Over the longer term, the structural improvement in the government's finances as evidenced by its growing revenues and shrinking debt levels should help keep interest rates low.

Low interest rates coupled with the availability of longer payments terms lead to lower monthly amortizations on housing loans, making home purchases more affordable.

Low interest rates also make purchases of real estate more attractive for investors searching for higher yields. We estimate that the current yield on rental properties is at 5.5%. This is higher than the current yield of 4.5% on the 10-year T-bond and 3.5% on SDA.

The said factors have fuelled demand for residential properties in the past and will most likely continue to drive demand this year. For example, during the first nine months of 2012, take up sales of the five listed property companies that we monitor grew by 40% to Php152.8 Bil. Although it would be difficult to replicate the same growth pace, we still expect take up sales to be higher this year.

Despite prevailing concerns, we believe there is still no bubble in the housing market given the moderate increase in asset prices. According to Jones Lang LaSalle, the compound average annual growth rate of resale capital values between 2009 and 2012 is only moderate at 11% based on a sample of the existing luxury and high mid-end condominium developments in the Makati CBD and Bonifacio Global City.

There is also no oversupply, since property companies are very disciplined in controlling their launches in response to market demand. FLI and SMDC have already trimmed their launches last year in order to manage their existing inventory. Based on our discussions with other property companies, we expect them to follow the same strategy assuming that demand for their projects weakens.

Growth of BPO industry to support office rentals. Office buildings will continue to enjoy high occupancy rates this year as demand from the business process outsourcing (BPO) industry remains strong. The Business Processing Association of the Philippines or BPAP sees revenues from the business process outsourcing industry growing by 17.6% this year to US\$16 Bil. In terms of number of full time employees, BPAP expects the industry to employ 936,000 individuals, up 20% from around 772,000 in 2012.

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As of 9M12, occupancy rate of offices was around 95%. Based on the expected amount of new supply totaling 285,000 sqm from ALI, MEG, RLC, and FLI and annual demand of 300,000 sqm, the demand and supply situation should remain balanced in 2013, allowing landlords to enjoy high occupancy rates and a slow but continuous increase in office rental rates.

Commercial properties to benefit from the continuous growth of consumer spending. Mall and other commercial properties will continue to enjoy high occupancy rates and same store sales growth this year, fueled by the favorable outlook of consumer spending. Aside from the country's favorable demographics, consumer spending is expected to benefit from the continuous growth in the BPO sector which provides higher paying jobs. Consumer spending should also benefit from the resilience of OFW remittances. During 11M12, OFW remittances grew by 6% to US\$19.12 Bil. BSP is forecasting remittances to grow another 5% for FY13 from an estimated US\$24 Bil in FY12. Aside from the said factors, consumer spending should benefit from campaign spending resulting from the 2013 midterm elections. For example, according to a study conducted by the NSCB, the 2007 midterm elections resulted to a 0.34% increase in GDP.

Growth of tourism sector bodes well for hotels and resorts. The government is actively promoting Philippines as a must-experience destination in Asia. The Department of Tourism is committing to its marketing strategy with the roll out of tactical marketing campaigns highlighting key tourism destinations such as Palawan, Cebu, and Boracay. With the help from the government, we believe tourism industry is on the cusp of a strong growth phase which will benefit primarily the resorts and hotels. In addition to international visitors, the growth of the economy has also fueled more domestic travel both for leisure and business. Last year, tourist arrivals reached around 4.3 Mil, up 9.1%. For 2013, the government is targeting tourist arrivals to grow by 16.3% to 5 Mil.

Properties outside Metro Manila to benefit from improving infrastructure. Property developers with big landbanks outside Metro Manila will also benefit from the infrastructure projects being rolled out under the PPP. Expressways like the Daang Hari-SLEX link and railway projects such as the LRT Line 1 Cavite extension will cut travel time, effectively bringing provinces closer to the city. This will increase the attractiveness of projects outside Metro Manila. Aside from the LRT Line 1 Cavite extension, the government plans to bid out several expressway projects this year including the NAIA Expressway, the CALA Expressway, and the NLEX-SLEX Connector Road.

Airport projects will also indirectly benefit property companies as the rehabilitation of provincial airports can help in attracting travelers to the area. In cases where the airport will be relocated, the property where the old airport is located might be bid out by the government. This could act as an opportunity for property companies to increase their landbank. Although the only airport project to be rolled out in 2013 is the Mactan-Cebu International Airport Passenger Terminal Building, there are several airport projects in the pipeline including the airports in Misamis Oriental, Bohol and Palawan.

Valuations already reflect positive outlook; MEG and SMPH are top picks. Most property companies are no longer cheap. In January of 2012, property companies traded at an average discount to NAV of 51.9%. However, property companies are currently trading at an average discount to NAV of 26.7%. We believe a lot of the positives have been priced in, although there are still some stocks trading at reasonable valuations, necessitating a bottom up approach in picking stocks.

Exhibit 1. Discount to NAV of property companies

	Discount to NAV	
	Jan-12	Jan-13
FLI	60.2%	38.0%
VLL	56.0%	31.4%
MEG	55.2%	34.3%
ALI	36.7%	7.4%
RLC	51.4%	22.4%
Average	51.9%	26.7%

Source: COL estimates

Among the property stocks that we cover, we like MEG and SMPH the most.

MEG is expected to be one of the major beneficiaries of the favorable outlook for the residential and office sectors given its massive landbank. For example, it has 50 hectares of land in McKinely in the Fort area which remains as one of the top choices of BPO locators. It also owns several properties in prime areas of Metro Manila, and in Iloilo and Cebu. MEG also has a strong balance sheet, with a net cash of Php5.82 Bil as of 9M12, providing the company the ability to roll out and complete new projects to capitalize on the strong demand.

MEG also remains relatively cheap despite the recent run up in its share price. At Php3.20, MEG is trading at a 34.3% discount to our NAV estimate. This is despite the fact that MEG has a more efficient balance sheet as its landbank accounts for only 17% of our NAV estimate. In contrast, ALI is trading at a 7.4% discount to NAV despite the fact that its landbank accounts for 53% of its NAV.

Meanwhile, we like SMPH given its undisputed market leadership position in the commercial leasing segment which provides it with numerous advantages including greater efficiency and a strong bargaining power over its suppliers. As of end September 2012, SMPH had 3.2 Mil sqm of mall space, 272% more than the next largest player RLC. SMPH is also expected to be one of the major beneficiaries of the favorable outlook for consumer spending. Last year, it enjoyed same store sales growth of 8% vs. its historical average of around 6%. Same store sales growth should remain elevated this year at around 7% and 8%, buoyed by the favorable outlook for consumer spending.

SMPH is currently trading at 25.71X FY13 P/E, which is slightly above the 23.7X average of the consumer sector. We believe this slight premium is warranted given the stability of SMPH's earnings. As a landlord, SMPH's income is not affected by the volatility in commodity prices, but reaps the benefits of strong consumer spending.

Investment Rating Definitions

BUY	HOLD	SELL
<p>Stocks that have a BUY rating have attractive fundamentals and valuations, based on our analysis. We expect the share price to outperform the market in the next six to twelve months.</p>	<p>Stocks that have a HOLD rating have either 1.) attractive fundamentals but expensive valuations; 2.) attractive valuations but near term earnings outlook might be poor or vulnerable to numerous risks. Given the said factors, the share price of the stock may perform merely inline or underperform the market in the next six to twelve months.</p>	<p>We dislike both the valuations and fundamentals of stocks with a SELL rating. We expect the share price to underperform in the next six to twelve months.</p>

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