Equity Strategy - Philippines

3Q23 may see slower core profit growth as inflation, interest rates bite

Equity Strategy

13 October 2023

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ASEAN | Philippines

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Profit growth in 3Q may slow on aggregate

For the universe of 36 stocks we cover, we reckon that on aggregate, core profit growth in 3Q23 may slow. Recall that core profit grew 27% in 1H23. For FY23, our estimates point to 19% earnings growth, which imply slower 3Q/2H growth. However, on a per stock basis, only 16 of 36 are seen to report slower growth but these are the larger-cap banks, conglomerates and property stocks (See Exhibit 2).

Overall, we think revenue growth would slow, as base effects from year-ago re-opening and election-related spending have almost fully faded. Demand may also be challenged by resurgent inflation. Margins seen mixed as commodity prices look more favorable, but for oil and foreign exchange. Financing charges too would take a bite out of earnings at companies with more leveraged balance sheets.

Banks: Rising NIMs, falling credit costs

Net Interest Margins to stay firm in 3Q23 as funding costs look to have peaked. Improving asset quality and declining credit costs would also provide an earnings lift. These may be enough to offset softer-than-expected loan growth, tracking 7% as of August and below our 8-10% forecast range for FY23.

Consumer: Retail may do better than staples

Staples likely a mixed bag. Softer commodity prices partly offset by higher fuel. Resurgent inflation may crowd out discretionary spending though this is mitigated by return-to-school and return-to-work. Retail benefitted by the July minimum wage hike.

Properties: Retail growth, steady office, mixed residential

The retail rebound in 3Q would not be as sharp as in 1H23. Office to remain stable with no visible shift in occupancy and rental rates among the property stocks we follow. Residential would be stronger up-market than in the affordable segment.

Power: Spot prices dip in 3Q but volumes sustained

The dip in electricity spot prices in 3Q may be short-lived as early 4Q spot prices recover on the back of unplanned generation outages in the sector. Volume growth may be stronger among the generators than distributors in 3Q.

Telcos: Lacks telco growth; non-telco flourishes

Overall revenue growth to stay muted, weighed down by lack of mobile growth. Pre-paid fiber broadband starting to gain traction. Enterprise likely to rebound from a disappointing 2Q. Non-telco fin-tech initiatives flourish toward critical mass.

Timestamp: 13 October 2023 05:02AM EDT

Exhibit 1: 3Q23 earnings expectations and FY23 core profit forecasts

What to expect from the upcoming 3Q earnings season

Company name (Bloomberg ticker)	Core profit growth (% YoY)			3Q results expectations
	1Q23	2Q23	FY23	
Ayala Corp. (AC PM)	60	50	30	Cyclicals BPI and ALI will drive bottom-line. ACEN also to provide additional uplift while performance of smaller business may remain mixed although we no longer expect additional provisioning (particularly from Yoma) to be booked. Php5.7bn gain from MWC partial sale in Oct-2023 to be booked only in 4Q.
Aboitiz Equity Ventures (AEV PM)	44	11	8	AP to remain the strong 3Q23 core profit driver for AEV as UBP continues to deal with the Citi-integration costs. Land should see similar 2Q23 weakness in reservation sales. Food may be the upside risk to earnings as they should sustain their 2Q23 profitability with raw material costs relatively flat QoQ. We also expect an update on the pending CCBPI purchase.
AC Energy (ACEN PM)	400	24	(31)	We expect sustained power generation volume growth across both Philippine and International portfolios as commissioning activities start for new plants starting 3Q23. Modest QoQ profit growth expected with ramp up of new capacity. Higher spot prices expected in 4Q also an upside moving forward given ACEN is a net seller to spot.
Alliance Global Group (AGI PM)	20	5	18	EMI and MEG to drive revenue and profits. MEG is expected to grow profits 28% in FY23E driven by resilient residential and stable office supported by rising retail. EMI to continue to deliver steady profits amid intense competition and margin pressure as revenue contribution shifts to whisky. Additionally, Travellers and McDonald's are no longer a drag– but these two account for only 10% of profits.
Ayala Land Inc (ALI PM)	42	40	34	3Q23 earnings to still be largely from residential segment, supported by stable office and rising retail. Residential revenues to be driven by completions, while mall revenues supported by return to pre-pandemic performance. Offices stable, owing to prime assets in key business districts and sticky tenants.
Aboitiz Power Corp. (AP PM)	158	68	14	YoY growth for AP should start to taper in 3Q23 now that the base effects of GNPD units 1&2 are fading. On a QoQ basis, we expect a drop off in core profit given lower demand from the peak summer months and softer spot prices in 3Q23 as we estimate a ~25% decline to Php5.5/kWh. However early 4Q data shows spot prices spiking again back to P8.5/kWh due to Malampaya supply disruptions and plant outages.
AREIT Inc (AREIT PM)	25	26	53	3Q23 earnings should show significant jump as new assets to start accruing following regulatory approvals. Occupancy should stay high (98% as of 1H23) while WALE remains at least 3 years, ensuring stable cashflow over that time frame.
BDO Unibank (BDO PM)	41	53	31	Loan growth should trend closer to 8% YoY with profit growth likely up high double digit on robust NIMs and lower credit costs. Low single-digit profit growth QoQ, driven by sustained NIMs.
Bloomberry (BLOOM PM)	338	72	42	QoQ, overall 3Q GGR likely down on the back of low hold rates seen in the months of July and August. This is despite steady volume growth. YoY, we think overall GGR will still see strong growth, still driven by its mass gaming business.
Bank of the Philippine Islands (BPI PM)	52	4	21	QoQ earnings likely down despite sustained net interest income growth on potential non-interest income softness and a catch-up in provisioning. Management guiding for a lower credit growth of 8% YoY, from low double-teens, suggesting soft loan growth figures in 3Q. YoY profit up double-digits on robust NIM.
Converge ICT (CNVRG PM)	10	7	19	Steady 3Q core profit growth in the 8-10% range, driven by a strong topline as the momentum of low-cost fiber appears to be sustained and cost control measures that provide some margin support. However, we also expect churn and provisioning to remain elevated due to the growth in prepaid.
D&L Industries Inc (DNL PM)	(24)	(31)	16	3Q23 earnings weighed down by the full impact of the operations of the new Batangas facility which commenced in June 2023. Underutilized capacities may take years to ramp up; high base on volume sales of commodities and narrowing GPM on this segment would weigh down earnings; The same factors seen to affect 4Q23.
Emperador Inc (EMP PM)	10	(11)	6	3Q23 is seasonally slow for liquor businesses particularly in PH; intense competition negatively affecting the brandy segment as even higher ad spend in 2Q23 may not help lift earnings through 3Q23; Whisky segment expected to buoy earnings which is mainly driven by price increases towards 4Q23
San Miguel Food and Beverage FB PM)	(8)	(7)	25	3Q23 beer sales volume will remain weak; gin sales volume looks toppish. Food group will see recovery in terms of earnings vs 1H23 on better poultry supply and wider margins. FY23 has non-recurring items booked from beer and GSMI, thus, core profit seems lower YoY.
FirstGen Corp. (FGEN PM)	60	9	10	We expect 3Q results to be in-line QoQ as lapsed EDC contract in 4Q22 provides a base effect. Malampaya outages in late September/Early October a downside risk as San Gabriel (500MW) is unable to run on alternative/liquid fuel.
Int'l Container Terminal Services Inc (ICT PM)	17	6	10	3Q23 volume growth to come from ports outside of Asia driven by economic recovery of the respective host countries. The yield per TEU higher YoY on higher tariffs awarded; we assume that the JV for Durban will come online in 1Q24 and boost volume throughput and yield per TEU next year.
Jollibee Foods Corp. (JFC PM)	433	11	413	3Q23 likely to see challenges from the international businesses particularly in China; PH operations should remain main driver of earnings growth as the resumption of 100% face-to-face classes this year is earlier versus last year; debt servicing may weigh down earnings through 4Q23; low visibility on the store conversion in North America is a downside risk.
JG Summit Holdings (JGS PM)	(279)	138	98	URC and RLC to still drive earnings, though CEB and JGSOC (petrochem) should see improvement owing to the low oil price environment during 3Q23. Overall, consumer-centric subsidiaries and investee companies to deliver stable earnings during the quarter and the remainder of the year.

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What to expect from the upcoming 3Q earnings season

Company name (Bloomberg ticker)	Core profit growth (% YoY) 1Q23	2Q23	FY23	3Q results expectations
LT Group Inc (LTG PM)	(2)	(25)	(5)	3Q23 tobacco sales volume seen to continue to drop YoY on growing product substitutes and down trading due to high prices of tobacco driven by higher excise tax (regressive impact of excise tax); Banking earnings lower YoY due to high base from last year's ROPA sales. Tobacco and banking accounts for at least 80% of LTG earnings.
Metropolitan Bank & Trust Co (MBT PM)	31	37	34	Stellar YoY profit growth driven by lower provisioning and broad-based revenue growth with higher NIMs and sustained fee-based income. QoQ, profit up low double digit amid sustained NIMs, muted cost growth, and a double-digit decline in credit cost.
Megaworld Corp. (MEG PM)	33	36	28	Stable 3Q23 earnings expected driven by resilient residential, specifically the upscale market, and stable office supported by rising retail.
Manila Electric Co (MER PM)	40	53	11	MER 3Q23 YoY growth to start to normalize as impact of strong generation profit contribution started in 3Q22. We expect QoQ profit to show modest growth as their Singapore investment in PacificLight sustains growth given their fixed-price contract ending in 1Q24.
Manila Water Co MWC PM)	108	51	35	Strong base effects from tariff hike implemented in 1Q23 should continue into 3Q23. Volume growth should be sustainable (5% in 1H23) in 3Q23 as El Nino risk faded as we saw more rainfall in July-August.
Monde Nissin Corp. (MONDE PM)	(17)	(17)	(15)	3Q23 may see sequential improvement in earnings as APAC BFB's noodles should pick up as the company noted that rainy season may drive demand; GPM expected to improve as the lower locked in wheat and palm oil prices are expected to be realized in 3Q23 and 4Q23; However, meat alternatives woes may see minimal QoQ earnings improvement and insufficient to service its own debt; domestic business expected to cover for the payment of cash dividends and paying down debt in UK in 2H23; SEC approved MONDE's deficit wipeout but may have minimal unrestricted retained earnings to payout cash dividends.
Nickel Asia Corp. (NIKL PM)	(8)	(72)	18	3Q23 nickel ore sales expected to be lower YoY on weak demand from China due to slow down in stainless steel demand and further weighed down by lower nickel prices (Shanghai metals and LME); FY23 volume guidance is expected to be lower than 18mn WMT. FY24 will be highly dependent on the recovery of China's economy and demand for EV batteries.
Puregold Price Club (PGOLD PM)	12	(6)	5	3Q23 earnings growth will be driven by higher store network growth, 20 additional DiviMarts assumed in 3Q23 alone and in 4Q23, additional 10 will be added. Revenue driver for 3Q23 is the resumption of 100% face-to-face classes. FY24 revenue growth may also be driven by additional S&R stores on top of the new DiviMarts. Holiday spending also expected to drive earnings growth.
Robinsons Land Corp. (RLC (PM)	90	(14)	28	Earnings to be driven by retail property, as the second largest mall operator. This will be supported by resilient residential and stable office.
Robinsons REIT (RCR PM)	10	9	15	No new property infusions in FY23 so growth should match escalation rates of existing contracts. Occupancy remains high (99% as of 1H23) with WALE (weighted average lease expiry) still at least 3 years, implying stable cashflow over the same period.
Robinsons Retail Holdings Inc (RRHI PM)	21	3	1	3Q23 revenues driven by non-essential store formats boosted by rising discretionary expenses mainly from the resumption of 100% face-to-face classes which commenced in August 2023. Margins expected to improve slightly. All formats are expected to deliver strong 4Q23 YoY due to holiday spending.
Semirara Mining Corp. (SCC PM)	(40)	(6)	(16)	We expect a weaker 3Q23 result from SCC as rainy season may have hampered coal shipments in the quarter and Newcastle coal prices averaged US$145/mt (-10% QoQ). Spot prices were estimated to be ~25% lower QoQ and impacts their power segment that is 70% exposed to WESM (Wholesale Electricity Spot Market).
Security Bank SECB PM)	(13)	(27)	6	High double-digit profit growth to be seen on a QoQ and YoY basis. Balance sheet rationalization will continue to drive net interest income growth with recent margin gains to be sustained. Non-interest income will continue to see softness while provisioning likely up QoQ, albeit down YoY.
SM Investments Corp. (SM PM)	33	42	17	3Q23 earnings will be driven by banking. Property and retail. Banks continue to benefit from high interest rate environment. Both SMPH and SM Retail driven by consumer-driven growth despite inflationary pressures in 3Q.
SM Prime (SMPH PM)	27	50	27	Malls, cinema ticket sales and hotels will be main drivers for revenues in 3Q23, while residential to slowly recover. Malls continue to benefit from higher foot traffic and tenant sales despite elevated inflation in 3Q23. Reclamation in Manila Bay still on hold, though we believe review by DENR (Dept. of Environment) has been completed.
PLDT (TEL PM)	5	(0)	3	We expect PLDT to resume its low-mid single digit revenue/core profit growth, driven by steady mobile/broadband segments and strong Enterprise segment after a relatively soft 2Q. We expect Enterprise to improve after disappointing in 2Q, while losses in Maya should continue to narrow. Impact of SIM registration will be felt for the first time since the July deadline - no impact on topline, but effect will be seen in subscriber count and ARPUs.
Universal Robina Corp. (URC PM)	11	11	12	3Q23 to sustain better volume sales particularly on Branded Consumer Foods - Philippines as it recovers from the setback of their system migration in 1Q23; fill rates in 3Q23 expected to improve further nearing 90% from 60% in 1Q23; 4Q23 earnings should see strong earnings growth as it is coming from a low base; In early FY24, earnings would be coming from a low base due to the weak sales volume of Branded Consumer Foods-Philippines in 1H23.
Unionbank of the Philippines (UBP PM)	30	(12)	6	QoQ, we expect low double-digit profit growth with single-digit PPOP growth on sustained net interest income. Provisioning to fall QoQ but should be materially higher YoY. YoY, profit likely to be weighed down by integration costs and higher opex with Citi only being consolidated effective August 2022.

Source: PEP estimates

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Exhibit 2: 3Q23 core profit growth expectations versus 1H23

We expect 21 of the 36 stocks we cover to show same or stronger 3Q growth, compared to 1H23. However, we see a number of large-caps showing slower growth

3Q growth expectations

	Slower than in 1H23	Same or Higher compared to 1H23
1	AC	AGI
2	AEV	AREIT
3	ACEN	CNVRG
4	ALI	DNL
5	AP	EMI
6	BDO	FB
7	BLOOM	FGEN
8	BPI	ICT
9	MEG	JFC
10	MER	JGS
11	MWC	LTG
12	RRHI	MBT
13	SM	MONDE
14	SMPH	NIKL
15	UBP	PGOLD
16		RLC
17		RCR
18		SCC
19		SECB
20		TEL
21		URC

Source: PEP estimates

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Sector views

Banks

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In 3Q, we still expect most banks to sustain their 2Q margin with a bias towards an increase as asset yields continue to reprice while funding costs appear to have peaked. Based on our channel checks, time deposit rates have started to ease. Loan growth likely to miss with industry numbers pointing to growth of 7.2% YoY as of end-August vs. our FY23 estimate of 10%. Tepid corporate lending amid high rates continue to weigh on demand. Nevertheless, bottom-line growth will remain robust on the back of high NIMs and lower credit costs. Prefer big banks over mid-sized banks.

Consumer Staples

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We see a mixed bag for the consumer staples through 2H23, owing to the respective business strategies of each company facing the various headwinds such as input costs and consumer trends.

In our view, all consumer staples should benefit from the easing prices of soft commodities, going back to 2020 to 2021 levels, such as wheat, palm oil, corn except sugar. However, even as oil prices have already subsided versus 2022, gross margins remain at risk in 2H23. Revenues may be driven more by price increases than volume. Meanwhile, increasing business activities and intense competition as business activity normalize leads to higher operating expenses, particularly ad spend and distribution costs.

We focus on the core profit growth to evaluate properly the earnings and cash flow from operations of the company. JFC has the highest core profit growth due to very low base as stores in China and Philippines were closed due to COVID. We believe that growth may taper in 4Q24 as business activity normalizes. In this case, the winner would be the company that has optimal production capacity expansion. URC appears to be on track to expand sales volume growth through FY23 via the mega plant (south of Metro Manila) which will commence operations in 1Q24, a continuing volume growth in 2H23.

Consumer retail

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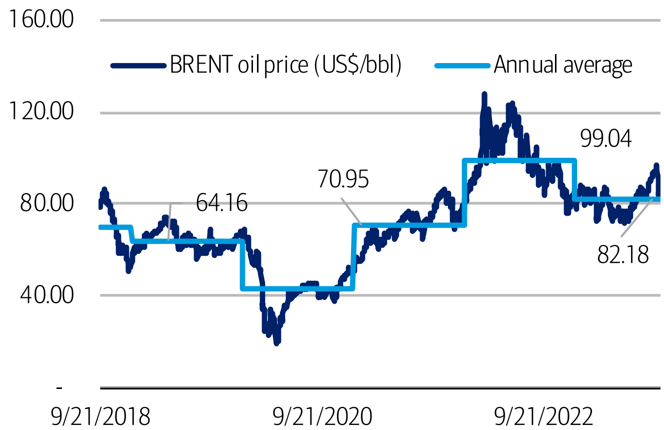
The rising discretionary spending in 2Q23 is seen to continue through 3Q23 despite elevated inflation rates. The resumption of 100% face-to-face classes is seen to drive demand for retailers regardless of formats. We see retailers catering to the middle income and up to benefit the most aside from retailers who grew store network significantly in 3Q23, Puregold increased by 20 stores as it assumed DiviMarts. 4Q23 holiday spending to boost revenues and earnings but this period may be coming from a high base. Puregold is focused on expanding its store network to increase customer base. By comparison, RRHI may be somewhat distracted by its effort to complete the acquisition of a minority interest in BPI which it secured by swapping its share in Robinsons Savings Bank – which will boost dividend income.

Exhibit 3: BRENT oil price 5-year trend

BRENT oil price year-to-date FY23 average price of US$82.18/bbl is significantly down vs FY22 at US$99.04/bbl however still higher than pre-pandemic average price levels; packaging costs are mostly correlated to oil price



Source: Bloomberg, BofA Global Research

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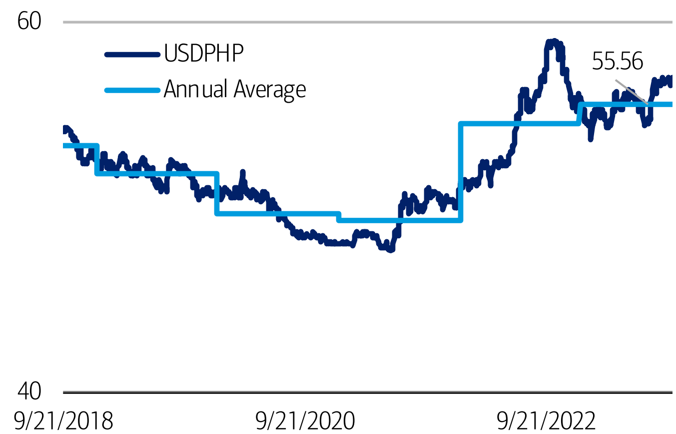
Exhibit 4: USDPHP 5-year trend

Imported raw materials prices, including oil, is made expensive by a weak peso; gross margins across consumer sector may not return to pre-pandemic levels if USDPHP continues to be elevated



Source: Bloomberg, BofA Global Research

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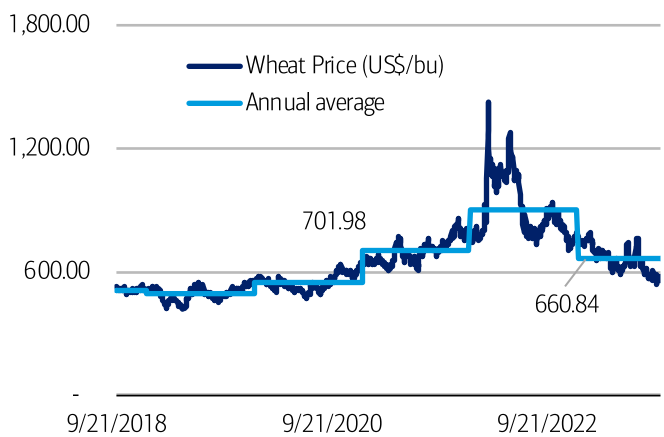
Exhibit 5: Wheat price 5-year trend

Post Ukraine-Russian conflict in 2022, annual average price of wheat has gone below pre-pandemic level, which would benefit food manufacturers



Source: Bloomberg, BofA Global Research

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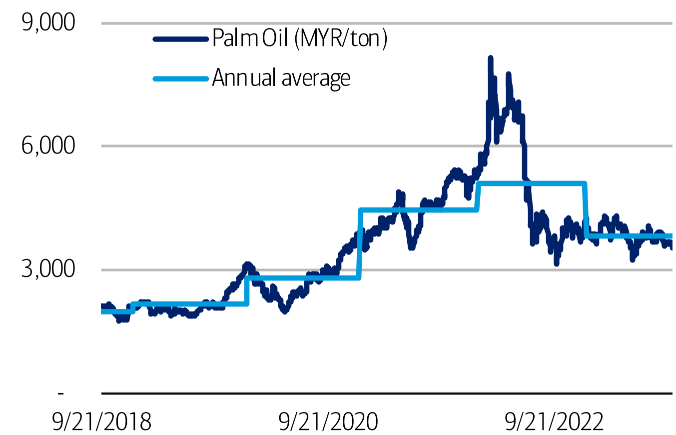
Exhibit 6: Palm oil price 5-year trend

Average year-to-date palm oil price has gone down significantly to pre-Ukraine-Russian conflict in 2022; fears of shortage due to El Nino seemed to have waned as prices continue to soften



Source: Bloomberg, BofA Global Research

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Mining

China's economy and the demand for electronic vehicle batteries will remain as the driver of demand for nickel. In 3Q23, China continues to reel from economic issues and low demand for stainless steel, which drives the demand for nickel pig iron and in turn drives the demand for nickel ore, may continue to be weak. 60% of Nickel Asia Corporation (NIKL) sales volume is exported to China which uses negotiated prices indexed to Shanghai metals. Meanwhile, the remaining 40% volume sales may be weighed down by soft LME nickel prices which continue to drop year to date to US$8.30/lb level (coming from US$10/lb in early 2023). These are consistent with our expectations of lower dividends from NIKL in FY23.

Transport

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International Container Terminal Services, Inc. (ICT) 2H23 volume throughput is seen to grow mid-single digit as the international ports outside of Manila and Manzanillo start to recover. Yield per TEU continue to rise on higher tariffs while % of cash operating expenses may be tempered as oil prices average below US$90/bbl. Upside would be the Durban port's assumption of operations in 1Q24 which may boost volume growth through FY24. FY23 EBITDA margin may be sustained at 63%.

Property

Retail property will continue to lead, driven by sustained consumer activity despite elevated inflation rates. Hotels to also capitalize on increased activity as foreign arrivals pick up to support the largely domestic driven growth. Office to remain stable as higher-grade offices are less impacted by vacancy and rent pressure. Residential revenues to post marginal growth as completions pick up. Middle-income to luxury segments largely unaffected by high interest rates, outperforming lower-income and affordable segments.

Telcos

While the modest growth trend in the sector may continue, the outlook for the sector is improving. Low-cost fiber appears to have gained momentum in its early launch, benefitting CNVRG the most after their prepaid launch in June. Enterprise disappointed in 2Q, but we expect growth in the segment to resume in 3Q, outpacing mobile and broadband. Meanwhile, non-telco/fintech will continue to flourish. We expect losses at Maya/Voyager to continue to narrow, while profits at Mynt/GCash to further improve. We will also see the impact of SIM registration for the first time since the July deadline – no impact on topline, as its impact will only be seen in ARPUs and subscriber counts.

Power & utilities

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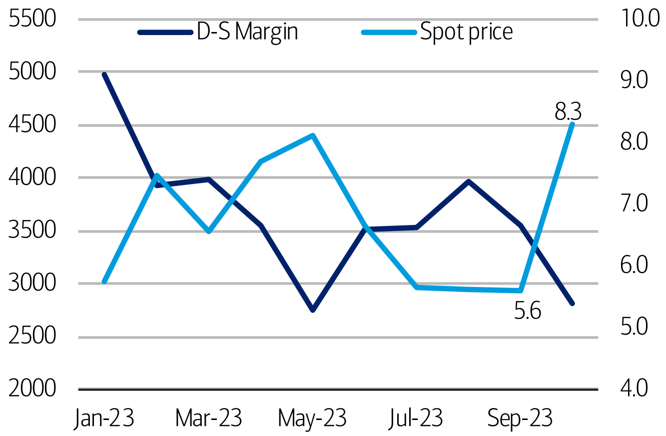
We expect the power and utility sector results to broadly be in-line or beat our expectations. An exception to this may be SCC as the rainy season starting July may have disrupted coal shipments in the quarter. On distribution, 3Q23 power demand growth is expected to sustain 2Q's 5% YoY print, a positive trend for the distribution segments of MER and AP that saw 1Q distribution volume growth at only 2%.

Meanwhile, spot prices saw a meaningful 25% drop QoQ from P7.5/kWh to an estimated P5.6/kWh in 3Q23. This may result in lower margins QoQ for gencos with significant spot exposure in SCC (~70%) and AP (~21%). However, supply curtailments from Malampaya and unplanned plant outages in end-September to early October have drove spot prices up to P8.3/kWh currently. We expect low 3Q23 spot prices may be short-lived as supply disruptions may keep spot elevated heading into 4Q23.

Exhibit 7: Monthly Demand-Supply margin vs. Spot price average
3Q23 spot prices fell 25% QoQ, though supply disruptions may keep prices elevated in 4Q23.



Source: IEMOP, PEP estimates

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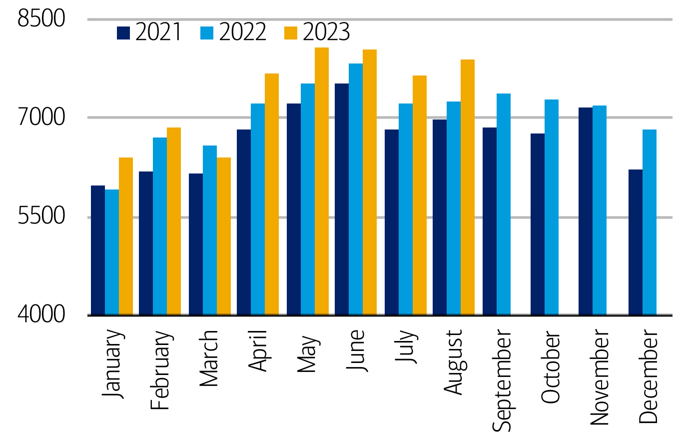
Exhibit 8: Monthly total metered quantity
August demand saw a rebound MoM as July experienced more rainfall this year.



Source: IEMOP, PEP estimates

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