A. Soriano Corporation

Bloomberg Ticker:	ANS:PM	Closing Price (2/23/17):	PHP6.34
6 Month Avg. Daily Vol. (USD mn):	0.017	Market Cap (USD mn):	156
Estimated Annualized Return:	18.0%		

February 23, 2017

INVESTMENT THESIS

A. Soriano Corporation (Anscor) is a Filipino investment holding company with investments in many different industries. The company has a healthy balance sheet and consistently generates a return on equity around its discount rate. Despite the healthy balance sheet and the consistency of the company's ROE, Anscor trades well below its book value currently at 0.56 times book and at 5.46 times cyclically adjusted earnings. There is significant upside to the company's earnings valuation (110% upside) and asset valuation (77% upside). We are taking a 2.0% starting position as the stock is very illiquid.

COMPANY DESCRIPTION

Anscor was incorporated on February 13, 1930. It is an investment holding company located in the Philippines. Anscor's largest investments are Phelps Dodge International Philippines, Inc. and Seven Seas Resorts and Leisure, Inc. Other investments include Cirrus Medical Staffing, KSA Realty, Prople Limited, and Enderun College among others.

Phelps Dodge International Philippines

Phelps Dodge International Philippines, Inc. (PDIPI) was incorporated in 1955 and started production in 1957. Its products are primarily copper-based wires and cables including building wires, telecommunication cables, power cables, automotive wires and magnet wires. PDIPI has a technical assistance contract with General Cable Company (GCC), the second largest cable company in the world. GCC was also a shareholder in PDIPI until December 2014 when Anscor acquired GCC's 60% shareholding for PHP3.0 billion. The Philippine wire and cable industry is comprised of both imported and domestically manufactured products. The four largest manufacturers are Phelps Dodge, American Wire and Cable Co., Inc., Columbia Wire and Cable Corp., and Philflex Cable Corp.

PDIPI and Subsidiaries	2013	2014	2015
Total assets	2,824	3,327	3,489
Equity	2,307	2,905	1,872
Net sales	5,726	6,552	6,102
Gross profit	823	1,123	1,126
Net income	434	536	574
Gross margin	14%	17%	18%
Net margin	8%	8%	9%
Asset turnover	2.0	2.0	1.7
Return on assets	15%	16%	16%
Return on equity	19%	18%	31%

Revenue by Product Line	2013	2014	2015
Building wires	75%	75%	75%
Autowires	9%	9%	9%
Communication/special	11%	11%	11%
Power cables	5%	5%	5%

Source: Company data

Over the past three years, PDIPI's average return on assets of 16% is well above its discount rate pointing to potential barriers to entry within the industry. Despite the strong returns, the industry is fragmented. There are no supply side barriers to entry as copper cables are a relatively simple product to manufacture and there is no favorable access to raw materials as raw materials are commodities that can be purchased from many suppliers. There are no demand side barriers to entry as purchasing copper cables does not create habit and there are no switching costs, search costs, or network effects. There may be some economies of scale but with gross margin at only 14%, it seems the cost structure of the business is primarily variable eliminating any real barriers to entry from economies of scale.

Seven Seas Resorts and Leisure

Seven Seas Resorts and Leisure, Inc. (SSRL) was incorporated on August 28, to plan, develop, operate and promote Pamalican Island as a world-class resort. The resort is named Amanpulo and started commercial operations on January 1, 1994. SSRL inventory is 103 rooms with 40 original casitas and 63 rooms in villas. SSRL is a joint venture between Anscor, Palawan Holdings, Inc., and Aboitiz & Co with Anscor owning 62% of the resort.

The resort's services are offered through the worldwide Amanresort marketing group based in Singapore, accredited travel agents, reservation sources/systems, and direct selling. Amanpulo is in competition with all other small 5 star resort companies in other destinations that are generally better known than the Philippines, such as Indonesia, Thailand, and Malaysia.

According to reviews on Tripadvisors.com, 90% of Amanpulo's reviews were excellent, the highest rating. It is rated as the #1 hotel in Palawan Province.

Seven Seas Group	2013	2014	2015
Occupancy rate	43.1%	34.4%	47.0%
Hotel revenue	445	527	645
Gross operating profit	59	57	197
Net income (loss) after tax	(16)	(32)	167
Total assets	1,372	1,655	1,799
Total equity	800	766	731
GOP ratio	13%	12%	31%
Net margin	-4%	-6%	26%
Asset turnover	0.3	0.3	0.4
Return on assets	-1%	-2%	9%
Return on equity	-2%	-4%	23%

Revenue Breakdown	2013	2014	2015
Rooms	53%	54%	54%
Food and beverage	24%	21%	23%
Others	23%	25%	23%

Source: Company data

Until 2015, SSRL failed to earn a reasonable return on assets. The company also failed to generate any meaningful growth with revenue increasing from PHP517 million in 2011 to PHP645 million in 2016. Similar to PDIPI, there does not seem to be any barriers to entry. There are thousands of luxury resorts around the world illustrating the lack of barriers to entry within the industry. There are no supply side advantages in owning a luxury resort. There are no demand side advantages. If there are economies of scale within the industry, SSRL is a smaller resort, which would be disadvantaged.

Cirrus Medical Staffing, Inc.

Cirrus Medical Staffing (Cirrus) is a US-based nurse and physical therapist staffing business. It places registered nurses on contracts of twelve weeks or longer. In January 2008, Anscor acquired Cirrus. Cirrus has a preferred vendor relationship with the US's largest home health company. Anscor owns 94% of Cirrus.

Cirrus Group	2013	2014	2015
Service income	1,201	1,250	1,850
Cost of services provided	998	1,018	1,469
Gross profit	203	232	382
EBITDA	(4)	32	109
Total assets	853	883	1,041
Total equity	731	759	912
Gross margin	17%	19%	21%
EBITDA margin	0%	3%	6%
Asset turnover	1.4	1.4	1.8
EBITDA ROA	0%	4%	10%
EBITDA ROE	-1%	4%	12%

Source: Company data

Similar to SSRL, Cirrus did not generate an acceptable on assets until 2015. Unlike SSRL, Cirrus has been growing its business at a rapid pace. Since 2011, service income growing by 16.7% per annum, gross profit grew by 21.3% per year, and EBITDA grew by 90% per year.

The nurse and physical staffing business is very fragmented and there are no supply side advantages. Potentially, there are demand side advantages in the form of switching costs. When using a staffing agency for a large number of employees as long as the staffing agent is doing a good job, the client should continue to use the agent and the agent has a bit of pricing power due to the cost of switching providers. The client can easily offset the staffing agent's bargaining power by using multiple providers. For small clients, it seems like the potential for a demand side advantage is much smaller as it is easier to find the necessary supply of labor. Economies of scale do not exist in the industry.

KSA Realty Corporation

Anscor exchanged its old building located at acquired a 11.42% stake in KSA Realty Corporation (KSA) 1990 in exchange for Paseo de Roxas in Makati. KSA develop The Enterprise Center, a two tower, grade A office building located in Makati.

KSA Realty Corporation	2012	2013	2014	2015
Gross rental income	765	827	900	992
Net income	524	618	690	1,300
Revaluation gain	-	350	-	517

Source: Company data

In 2015, KSA had an occupancy rate of 96%, generating PHP992 million in revenue, and PHP1,300 million in net income including a PHP517 million revaluation gain. Despite a decrease in the occupancy rate from 2013, KSA was able to increase revenue by 20% over the past two years. KSA's assets have been revalued twice in the past three years. There are no competitive advantages in the property business.

Enderun Colleges, Inc.

In October 2008, Anscor acquired 20% equity stake in Enderun Colleges, Inc. Enderun was established in 2005 by a group of business leaders, including senior executives from Hyatt Corporation in the U.S., Enderun offers a full range of bachelor's degree and non-degree courses in hospitality management, culinary arts, and business. Enderun has close to 1,200 full time and certificate students spread almost evenly across the school's three main degree offerings.

Enderun recently launched Enderun Extension, a continuing education unit that is the college's language training and tutorial business. In 2014, Enderun launched a hotel and management consultancy unit. Several hotels and resorts are under Enderun's management.

Management expects Enderun to deliver double-digit growth in the coming years.

Enderun Colleges, Inc.	2013	2014	2015
Revenue	406	457	493
EBITDA	90	120	139
Consolidated net income	39	64	94
Sales growth	12%	13%	8%
EBITDA margin	22%	26%	28%
Net margin	10%	14%	19%

Source: Company data

Within education, there is a brand advantage at the very elite schools but Enderun does not have that advantages.

Prople Limited

In December 2007, Anscor acquired 20% of Prople for US$800,000. In November 2013 acquired 100% of the non-audit business of US-based Kellogg and Andelson Accountancy Corporation (K&A). Founded in 1939, K&A is a well- established accounting firm that provides tax, general accounting, and consulting services to thousands of small to medium sized companies in California and the Midwest. It operates out of five locations in Los Angeles, Woodland Hills, San Diego, Kansas City and Chennai (India). Following its acquisition of K&A, Prople now employs 373 people serving over 5,500 clients from operations located in six cities worldwide. In 2015, Prople closed K&A's San Diego office and client attrition in the Midwest. Prior to the acquisition of K&A, Prople's services included business process outsourcing, knowledge process outsourcing, and content services. K&A tripled the company's revenue.

Prople Limited	2013	2014	2015
Revenue	168	508	443

Source: Company data

With the acquisition of K&A, Prople is primarily a tax, accounting, and consulting provider. Professional services, like tax and accounting, have some switching costs as the provider is embedded in the company's operations becoming an integral part of the team. Despite the switching costs, the industry is fragmented and bargaining power of the provider can be decreased by using multiple suppliers.

AGP International Holdings Ltd.

AGP International (AG&P) is Southeast Asia's leading modular fabricator of refinery and petrochemical plants, power plants, liquid natural gas facilities, mining processing, offshore platforms, and other infrastructure. AG&P has 110 years of experience serving clients like British Petroleum, Shell and Total.

Anscor made its first investment in AG&P in December 2011. In June 2013, Anscor subscribed to 83.9 million series C, voting preferred shares in AG&P. Series B and Series C preferred shares are convertible at the option of the holder, into class A common shares. The subscription increased Anscor's holdings to 27%.

AGP International Holdings Ltd.	2013	2014	2015
Total assets	10,743	15,060	17,118
Equity		5,204	6,168
Revenue	3,358	9,589	16,657
Income (loss) from continuing operations before tax	445	(171)	614
Net income (loss)	377	(250)	569
Net margin	11.2%	-2.6%	3.4%
Asset turnover	0.3	0.6	1.0
Return on Assets	3.5%	-1.7%	3.3%
Return on Equity		-4.8%	9.2%

Source: Company data

Similar to cable manufacturing there are no barriers to entry within the modular fabrication.

Anscor's businesses do not appear to be competitively advantaged. The lack of barriers to entry makes industry analysis irrelevant.

Shareholder	Relationship	Total direct & indirect shares	% to Total Outstanding Shares
Anscor Consolidated Corporation	100% Subsidiary	1,267,326,746	50.7%
Andres Soriano III	Director	489,428,270	19.6%
Eduardo J. Soriano	Director	188,515,944	7.5%
Edmen Property Holdings, Inc.	Affiliate	27,462,404	1.1%
MCMS Property Holdings, Inc.	Affiliate	26,513,928	1.1%
C&E Property Holdings, Inc.	Affiliate	24,930,611	1.0%
John L. Gokongwei, Jr.	Director	205,737	0.0%
Jose C. Ibazeta	Director	32,951	0.0%
Oscar J. Hilado	Director	20,000	0.0%
Roberto R. Romulo	Director	20,000	0.0%
Ernest K. Cuyegkeng	Director	20,000	0.0%
Free Float	Public	475,523,409	19.0%
Shares issued		2,500,000,000	
Subsidiary shares		1,267,326,746	
Shares outstanding		1,232,673,254	

Source: Company data

Listed above is the company's shareholder structure. 50.7% of the shares issued are held by a 100% owned subsidiary. Insiders own another 27.1% of shares issued, affiliates own 3.2% of shares issued, and the public own 19.0% of shares issued.

VALUATION

The lack of barriers to entry within Anscor's businesses and the management team is deeply entrenched the company's earnings power is the best method of measuring the company's value as the earnings generated are likely to continue. Assuming average management and a lack of barriers to entry means the value of the company's assets should be close to the company's earnings valuation as excess returns are unlikely and cyclical adjusted earnings should be close to the company's discount rate.

Given the company's large investments in securities and associates, we use net income as the best measure of the company's earnings and equity as the best measure of investment capital. Since 2010, Anscor has generated an average net income of PHP1,423 on an average tangible equity of PHP12,106 equating to a roughly 11.8% return on equity.

Earnings Valuation	2011	2012	2013	2014	2015	Q3 2016
Target market cap	11,758	12,811	14,328	14,317	12,875	16,427
Current market cap	4,313	6,504	8,436	8,409	7,871	7,822
Upside	172.6%	97.0%	69.8%	70.3%	63.6%	110.0%

Source: Reperio Capital Research estimates

Given the lack of barriers to entry in Anscor's businesses, growth does not create value and therefore is irrelevant; therefore, assuming a 10% discount rate Anscor should be trading at roughly 1.18 times tangible book value representing a 110% upside.

Anscor is trading on a cyclically adjusted PE of 5.46 times meaning in the absence of growth, the company's expected annualized return in 18.3%.

Given the company's ability to generate a consistent return on equity equal to the company's discount rate, the reproduction value of the company's assets should equal the company's tangible book value. It is difficult to say a collection of assets are impaired if they generate a return equal to the discount rate.

Anscor's fair value is between tangible book (77% upside) and 1.18 times tangible book (110% upside).

RISKS

A company with a dominant shareholder (A. Soriano III) brings potential corporate governance issues. Anscor only material related party transactions are key management remuneration, which averaged 8.8% of net income over the past five years. Key management remuneration is a little high but the absence of any other related party transactions and the cheap valuations means it can be overlooked.

Our goal with assessing macro risk is not to forecast the path of macroeconomic indicators but to eliminate risks from a poor macroeconomic position. Anscor's business is primarily in the Philippines, a country that seems to be in very good financial health. In 2015, the country's current account was 2.6% of GDP and its structural balance was 0.18% of GDP allowing the country to self-finance all the domestic initiatives as well as decrease the country's debt load. The country does not have too much credit in the system with domestic credit provided by the financial sector at 59.1% at the end of 2015, which is well below the Emerging Markets average of 97.5% and the High Income countries average of 205%. Gross government debt as a percentage of GDP stood just under 35% with External Debt to GDP at 36%. The one concerning macroeconomic indicator is the level of growth in credit in the Philippines. Over the past five years, the amount of domestic credit provided by the financial sector has increased at a rate 12% per annum. When a country is growing its banking assets at this pace, there is a high probability of an increase in non-performing loans. The country's banking system has a healthy capital balance with capital to assets at 10.6%.

The investment is based on Anscor's strong financially health. If the company were to leverage its balance sheet, the attractiveness of the investment opportunity would decline.

The investment is also based on Anscor's consistently generating net income around its cost of capital. If earnings in the business were to permanently decline, the investment would become much less attractive.

If earnings were to decline making a liquidation value a more appropriate valuation methodology, there is still 30% upside meaning there is significant downside protection.

Liquidation Value (PHP mn)	Q3 2016 Balance Sheet Value	Liquidation Multiple	Liquidation Value
Cash and cash equivalents	2,028	100%	2,028
Fair value through profit or loss investments	678	90%	610
Receivables	2,229	75%	1,672
Inventories	670	75%	502
Property development in progress	3	50%	2
Available-for-sale investments - current	25	90%	22
Prepayments	103	50%	51
Other current assets	94	0%	-
Total current assets	**5,829**	**84%**	**4,888**
AFS investments - net of current portion	8,291	90%	7,462
Investments and advances	1,876	75%	1,407
Goodwill	1,869	0%	-
Property and equipment	2,671	50%	1,336
Investment properties	258	75%	193
Retirement plan asset - net	59	100%	59
Other noncurrent assets	142	0%	-
Total assets	**20,996**	**73%**	**15,345**
Total liabilities	**5,257**	**100%**	**5,257**
Equity value	**15,739**	**64%**	**10,087**
Current market capitalization			7,822
Upside to liquidation value			**29.0%**

If Anscor were to make expensive acquisitions, it would decrease the returns in the business through the write down of income and equity.

Given the nature of Anscor's businesses, they all lack barriers to entry and therefore are at risk of increased supply depressing profitability.

Most of Anscor's businesses are cyclical in nature and subject to macroeconomic risks.

At the end of Q3 2016, 47% of Anscor's assets were in available for sale securities or fair value through the profit and loss investments making the company exposed to the fluctuations of the Philippines Stock Exchange.

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