

MERALCO SECURITIES CORPORATION

1962

Chronicle Bldg., Manila, Philippines • Telephone: 3-00-61

June 30, 1962

To the Stockholders
MERALCO SECURITIES CORPORATION

I take pleasure in presenting to you this First Annual Report of Meralco Securities Corporation.

Organization and Capital Structure

Meralco Securities Corporation was registered with the Securities and Exchange Commission on June 30, 1961, for the purpose of acquiring ownership of the Manila Electric Company. Public enthusiasm during the organization was so great that many offers to subscribe to the capital stock had to be declined, the original capitalization requirements already having been oversubscribed. There are on record as of this date 1,164 subscribers to 9,000,000 shares of common stock.

The initial capital structure is as follows:

Authorized Capital		₱ 450,000,000
Common Stock		
(Par value ₱10.00)	₱400,000,000	
Preferred Stock	50,000,000	
Subscribed Capital Stock		90,000,000
Paid-up Capital		22,507,500

Purchase of MERALCO

The Manila Electric Company is a Philippine public utility corporation. It had been a wholly-owned subsidiary of General Public Utilities Corporation of New York whose holdings and equity therein consisted on December 31, 1960, of the following:

Common Stock (6,000,000 shares)	₱ 60,000,000
Preferred Stock (350,000 shares)	7,000,000
Dollar Advances	10,066,292
First Mortgage Bonds, Series A, 6%	8,000,000
Accumulated Surplus	55,012,344
	<u>₱140,078,636</u>

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These holdings and interests in MERALCO were the subject of sales negotiations between GPU and Meralco Securities Corporation. Negotiations were started in May 1961. They were prolonged because of the need for securing concurrent agreements not only from the parties in interest but also from various governmental and financial institutions in the Philippines and in the United States. On January 3, 1962, the U. S. Securities and Exchange Commission issued its final approval to the transaction. On January 5, 1962, ownership finally passed from General Public Utilities Corporation to Meralco Securities Corporation.

MERALCO was purchased at a base price of \$46 million, corresponding to the book value of GPU's holdings and interests as of December 30, 1960, plus the undistributed earnings for 1961 amounting to \$8.4 million. A down-payment of \$5,250,000 was effected on January 5, 1962. The balance, including accrued interest at 3% per annum, will be paid in nine (9) equal annual installments starting January 5, 1963.

Annual amortizations will be met largely from MERALCO yearly net earnings, prior provision always being made for the future growth of that Company. In the past, those earnings have shown a steady growth relative to production. The stability in the revenue pattern is expected to continue in the future. Consequently, net earnings should increase as production expands to meet growing power requirements.

Confidence in the future of MERALCO and in the capacity of Filipino entrepreneurship to continue the highest standard of service was best demonstrated by the decision of sixteen (16) Philippine banks and ten (10) American banks to undertake the financing of the MERALCO purchase. Three (3) irrevocable revolving letters of credit covering the total purchase price were issued by the Philippine banks and were confirmed by the U. S. banks. This financing operation has been described by a leading New York bank in its Annual Report for 1961 as "one of the largest private credit transactions ever concluded between American and Asian interests".

Under the Agreement entered into between the Syndicate of Philippine banks and Meralco Securities Corporation, the peso amounts required to meet annual amortizations under the letters of credit will be deposited by the Corporation with members of the Syndicate sixty (60) days before the annual amortization due dates. It has further been agreed not to declare cash dividends during the life-time of the credits without the prior consent of the Syndicate Banks. The notes and securities acquired from GPU, which

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had a book value of ₱140,078,636, have been pledged to the Syndicate as security for the credits issued.

MERALCO Operations in 1961

Total MERALCO sales in 1961 amounted to ₱89,790,000, an increase of 14% over 1960 figures.

Industrial sales set the pace with an increase of 22%. Industrial use of service is considered to be a barometer of a nation's industrial progress. It is of great significance that industrial use in 1961 was over 13 times the use ten years ago. There were 167 industrial customers at the end of 1951 and 902 at the end of 1961.

Residential sales increased 10.9%. At the end of 1961, MERALCO was serving 329,516 residential customers representing an increase of 16,922 during the year. Although this was an increase of only 5.4%, residential kilowatt-hour sales rose 10.9%. This reflects the increased use of electricity by the individual consumer and is an indication of an improved standard of living. The average use per residential customer was 132 KWH per month compared with an average of 124 KWH a year earlier.

Commercial sales increased 7.8%. Better lighting and more air-conditioning in commercial establishments and buildings were the main causes of the increase.

Operation and maintenance expenses in 1961 totalled ₱49,205,000, an increase of 17.6% over 1960 figures. This increment of 17.6% is slightly higher than the increase in revenues of 14%. The main reason therefor was decontrol which caused the price of fuel oil and other materials to rise considerably.

Despite the impact of higher costs for fuel and other materials, MERALCO was able to record a small increase in net income in 1961. This rose from ₱24,561,722 in 1960 to ₱24,642,188 in 1961. Although the rate of return on investment in plant and property decreased as compared to 1960, the increase in sales was sufficient to offset higher expenses. Two factors helped greatly in obtaining this desirable result. The first factor was improved generating efficiency due to the use of the two new 66,000 KW Units Nos. 6 and 7 at Rockwell Station. The second factor was a substantial decrease in energy losses from 13.85% in 1960 to 12.56% in

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1961. MERALCO's loss ratio now begins to compare favorably with that of large electric utilities in the United States.

From its 1961 earnings, MERALCO declared dividends amounting to ₱19 million to holders of common stock. Of this amount, ₱5,000,000 had actually been paid to Meralco Securities Corporation as of June 30, 1962. Payment of the balance is scheduled to be made prior to November 5, 1962 to permit Meralco Securities Corporation to meet its obligations to the ~~Syndicate of Banks under the terms~~ of the revolving letters of credit opened ~~in favor of General Public Utilities Corporation.~~

Financial Operations of Meralco Securities Corporation

The Corporation started operations with ₱22.5 million received from subscribers to capital stock. This was used principally to effect the down-payment of \$5,250,000 to General Public Utilities Corporation.

The peso outlay for this down-payment totalled ₱20,890,454 consisting of ₱15,807,750 for the down-payment itself, ₱2,622,209 for margin fee, ₱1,673,645 for U. S. banks' confirmation charges, and ₱786,850 for Philippine banks' commissions.

Revenues during the six month period ended June 30, 1962 totalled ₱5,946,419.29, consisting of dividend and interests payments from Manila Electric Company. Operating expenses totalled ₱5,367,226.47 as detailed in the Statement of Income herein. Net income at the end of the fiscal period was ₱579,192.82.

The Balance Sheet enclosed shows the financial position of the Corporation on June 30, 1962. The large current liability shown therein consists mainly of the next installment due GPU on January 5, 1963. This will be met from the balance of the ₱19 million dividends still to be received from MERALCO and from additional dividends from MERALCO net earnings in 1962.

As stated before, out of the ₱19 million dividend declared by MERALCO for 1961, only ₱5 million has been paid thus far to Meralco Securities Corporation to comply with Export-Import Bank restrictions. Although the financial operations of both Manila Electric Company and

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Meralco Securities Corporation have exceeded the best expectations of their respective managements, several problems have to be met in the future.

Future Problems

These problems stem largely from the fact that available internal funds of MERALCO are being used to finance in part construction of an eighth electric-generating unit of 66,000 KW at Rockwell. It is estimated that construction of this unit will require a total outlay of P35 million. This unit must be in operation by October, 1963 to avoid an anticipated power shortage due to increased demand.

There are three possible sources of dollar funds needed to finance this project. These are the Export-Import Bank of Washington, the Agency for International Development, and medium-term credit by the suppliers of machinery and equipment.

A formal application has been made with the Export-Import Bank for a loan of \$7.5 million. This application is now being processed by the bank. In anticipation of a new Export-Import Bank requirement for a guarantee from the Development Bank of the Philippines, an application for such guarantee has also been filed with the Development Bank. The solid financial condition of MERALCO and the economic justifications of the loan application permit optimism that the Development Bank guarantee will be issued, making it possible for the Export-Import Bank to act favorably on the loan proposal. In the past, the Export-Import Bank has financed MERALCO expansion and its payment record has been excellent.

Decontrol measures and the "floating" rate adopted by the government early this year pose another serious problem to MERALCO. In 1961, due principally to decontrol, operating expenses rose 17% while revenues increased by only 14%. The situation may be further aggravated in 1962, as calculations show that MERALCO fuel oil expenses increase by nearly P1 million for every P0.20 increment in the exchange rate over P3.45 to \$1.00. At the same time, the "floating" rate system increases uncertainty in forecasts of future earnings. Thus, while MERALCO is committed to provide cheap electric power at fixed rates to its customers, expenses for fuel oil, which is the largest cost component in electricity production, are not fixed but fluctuate in sympathy with the exchange rate.

Despite these uncertainties and the tight cash situation which appears

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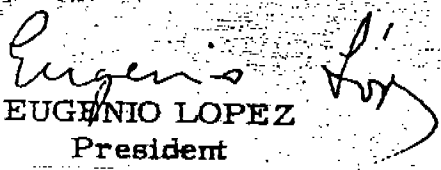
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to plague the whole economy, MERALCO, under its new management, is determined to continue providing a reliable supply of electric power to its customers at the lowest possible cost. All sources of external financing will be tapped to that end. Internal funds are already being utilized though this has caused liquidity problems for Meralco Securities Corporation.

This desire to serve the power needs of the country and to continue the excellent record of MERALCO has dominated the policies and actuations of your Board of Directors during the past year. The impressive growth over the past years of power output and revenues of MERALCO, our wholly-owned subsidiary, are evident from the financial and statistical statements herein. They show the excellent manner in which MERALCO has fulfilled its pledge to meet the rapidly growing power requirements of the economy. The record of the past year, in particular, manifests concretely the desire of the new Filipino owners of MERALCO to commit large capital investments to contribute further to power development in the country.

Very truly yours,


EUGENIO LOPEZ
President