

MAYNILAD



ON THE MEND

Rebidding Process Infuses New Life
to a Struggling Concessionaire

Asian Development Bank



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Anand Chiplunkar
Ma. Christina Dueñas
Mai Flor

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In January 2007, the new and all-Filipino partnership of DM Consunji Holdings Incorporated and Metro Pacific Investments Corporation (DMCI-MPIC) took over the reins of Maynilad Water Services, Inc., Metro Manila’s beleaguered water concession. They replaced the almost decade-long partnership of Maynilad’s previous shareholders—Benpres Holdings Corporation, Suez Environment, Lyon-aise Asia Water Pte Ltd, and Metrobank. Exactly 1 year later, the new Maynilad has paid off its remaining foreign debts of about \$240 million, allowing them to exit Maynilad’s rehabilitation phase way ahead of its 2013 deadline. In addition, the newly revitalized company has embarked on a 33 billion Philippine Peso (P) capital expenditure program for 2007–2015, with P8 billion earmarked for 2008 alone.

The road to Maynilad’s recovery is long, with the outcome still uncertain. But the entrance of a new player into the fray gave the struggling concession a new shot at success.

Concession at a Glance

Maynilad’s entrance into the picture was watched by the global water community. In August 1997, in a bold move hailed as the biggest water privatization effort at the time, the state-owned Metropolitan Waterworks and Sewerage System (MWSS)¹ handed over its operations to two private concessionaires: the Manila Water Company, Inc. (MWCI) and Maynilad Water

Services, Inc. (Maynilad). A 25-year concession agreement governed the turnover.

MWCI was awarded the rights to operate the waterworks and sewerage services in Metro Manila’s East Zone, home to then 4 million people and comprising eight cities and municipalities.² Maynilad was awarded the West Zone, home to then 7.3 million people and comprising 17 cities and municipalities³ (Figure 1).

Before the concession began, MWSS was weighed down by two major problems. First, it was deeply indebted to foreign creditors—the debts were estimated at almost \$900 million in 1997—and badly needed more financing. Second, its operations were characterized by myriad inefficiencies. MWSS was then providing water to just over 60% of Metro Manila’s residents, and not even half of them had 24-hour water supply.



Figure 1: Metro Manila Water Supply System Concession Service Area

¹ Metropolitan Waterworks and Sewerage System (MWSS) has jurisdiction over all waterworks and sewerage systems in a service area comprising the National Capital Region, the entire province of Rizal, and part of the province of Cavite.
² East Zone comprises the cities of Makati, Pasig, Mandaluyong, most parts of Quezon City, some parts of Manila, and the municipalities of San Juan, Taguig, and Pateros.
³ Maynilad’s area of coverage includes Valenzuela, Caloocan, Malabon, Navotas, parts of Quezon City, Manila, Pasay, a part of Makati, Las Piñas, Parañaque, Muntinlupa, Cavite City; and Cavite municipalities of Rosario, Imus, Noveleta, Bacoor, and Kawit.

Less than 9% were connected to a sewerage system and water losses were staggering at 63%. The utility also had 8,000 employees—too many as this translates to 9 staff handling a single household connection.

The concession agreement between MWSS and the two concessionaires called for the latter to provide 24-hour water supply that meets water quality standards and maintains certain pressure levels (16 pounds per square inch [psi]). It also binds the concessionaires to the following service connection targets:

Table 1: Service connection targets (% of service population)

Indicators	East Zone		West Zone	
	1997	Target	1997	Target
Water Supply	63.0	94.6	65.0	98.4
Sewerage	13.0	55.0	7.0	66.0

Source: Concession Agreement between MWSS and Maynilad, 1997.

In addition to these targets, the concessionaires also had to service MWSS’s foreign debt through annual payments of concession fees and the posting of a \$120 million performance bond. Given that the West Zone had the more developed infrastructure and larger customer base and, therefore, was assumed to require less capital infusion, Maynilad was made responsible for paying back 90% of MWSS’s debts (approximately \$800 million). MWCI shouldered the remaining 10%. As it

turned out, this skewed division of foreign debt service responsibilities was a major contributor to Maynilad’s downfall.

The concession agreement also created the MWSS-Regulatory Office (MWSS-RO), which regulates the performance of both concessionaires and conducts tariff rate determinations.

As for tariff rates, the agreement also provided for the following

- yearly adjustment based on inflation (consumer price index adjustment or C factor);
- price adjustment covering extraordinary events (extraordinary price adjustment or E factor); and
- rate rebasing exercise 5 years upon the start of the concession, the commencement date to be set by MWSS-RO, and every 5 years thereafter (R factor).

Applications for tariff adjustments are submitted to MWSS-RO, which only has recommendatory powers. The power to approve any tariff adjustment rests on the MWSS Board of Directors.

Returning the Concession

Serious financial difficulties attacked Maynilad almost from day one. The 1997 Asian financial crisis, which saw the peso depreciate against the United States (US) dollar by more than 100% by the end of



The unserved wait in line to get water from public tap stands

1998,⁴ severely affected its ability to service MWSS’ debts and pursue much-needed capital expenditures. Topping this are other factors that further crippled the company’s operations—from critical regulatory issues to the El Niño phenomenon in 1997–1998 that reduced the metropolis’ water supply to by at least 40%, to alleged financial mismanagement, e.g., unnecessarily expensive procurement deals.

In the first 2 years of operations, Maynilad’s concession fee payments were higher than the generated revenues. By end-2000, Maynilad’s revenues rose just enough to equal roughly the concession fee payments, but still nothing was left for operational and capital expenditures (see Table 2).

Table 2: Key financial figures for Maynilad (P million)

Indicators	1997	1998	1999	2000
Concession fee paid	866	2,265	1,978	2,082
Revenue	751	1,662	2,379	2,634

Source: Thierry Krieg, Powerpoint Presentation at the Multi-stakeholders Dialogue on Water Services for the Poor, 31 May 2002.

In an effort to recover from foreign exchange (forex) losses, Maynilad petitioned for tariff increases and was granted an extraordinary price adjustment in 2000. However, this increase was not enough to cope with the concessionaire’s losses. Maynilad again filed a petition to allow for more flexible currency rate adjustments, given that the existing provision in the concession agreement only covers normal fluctuations (within 2%). MWSS rejected the petition, saying that this can be construed as changing the bid. On 8 March 2001, due to heavy financial losses, Maynilad was forced to suspend its concession fees payment on grounds of “force majeure.”

Maynilad and MWSS went back to the negotiating table to resolve the conflict and, on 5 October 2001, agreed on amendment

no. 1 to the concession agreement.

Amendment no. 1 offered many promises, but fell short on delivery. In a nutshell, the amendment

- recognized the gravity of the forex problem and allowed for the recovery of past forex losses through staggered tariff increases (within 18 months);
- allowed for tariff rate adjustments based on prevailing exchange rates for the remainder of the concession, referred to as the foreign currency differential adjustment (FCDA);
- allowed for the implementation of the first rate rebasing exercise on 1 January 2003; and
- called upon MWSS to address the concerns of Maynilad’s lenders—primarily those of a regulatory nature—to enable the concessionaire to close a \$350 million loan application crucial to its operations.

Despite efforts by both parties, amendment no. 1 was not fully implemented and Maynilad failed to secure the much needed \$350 million loan.

Many factors affected the loan negotiation. Involved foreign and local banks wanted assurances that the tariffs will be increased as necessary, regardless of the political upheavals taking place at the time.⁵ They also wanted to ensure that the Government will not sequester Maynilad’s assets in times of war or emergency. Unfortunately, no such assurances were forthcoming. But the bigger barrier was the issue of contract termination, which was a major concern then given Maynilad’s precarious financial position. Ultimately, Maynilad, MWSS, and the lenders could not agree on the terms and conditions for termination (e.g., qualifications and procedures for the appointment of a replacement operator, early termination amount, etc.).

⁴ From P26=\$1 at the time of the bidding in January 1997, the peso devaluated to P50 to \$1 by 1998 and continued to increase in the succeeding years.

⁵ 2001 was the year of the EDSA II revolution that ousted then President Joseph Ejercito Estrada, who was succeeded by then Vice-President Gloria Macapagal-Arroyo.

By end-2002, a nearly bankrupt Maynilad announced that it was returning the concession back to MWSS, issuing a notice of early termination on 2 December.

Surviving the Legal Battles

MWSS questioned Maynilad's move, saying that only they have the right to terminate the concession due to nonpayment of concession fees. Maynilad claimed the same right by virtue of force majeure.

Since the concession agreement provides that all disagreements and claims between the parties in relation to the agreement must be resolved by arbitration,⁶ the matter went before the appeals panel for major disputes.

The appeals panel had three members, with MWSS-RO and the concessionaire appointing a member each. The president of the Paris-based International Chamber of Commerce designated the third and independent member, who acted as chairperson of the panel.

Nine months of closed deliberations and roughly \$3 million later, the panel's much-awaited decision came on 5 November 2003. It was not, however, the panacea that both Maynilad and MWSS sought. The panel decided that neither party was entitled to terminate the concession agreement, leaving them in exactly the same position they were in prior to arbitration. To compound Maynilad's troubles, the panel ordered it to pay the outstanding concession fees, which had already ballooned to P6.77 billion (\$120 million) since 2001. If Maynilad fails to pay, the panel granted MWSS the authority to draw on the company's \$120 million performance bond. As can be expected, the panel's decision drew the ire of privatization watchdogs who felt that it should not have taken a long and complex arbitration process to compel Maynilad to do something that is, in the first place, already explicitly stated in the concession agreement.

On 13 November 2003, Maynilad

sought court protection from its creditors by filing a petition for corporate rehabilitation. Maynilad won a minor victory as the Rehabilitation Court appointed a receiver, issued an order staying all claims against Maynilad, prohibited the company from disposing its properties, and disallowed the drawing against the performance bond for a few months.

However, MWSS countered this before the Supreme Court and won the right to draw on the performance bond. This prompted Maynilad's other lenders to pressure the company to pay its outstanding loans. As Maynilad failed to pay, all the lenders called on the sponsors' guarantees. Benpres Holdings Company, which owned 59% of Maynilad's shares, defaulted.

Forced to negotiate a way forward, all parties began discussions on restructuring Maynilad's debts. On 28 April 2005—2 years down the line—MWSS, Maynilad, its shareholders, and creditors entered into a debt and capital restructuring agreement (DCRA) that spelled out the steps for restructuring Maynilad's financial obligations. The provisions of the DCRA were incorporated in Maynilad's rehabilitation plan, which was approved by the Rehabilitation Court on June 2005. DCRA gave MWSS the option to subscribe to 83.97% of Maynilad's equity, paving the way for the entry of new private shareholders into the company.

Losing Big to Win: Maynilad's Debt and Capital Restructuring

The customers of Metro Manila's West Zone have to be served, with or without Maynilad's financial woes. Working from that premise, the Government explored all possible avenues to straighten out Maynilad's finances. This included MWSS lending money to Maynilad—in the form of deferred concession fee payments—to fund the latter's operations and some capital

⁶ Arbitration should be in accordance with the rules of the United Nation Commission on International Trade Law.

improvements while its owners are entering into a debt restructuring arrangement with the creditors. MWSS also agreed to a deferred and staggered payment of past due concession fees in excess of the \$120 million performance bond, a postponement of the sewerage targets that would entail massive investments, and to buy into approximately 84% of Maynilad's equity, on the understanding that the equity will later be offered to the private sector.

All the other stakeholders joined the race to find workable long-term solutions for Maynilad's chaotic finances. The sponsors agreed on substantial write-offs, the lenders agreed to deferred payments with much reduced interest rates, and the contractors and suppliers agreed to deferred payments over 2 years.

Bar none, all stakeholders agreed to lose big—whether on par value of shares,

Bar none, all stakeholders agreed to lose big to ensure that Maynilad's finances are rehabilitated and its obligations paid.

foregone interest earnings, or debts written off—to ensure that Maynilad's finances are rehabilitated and its obligations paid.

The rehabilitation of Maynilad's finances hinged on debt and capital restructuring.

RESTRUCTURING MAYNILAD'S DEBTS

At the time of the restructuring in 2005, the balance of Maynilad's payable debts amounted to roughly \$488 million, payable to four categories of creditors: MWSS, Suez Group, lenders (banks),⁷ and other creditors (contractors and suppliers). Table 3 shows the breakdown of the debts.

Table 3: Maynilad's debts payable at the time of restructuring

Creditor	Amount	Nature
MWSS	P7,884,500,000.00	Concession fees from 2004–2007, this is the estimated peso equivalent of MWSS's foreign currency-denominated loans as of privatization
	\$30,100,000.00	Cost of borrowing incurred by MWSS as of December 2003, this was the interest for a \$100 million loan MWSS took out from a bridge bank (BNP Paribas) to cover the concession fees that Maynilad failed to pay
	\$31,000,000.00	Financial assistance to Maynilad for capital expenditures and operational expenses, to be derived from future concession fee payments
Suez Group	\$122,651,568.00	Suez payments of its guarantees under the CAI facility, bridge loan facility, and performance bond facility and advances to Maynilad
SBLC banks	\$72,000,000.00	Balance owed to the SBLC banks following a draw on the performance bond and the payment by Suez of \$48 million
Bridge banks ⁸	\$46,096,578.06	Balance under the bridge loan facility
Peso lenders	P1,421,804,988.06	Balance under the peso loan facilities

BNP = Banque Nationale de Paris, CAI =Credit Agricole Indosuez, SBLC = standby letter of credit.
Source: Debt and Capital Restructuring Agreement, 2005.

⁷ Lenders are limited to creditor banks (i.e., standby letter of credit (SBLC) banks, bridge banks, and peso lenders). This group comprises 19 international and four local banks. Local banks, such as the Development Bank of the Philippines and Landbank of the Philippines, only started lending to water utilities after the 1997 privatization.

⁸ These banks provided bridge financing to Maynilad amounting to \$100 million, while the loan application for \$350 million was still pending.

Table 4: Upfront payment upon DCRA approval

Creditor	Balance of Original Debt (in \$)	Upfront Payment (in \$)	Balance (in \$)
MWSS	218,790,000.00	320,963.00	218,469,037.00
Suez Group	122,651,568.00	27,000,000.00	95,651,568.00
SBLC Banks	72,000,000.00	26,400,000.00	45,600,000.00
Bridge banks	46,096,578.00	3,900,000.00	42,196,578.00
Peso lenders ⁹	28,437,899.76	2,000,000.00	26,437,899.76
Total	487,976,045.76	59,620,963.00	428,355,082.76

MWSS = Metro Manila Water Supply and Sewerage Corporation, SBLC = standby letter of credit.
Source: Debt and Capital Restructuring Agreement, 2005.

Upon approval of the DCRA, Maynilad's first step was to make roughly \$60 million worth of upfront payments to the main creditors (shown in Table 4).

This represents just over a tenth of Maynilad's debts. The rest—reduced to roughly \$240 million after a series of restructuring arrangements—were consolidated into a single facility with two tranches: the US dollar tranche with final maturity on 31 December 2012 and the peso tranche with final maturity on 31 December 2013, both of which had reduced interest rates.¹⁰

Maynilad's outstanding debts to MWSS cover unpaid concession fees and the cost of borrowing incurred by MWSS. Since cash flow remains an issue for Maynilad, MWSS also agreed to provide the concessionaire with financial assistance amounting to \$31 million that would be derived from future concession fee payments. These debts were portioned off—part of the concession fees were to be paid on a current basis and the rest deferred to 2008–2010, while the cost of borrowing was deferred for 2010–2012.

Between 2004 and 2006, Maynilad's concession fee payments were restructured (see Table 5).

The amounts owed to the contractors and suppliers were to be paid in the next 2 years. As for Maynilad's outstanding debts to Suez, a complex process of debt and capital restructuring allowed the company to

Table 5: Restructured Maynilad's concession fee payments, 2004–2006.

CY	Current (in %)	Deferred to 2008–2010 (in %)
2004	50 was converted to MWSS equity	50 deferred
2005	65 was paid currently through the following means <ul style="list-style-type: none"> • 27 paid by Maynilad, • 33 paid out of the MWSS financial assistance of \$31 million, and • 5 converted to MWSS equity 	35 deferred
2006	70 was paid currently through the following means <ul style="list-style-type: none"> • 9 paid by Maynilad • 61 paid from the MWSS financial assistance of \$31 million 	30 deferred

CY = calendar year.

Source: World Bank and Public-Private Infrastructure Advisory Facility, 2007. *A Case Study of the Experience of the Two Water Concessions in Manila, Philippines: Its Impact on the Population and Improved Operational Efficiency (1997–2006)*. Manila

write off over \$38 million, reducing the debt from \$95.6 million to \$57.3 million by the end of 2005.

RESTRUCTURING MAYNILAD'S CAPITAL

Capital restructuring involves the simultaneous decrease and increase in capital stock to enable a company to

⁹ Philippine peso figures converted at P1= \$50.

¹⁰ London Interbank Offered Rate (LIBOR) + 1 for SBLC Banks, bridge banks, and Suez Group; Money Market Association of the Philippines (MART) + 1 for peso lenders.

reduce, if not completely eliminate, its capital deficit.

In 2005, Maynilad underwent this process not just to reduce its capital deficit but also to allow for the exit of Benpres as majority shareholder of Maynilad, reduce the equity of Lyonnaise Asia Water, Ltd (LAWL) and Suez Environment to 16%, and pave the way for the entry of MWSS as shareholder of Maynilad.

Before capital restructuring, Maynilad's outstanding capital stock was P5.24 billion, shared among the sponsors: Benpres owned 59%, LAWL and Suez Environment jointly owned 40%, and Metrobank owned 1%. However, by 2004, Maynilad's capital deficit had escalated to P5.19 billion, almost equal to its capital stock.

To reduce this capital deficit, Maynilad's shareholders agreed to slash drastically the par value of their stocks, from P100 per share to P1 per share. The remaining capital stock—except for a portion held by

LAWL—were then surrendered to Maynilad and retired. This, in effect, meant that Benpres wrote off its entire equity of P3.09 billion and about \$11.2 million in shareholder advances,¹¹ while Suez wrote off almost all its P2.1 billion equity in Maynilad. This wiped out Maynilad's remaining capital deficit.¹²

Simultaneous with decreasing the value of its stocks, Maynilad increased its volume to P1.475 billion¹³ worth, with the stocks still priced at P1 per share. MWSS then subscribed to a total of P1.238 billion (\$22.7 million) of these stocks, roughly 84%, through a debt-to-equity conversion. LAWL, on the other hand, converted \$5.1 million¹⁴ for its 16% share.

Soon after these were completed, MWSS proposed to conduct an international competitive tender for the right to subscribe to the 84% Maynilad shares currently in its possession.



¹¹ The exit of Benpres from Maynilad also allowed its release from its guarantees for the bridge loan, SBLC facility, and loans of \$118.1 million and P1.4 billion.

¹² Maynilad's capital deficit after the par value reduction was P41.4 million.

¹³ \$27 million based on an assumed exchange rate of P54.63 to \$1.00.

¹⁴ Lyonnaise Asia Water, Ltd shares were bought for a premium, as the 16% was equivalent to only \$4.32 million.

Finding New Sponsors: The MWSS Competitive Tender

Key players in the sector knew—or thought they knew—that auctioning off MWSS’s 84% stake in Maynilad was going to be a tough sell. After all, the company was still in dire straits, with customers unwilling to trust its services and its 540-square kilometer area having seen little service improvements while the negotiations for the turnover continued. Moreover, there was a general distrust in the Government’s ability to manage the rebidding process with integrity, seeing that the Government has received more than its fair share of corruption and rigging charges. Finally, the capital infusion needed to put Maynilad on the right track is quite steep—an estimated P3 billion–4 billion between 2007 and 2013 and a capital spending requirement of \$12 million for a 3-month period.

Fortunately, reality made mincemeat of these fears.

Maynilad, through a competitive selection, appointed ABN-AMRO¹⁵ as financial advisor to MWSS. ABN-AMRO helped MWSS design the bid terms, which had two main parts.

Part 1 covers the minimum condition for bidders. This sets the minimum bid at \$56.7 million, comprising the

- value of the actual 84% equity of the company at P1 per share (\$22.7 million) plus \$3 million interest; and
- \$31 million financial assistance that MWSS previously provided Maynilad in the form of deferred concession fees and arbitration costs granted by the appeals panel.

Part 2 involves the amount of additional resources that bidders can put in the company. This includes

- a financial supplement of \$2.5 million, which represents MWSS arbitration costs

to be remitted in cash; and

- additional resources to fund capital expenditure and/or prepayment of Maynilad’s outstanding obligations. The winning bidder will assume Maynilad’s obligations under the DCRA.

A two-envelope system was used for the tender—one for the technical and business bid and another for the financial bid. The first stage of the evaluation was scrutinizing the technical and business bid on a pass-or-fail basis. The bidder’s financial offer will only be opened if its technical and business qualifications pass scrutiny.

MWSS formed a technical committee to evaluate the bids and hired the Halcrow Group¹⁶ to help evaluate the technical plans. The technical committee also set these minimum qualifications for bidders

- a competent operator of water supply and/or sewerage services owns at least 15% of the equity interest in the consortium or;
- collectively, the bidder and at least one member with at least 20% of the equity interest in the consortium has demonstrable experience and satisfactory track record in at least one of the following areas
 - water supply and sewerage services,
 - telecommunications,
 - power distribution, and
 - construction.

Of course, given Maynilad’s need for capital, the bidder’s financial capacity was considered primary. As such, steep requirements were imposed to weed out prospective bidders who have no real financial capability to improve Maynilad’s services. These requirements included

- a minimum of P6 billion (\$120 million) capitalization in Maynilad, backed up by an irrevocable standby letter of

¹⁵ ABN-AMRO is a holding company with subsidiaries that perform commercial banking operations, investment banking, and other financial activities.

¹⁶ Halcrow Group is a multidisciplinary consultancy specializing in planning, design, and management services for infrastructure development.

credit issued by a bank¹⁷ of the highest standing, and

- a bid guarantee of \$2.5 million in the form of a standby letter of credit in favor of MWSS to ensure that the winning bidder will assume all the obligations of MWSS, including entering into contracts and other legal documents to implement the necessary transactions.

When the bid was first announced in August 2005, 11 investor groups expressed interest and procured the bid documents.

These were

- Amroc Investments Asia, Ltd.;
- DMCI Holdings, Inc., a Philippine infrastructure company that also owns a majority stake in the joint venture company, Subic Water and Sewerage Company, Inc.;
- Gancayco, Balasbas and Associates, a firm of Philippine lawyers;
- Gil Valera and Associates, a firm of Philippine accountants;
- Infrastructure Leasing and Financial Services, Ltd. (IL & FS), an Indian nonbanking financial company with interest in infrastructure development;
- LILI Investments Services, Ltd./Orix Corp.;
- MWCI, concessionaire of the East Zone;
- Marubeni Corporation, a Japanese infrastructure company;
- Noonday Asset Management Asia Pte., Ltd., a Singapore-based investment fund;
- The AES Group; and
- YTL Power International Berhad, a Malaysian infrastructure group.

However, only five firms submitted the requirements to qualify for the second phase of the bidding. These were

- the consortium of DMCI-MPIC,
- IL & FS,
- MWCI,
- Marubeni Corporation, and
- Rubia Holdings-Noonday Asset Management Asia, Pte.

Of these five, only three firms submitted their technical and financial bids: MWCI, DMCI-MPIC, and Rubia Holdings-Noonday consortium. The Indian financial firm IL & FS expressed concerns over the 16% shares owned by Suez¹⁸ and did not submit its proposals.

Of the three, the Rubia Holdings-Noonday consortium was disqualified after it failed to submit the standby letter of credit for \$2.5 million. The submissions of Rubia were returned unopened, and the firm conceded its disqualification.

The technical submissions of both MWCI and DMCI-MPIC passed the scrutiny of MWSS' technical committee. The battle, therefore, came down to the dollar bottomline. On 8 December 2006, the financial bids of both companies were opened.



Special Bids and Awards Committee Vice-Chairman Agnes Devanadera and Chairman Oscar Garcia open the carefully sealed financial bids

¹⁷ The bank should have senior unsecured obligations rated at least “BBB” by Standard & Poor’s Investors Service, Inc. or “Baa2” by Moody’s Investors Service, Inc.

¹⁸ Suez holds only 16% of Maynilad but has the power to block key corporate decisions—the legacy of a shareholder agreement from 1997 when it owned 40% of the company. But the special bidding and awards committee said the Philippines’ Corporation Code offered sufficient protection for both majority and minority shareholders. Suez has since sold its shares.

The minimum bid required was \$56.7million. The MWSS special bids and awards committee was anticipating bids of no more than \$100 million, especially given that the company’s existing debt load is still over \$200 million. The final result could not be more surprising or encouraging.

With a total bid of \$503.9 million, the consortium of DMCI-MPIC eased MWCI out of the competition and emerged as the new owners of Maynilad. Its bid comprised the minimum bid and a financial supplement of \$447.2 million. MWCI’s financial supplement was almost \$50 million less, at about \$400 million.¹⁹



DMCI Holdings present Isidro Consuji receives congratulations after the bids were flashed on stage

Maynila’s New Lease on Life

So where has the successful rebidding process landed Maynilad?

Simply put, the rebidding exercise just changed a single but crucial aspect of the Maynilad setup—the operator. This means the original concession agreement remains in operation, and the new owners will be measured against the long list of performance and service coverage targets that governed Benpres and its co-shareholders.

Amendment no. 1, approved in October 2001, is the sole modification to the concession agreement. Its provisions continue to be crucial since they address the one glaring weakness of the concession agreement—the forex fluctuations and how they impact the peso income and debts in hard currencies. However, the new owners will begin their stint with one important target adjustment—under the DCRA, MWSS agreed to suspend the sewerage targets temporarily, which understandably requires huge investments.

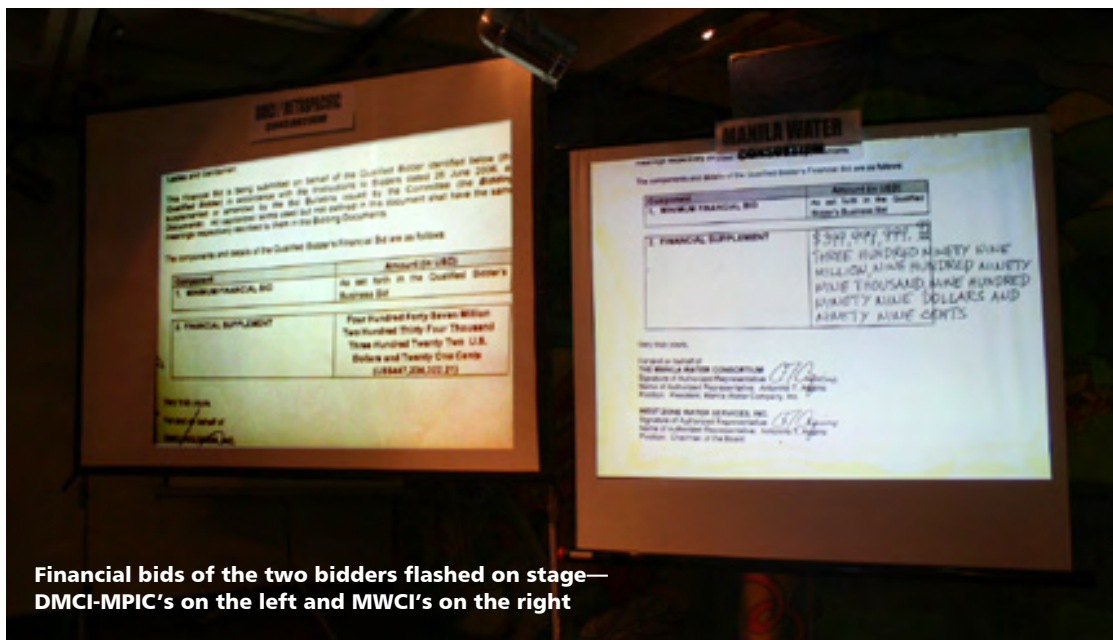
The new owners are undaunted by their new challenge despite having only 15 years to fulfill the terms of the concession agreement, improve and expand Maynilad’s services, and turn their investments into profit. The fact that they bring to Maynilad a wealth of experience both in and out of the water sector could account for this confidence.

DMCI is a leading construction company and real estate developer in the Philippines. It has considerable experience in the water sector, being the majority owner of the Subic Water and Sewerage Company, Inc. (SubicWater) since 1996. SubicWater is the joint venture company that serves as primary water, sanitation, and sewerage provider for the Subic Bay Freeport, a special economic zone northeast of Metro Manila.

MPIC, on the other hand, is a major player in the telecommunications, shipping, and real estate industries in the country. Among its strengths is its substantial experience in rehabilitating ailing public utilities. MPIC Chairman Manuel Pangilinan was largely responsible for turning the country’s problematic Philippine Long Distance Telephone Company into the efficient and profitable company that it is today.

Maynilad’s new owners recognize the need to turn the company’s performance around in the shortest time possible. Their first order of business is, therefore, a quick exit from the 2005 Rehabilitation Plan and DCRA.

¹⁹ The exact figure is \$399,999,999.99.



Financial bids of the two bidders flashed on stage—DMCI-MPIC's on the left and MWCI's on the right

Under the DCRA, all creditors would have to be paid first before serious investments in infrastructure and service expansion can be made, with the schedule of payments extending to 2013. In addition, Maynilad can only apply for rate rebasing to recover their investments once they have exited the rehabilitation phase. Remaining in this phase, therefore, curtails Maynilad's ability to expand and optimize its operations.

In August 2007, DMCI-MPIC signed a prepayment and settlement agreement with Maynilad's creditors and MWSS. By December of the same year, the Rehabilitation Court approved Maynilad's petition to get out of corporate rehabilitation, lifting the restrictions imposed by the DCRA. A month later, helped by the peso's substantial appreciation against the dollar,²⁰ the company paid off all its remaining debts, now pegged at roughly \$240 million—\$199 million for Maynilad's debts to banks and the rest for its obligations to nonbank suppliers.

The next order of business is to implement its aggressive, two-stage recovery plan designed to bring in revenues and bring down commercial losses.

The first stage of the recovery plan involves a system-wide water audit,

improving water supply and pressure management, enhancing reservoir management and pump station efficiencies, and upgrading the system's software and information technology facilities. The second stage focuses on the replacement of old water mains, conducting extensive post-rehabilitation network maintenance, and improving overall service repairs and connections.

Maynilad plans to invest P33 billion in capital expenditures up to 2015, with P5 billion for 2007 and another P8 billion earmarked for 2008. These are far higher than was ever poured into Maynilad by Benpres and its partners, which attained its highest point at P1.5 billion a year. As can be expected, a lot of new construction and rehabilitation measures are ongoing in Metro Manila's West Zone.

But concurrent with the physical developments are the soft-side interventions. One major thrust of the new Maynilad is making its customers happy. This means retooling its human resources and management style to increase Maynilad's service orientation. It also means stepping up the capacity development of its human resources—from establishing new incentive

²⁰ The average conversion rate in January 2008 was \$1= P40.9 (National Statistical Coordination Board).

programs for employees to introducing a cadetship program to attract younger people to improving the commercial and marketing abilities, image, and efficiency of the employees.

In the coming years, the new Maynilad management has vowed to work on its vision—transforming Maynilad from a mere water supply company to one with a strong advocacy for sustainable water management.

Triumph of the Rebidding Process

Whether Maynilad will attain this vision and its performance targets remain to be seen. What is certain at this point is that the 5-year negotiation process with lenders for the execution of the DCRA and the rebidding of Maynilad has contributed significantly to the concessionaire’s new lease on life.

ABN-AMRO, financial advisers of MWSS for the rebidding process, said that the Maynilad deal has created a template for future privatization initiatives in the Philippines. But what, exactly, is this new template?

UPHOLDING INTEGRITY

To say the least, the 2 years that it took to find new owners for Maynilad was grueling, but at its heart is the integrity that all key players strove to uphold.

To ensure credibility and transparency in the bid process, MWSS engaged ABN-AMRO and Halcrow to act as advisors for the tender. This resulted in a straightforward bidding procedure that did not allow for bureaucratic haggling and maneuverings and a comprehensive terms of reference (TOR) that served to filter nonserious bidders. The TOR’s requirement for an irrevocable standby letter of credit in the amount equal to P6 billion for the winning bidder, along with the \$2.5 million bid bond, deterred those without the right financial capacity from participating in the bid.

Throughout the entire selection process, MWSS and its advisers also held dialogues with the owners, creditors, and

We are not just a water company. We are partners of the West Zone communities in working for their well-being and progress, and we protect and nurture the environment which provides the resources that is our lifeblood, ensuring sustainability of this precious resource from source to discharge.

Rogelio L. Singson, President, Maynilad



other stakeholders to understand their issues. In addition, MWSS issued regular updates to keep all stakeholders abreast of developments.

When the bidding finally ended, the losing party congratulated the winner and the special bids and awards committee for the professionalism and transparency of the process.

GOING LOCAL

International water operators that usually participated in similar tenders over the past years were conspicuously absent in this procedure. In fact, none of the large water companies from Europe, United States, and even Asia showed any interest in participating in the bid.

This confirms recent trends in the water sector, which show international water companies shying away from

- high-risk areas, particularly those where they perceive regulatory regimes to be not very mature; and
- deals that require massive investments.

Learning from the lessons of Latin America, Jakarta, and Manila, these

companies restrict their participation to build-operate-transfer (BOT) or management-type contracts that limit their financial exposure to manageable levels and do not carry regulatory risks.

The fact that the winning bidder is 100% Filipino-owned, as opposed to the other bidders that had foreign partners, also gives the Maynilad deal a new spin. Both DMCI-MPIC and MWSS hope that with Filipinos partnering with Filipinos, the management conflicts²¹ experienced by the previous owners will not be present this time around.

SERVICE AND REVENUE POTENTIALS

DMCI-MPIC said that with water being a critical and essential public service, the potential for creating long-term value—either in sustainable water management or customer satisfaction—and generating profits is vast. Judging by the large number of interested partners in the early stages of the bidding process—many of them investment funds—DMCI-MPIC is not alone in this belief.

This certainty that providing water supply and sewerage services is a viable and



²¹ According to Suez, the partnership with Benpres had troublesome dynamics from the beginning. Benpres quickly asserted its management role and limited Suez's role to technical advisory, with the advisors not sufficiently integrated into the management structure (Source: World Bank and Public-Private Infrastructure Advisory Facility. 2007. *A Case Study of the Experience of the Two Water Concessions in Manila, Philippines: Its Impact on the Population and Improved Operational Efficiency [1997–2006]*).

profitable investment is, in all probability, boosted by the successful run of the East Zone concession.

In December 2007, MWCI—with its smaller concession area and customer base—posted a P2.4 billion net profit, this despite the fact that its 6-year income tax holiday lapsed in July 2007 and the company had to pay over P808 million in income tax. Its 2007 revenues also rose by over 15% compared to 2006 figures, helped by the significant increase in water volume sales and customers, and the further reduction of water losses from 30% to 24%.

PERCEIVING MAYNILAD'S TRUE VALUE

When the financial bids were opened in December 2006, the room erupted into cheers. With the winning bid being five times more than the expected, this was not surprising at all.



Former Maynilad president Fiorello Estuar said the bids reflect the true value of Maynilad. In 2004, the company's value was practically zero. After the bid, just 84% of Maynilad is already worth half a billion dollars.

In separate discussions with both DMCI-MPIC and MWCI, the bidders revealed that their aggressive bids are based on their belief that the return on investment would be good. The most obvious area for improvement is, of course, reducing nonrevenue water (NRW) as this directly impacts revenues. At the time of the bid, the NRW level was at 70%, higher than its 1997 rate when the concession started. Both bidders' confidence in their ability to reduce NRW is attested to by their respective experiences.

Forging Ahead

When Maynilad's original shareholders pulled out of the company, naysayers predicted the decline of private sector participation in the Philippine water sector. The successful rebidding process showed them that Maynilad's past problem-filled decade has produced valuable lessons that foster, not deter, private sector involvement.

In particular, the experience identified the critical factors for engaging private investors in the water sector—good information, competent regulators, innovative risk management strategies, flexible provisions for forex fluctuations, and a government ready and willing to uphold the principles of private sector participation.

Now that the rebidding process is over and Maynilad has successfully entered its second decade, it is important to remember that all parties—MWSS, former sponsors of Maynilad, and creditors—worked together toward the successful rebidding to ensure that services to the West Zone will continue and improve over the remaining period of the concession.

The whole exercise shows that if the process is done right, investors are ready to bet even on an ailing water utility. ■



Photos: Maynilad Water Services, Inc. (MWSI)

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Authors

Anand Chiplunkar
Senior Water Supply and Sanitation Specialist
achiplunkar@adb.org

Ma. Christina Dueñas
Water Knowledge and Communications Coordinator (Consultant)
cduenas@adb.org

Mai Flor
Water Governance Specialist (Consultant)
mmflor@adb.org

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