



RATINGS (NOVEMBER 2010)

SUI NORTHERN GAS PIPELINES LIMITED (SNGPL)

Entity	New	Previous
Long Term	AA	AA
Short Term	A1+	A1+

LT Entity Rating - History

Rating	Apr 2006	Jun 2007	Sep 2008	Aug 2009	Nov 2010
AA+					
AA					
AA-					
A+					

FINANCIAL DATA

PKR (mln)

	1QFY11*	FY10	FY09
Total Assets	139,197	138,422	122,348
Average Operating Assets	55,170	50,829	45,789
Equity	19,164	18,703	16,148
Net Income	461	2,555	931
ROA (%)	0.3	1.9	0.8
ROE (%)	2.4	13.7	5.8
EBITDA	3,171	14,412	8,067
Net Debt /Net Debt + Equity (%)	4.3	5.2	13.6

* Based on unaudited accounts for the 3 months ended September 30, 2010.

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RATING RATIONALE AND KEY RATING DRIVERS

- The ratings reflect SNGPL's sovereign ownership structure and strategic importance, implying strong sponsor support. The ratings also incorporate the company's low business risk, attributable to its monopolist position in its area of franchise (Punjab & Khyber Pakhtunkhwa) – and guaranteed return on its net operating assets. Meanwhile, robust cash flows and low leveraged capital structure of the company lend it financial flexibility.
- Effective implementation of the management's strategy for the curtailment of gas losses to keep profitability intact and continuing regulatory support would remain critical for the ratings. Favourable circular debt developments and uninterrupted gas supplies would also be crucial. Meanwhile, excessive leveraging, impacting SNGPL's financial profile, would have negative rating implications.

ASSESSMENT

- There are two gas utilities in Pakistan – SNGPL and Sui Southern Gas Company Limited – having exclusive licenses for the distribution and transmission of natural gas in their respective areas of operation. The cost of gas, a major, pass-through component of their cost structure, is linked to international crude oil prices, which have depicted a rising trend lately. While domestic gas wellhead prices are revised on a biannual basis, the impact of a change in these is transferred to the customer with a time lag, so reported operating margins of the utilities come under pressure in a rising cost environment.
- SNGPL's profitability is dependent upon the quantum of net average operating assets, on which it earns a 17.5% guaranteed return. However, certain adjustments, mainly relating to Unaccounted for Gas (UFG) losses, are made to the guaranteed portion of return by the Oil and Gas Regulatory Authority (OGRA), in case the prescribed operating efficiency benchmarks are violated. Recently, OGRA raised the UFG benchmark from 5% to 7% for FY10 in order to reduce the associated financial burden on the sector, thus, providing interim relief to it.
- During FY10, the average net operating assets of the company increased significantly, impacting profitability positively, on a YoY basis. However, despite the UFG benchmark revision, the high level of losses (9.6%) still resulted in large disallowances (PKR 4,670mln). Meanwhile, the contribution of interest income on bank deposits to the bottomline remained relatively low due to the change in the deferred credit mechanism, whereby funds for future expansion are now placed in an assignment account, instead of directly being placed with SNGPL. During 1QFY11, UFG disallowances (PKR 1,713mln) remained high, reducing the total effective rate of return to 4.6%. The high UFG losses are expected to remain a concern in the future, especially given the increase in the weighted average cost of gas. Moreover, in case the prescribed UFG loss limit reverts to its previous level, the bottomline would be hampered.
- The increasing focus of the company on controlling losses is highlighted by the fact that a committee has been formed for the recommendation and monitoring of UFG control measures at the board level. A five-year UFG reduction plan has also been formulated by the management. However, timely and effective implementation of these measures, resulting in keeping the related disallowances low, would be crucial for SNGPL's future prospects.
- SNGPL spent a significant amount (PKR 14,769mln) on capex during FY10, although this was lower than the FY09 amount (PKR 22,139mln). For FY11, it has targeted capex of PKR 11,000mln, while actually spending PKR 2,535mln by end-1QFY11. Going forward, the management intends to consolidate its operations, while rehabilitating the existing network to curb losses. Moreover, expansion, to some extent, is contingent upon gas availability, which has lately registered flat growth.
- The company currently enjoys a low leveraged capital structure. SNGPL has traditionally enjoyed a sound liquidity position. The management plans to obtain additional loans to the tune of PKR 14,500mln during FY11, resulting in a moderately leveraged capital structure. These funds would be utilized to partially finance future capex and to meet delayed supplier payments. However, this borrowing and subsequent charges would further reduce the effective rate of return of SNGPL, in turn, eroding the profitability. SNGPL has traditionally enjoyed a significant liquidity position. However, as a result of the circular debt issue, both its trade receivables (end-1QFY11: PKR 44,065mln; FY10: PKR 42,875mln), from WAPDA and other industrial customers, and trade payables (1QFY11: PKR 56,762mln; FY10: PKR 55,422mln), mainly to SSGC and gas suppliers, have grown significantly. Although SNGPL has been able to manage its working capital requirements by delaying payments to its creditors, the issue, if unresolved, could adversely impact the company's relationship with gas suppliers. At the same time, the stable cashflows of the company have provided financial flexibility in the past, allowing SNGPL to maintain strong coverages.

PROFILE

- Established in 1963 and listed on all three stock exchanges, SNGPL is the largest integrated gas company in Pakistan, engaged in the business of the purchase, purification, transmission and distribution of natural gas. The government, mainly through the President of Pakistan, has the largest stake (55%) in the company and nine nominees on the thirteen member BoD. Among the private groups, Dawood Hercules Group holds 16%, while Nishat Group owns 9%.
- SNGPL caters to the gas requirements of around 3.5mln customers, with a network that spans over 83,000kms and covers 1,921 towns.