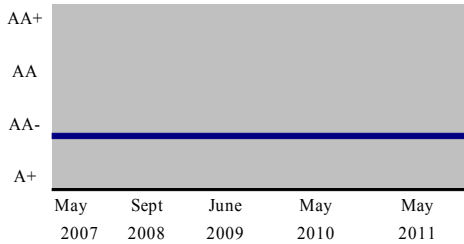


RATINGS (MAY 2011)

SUI SOUTHERN GAS COMPANY LIMITED (SSGC)

ENTITY	NEW	PREVIOUS
Long Term	AA-	AA-
Short Term	A1+	A1+
Debt Instrument		
Sukuk (PKR 4,700mln)	AA	AA
Outlook	Negative	Negative

LONG TERM RATING HISTORY GRAPH



FINANCIAL DATA

PKR (mln)

	3QFY11*	FY10	FY09
Total Assets	133,923	110,759	100,554
Net Operating Assets	34,700	31,938	29,157
Equity	15,285	14,072	9,684
Guaranteed Return	5,899	5,429	4,957
Net Income	2,231	4,399	258
ROA (%)	2.2	3.9	0.3
ROE (%)	19.5	31.3	2.6
EBITDA	6,974	11,200	3,931
Total Debt / (Total Debt + Equity) (%)	57	59	70

*Based on unaudited accounts for the 9 months ended March 31, 2011.

ANALYSTS

Aisha Khalid
+92 42 35869504
aisha@pacra.com

Jhangeer Hanif
+92 42 35869504
jhangeer@pacra.com

SUKUK ISSUE

SSGC issued a privately placed Sukuk of PKR 4,700mln in December 2007. The principal repayment has commenced since September 2010 in equal quarterly installments. The Sukuk, carrying a profit at the rate of 3 months KIBOR plus 20bps, payable quarterly in arrears, would mature in December 2012. The instrument is secured by way of first pari passu charge over all present and future moveable fixed assets of the company, with additional 25% margin.

RATING RATIONALE AND KEY RATING DRIVERS

The ratings reflect SSGC's monopolistic position in its area of franchise (Sindh and Balochistan) and guaranteed return on its net operating assets, translating into low business risk. Moreover, the company's strategic importance supplemented by its sovereign ownership structure remains a key rating factor. The recent regulatory relief has benefited the company in improving its financial profile though its continuity remains to be seen. In the meantime, effective management of the company's debt profile is important.

Outlook on the rating is negative, which indicates potential pressure on the company's financial profile in the wake of rising UFG losses, and pending adjudication of the court case on non operating income and UFG benchmark. Effective curtailment of gas losses, amicable resolution of the circular debt issue and uninterrupted gas supplies for continued network expansion also remain crucial.

ASSESSMENT

Sui Southern Gas Company Limited and Sui Northern Gas PipeLines Limited, Pakistan's key gas utilities, have exclusive licenses for the distribution and transmission of natural gas in their respective areas of operation. The cost of gas, which is a major pass-through component of their cost structure, is linked to international crude oil prices, which has experienced a rising trend for the last couple of months. The impact of a change in prices is transferred to the customer with a time lag, so reported operating margins of the utility companies come under pressure in a rising cost environment.

SSGC's profitability remains dependent on the quantum of net average operating assets, on which it is entitled to a 17% guaranteed return, plus non-operating income. During FY10, SSGC's net operating assets witnessed modest increase thus generating better returns on YoY basis. Moreover, SSGC benefited from OGRA's decision regarding the inclusion of few items (royalty income from JJVL and late payment surcharge) in the non-operating income as against the historical practice of including them in operating income. Furthermore, revision in the UFG losses benchmark from 4.5%-5.5% to 7% by OGRA also reduced the UFG losses disallowance significantly (FY10: PKR 934mln; FY09: PKR 2,818mln). This two-fold comfort, while providing benefit of ~ PKR 5.6bln, led to a higher bottom-line on YoY basis. However, these relaxation were provided for a period of one year only – FY10. In its latest decision, OGRA has taken back both relaxations while setting the new UFG benchmark of 4.25% - 5%. In response to this, SSGC has filed an appeal in the Honorable High Court of Sindh. The Court, while providing interim relief, allowed SSGC to follow OGRA's previous decision until OGRA provides UFG impact assessment study (including its assessment about the treatment of non-operating income) to the Court. OGRA is still in process of engaging consultants and exact time frame for completion of the study remains indeterminable.

During 3QFY11, SSGC's operating assets attained a speedy pace (~13%). However, the company's UFG losses reached a higher level of 9.8% (3QFY10: 8.6%), which may result in higher disallowance on a YoY basis. Moreover, the company's reported margin has squeezed, owing to sizable hike in average wellhead purchase price (18%).

The company made capex of PKR 6bln during FY10 (budgeted PKR 8bln). The management plans to incur PKR 8bln on capex annually. In this regard, it has already spent ~PKR 7bln during 3QFY11. The company continues to focus on UFG reduction and to improve the efficiency, enhance measurement accuracy and replace the old distribution network. For these, the company plans to incur cost of ~ \$350mln over a period of five years. In this regard, it has been offered a loan of \$200mln from World Bank. Moreover, to cope with the supply side constraints, the company is exploring avenues for LNG import.

The circular debt issue in the oil & gas sector has been continuously creating liquidity issue for the players. As at end April11, the company's receivables stood at ~ PKR 46bln with the highest contribution arising from KESC. To manage its working capital needs, the company delays payments to suppliers (PKR 42bln as at end-April11). Moreover, it has also obtained short term lines of amount PKR 12bln. The net receivables position at end-April11, has been financed through short term borrowings.

SSGC has a highly leveraged capital structure, signifying high financial risk. The company has been leveraging its balance sheet over the years, mainly to support capital expenditures and, of late, to meet working capital needs. Cognizant of this, the company intends to deleverage the balance sheet, though its extent would remain limited due to upcoming additional borrowing for UFG control from World Bank. While the coverages would remain under pressure, the repayment ability for the additional debt would be a function of earning capability that it creates.

PROFILE

SSGC, formed in 1989 as a result of a series of mergers, is an integrated gas company with transmission and distribution operations in its franchise area, where it enjoys a monopoly position. SSGC is currently catering to gas requirements of around 2.4 million customers in domestic, commercial and industrial sectors, with a network that spans over 38,631 kilometres. The government owns ~55% of the company's shares, which are listed on the Karachi, Lahore and Islamabad stock exchanges.

Recently Mr. Azim Iqbal Siddiqui – Deputy Managing Director (South) – has taken over the affairs of the company after resignation of the Managing Director - Dr. Faizullah Abbasi. Mr. Siddiqui is a career executive with SSGC. The fourteen member Board of Directors has eleven representatives of the GoP. The board members have vast experience in the energy, financial and civil services sectors.