

2010 floods:

Impact & corporate feedback



JS Global Capital Limited

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Floods; Corporates' initial impression

Pakistan is encountering the worst of natural disasters in its history in the shape of seemingly unending floods since July 22nd, 2010. Various agencies, including USAID, IFIs, UN, and Pakistan's National Disaster Management Authority (NDMA) have yet to estimate the extent of the national loss incurred as a result of this. However, initial estimates suggest that over 13.8mn people have been affected from this calamity. We opine, this will have notable negative consequences on the government's budgetary estimates and may risk running a higher fiscal deficit than earlier estimated which in turn will lead to increased government borrowing. Despite this gloomy picture, we believe, the country's major economic activity areas (industrial & agricultural) are safe from significant destruction and work is continuing as usual. This was verified by several major corporates whom we contacted, and barring a few exceptions, a relatively better situation was portrayed by them than initially feared by all (details to follow). As fore-mentioned, the flood flow is not over yet, and thus an increased risk to our initial assessment cannot be ruled out, as there is forecast of further rainfall to occur in the country.

2010 floods impact; taking the 1992 floods as a reference point

Brief history - 1992: As highlighted above, it is too early to ascertain the macro impact of the ongoing flood situation, but we are taking the September 1992 floods as a case point for estimation purposes. In 1992, Pakistan witnessed record floods (also classified as one of the worst floods in the world at that point in time) and the country witnessed massive infrastructure and agricultural losses. Approximately half a million people were displaced, over 5 million acres of land, 3 million acres of crops, 200,000 Kacha-area mud houses and about 100,000 houses in other areas were destroyed.

As per the economic survey of 1993, record agricultural losses were witnessed, e.g. cotton production came in at 9.33mn bales vs. the target of 12mn bales, rice output was recorded at 3.08mn tons vs a target of 3.48mn tons, and sugarcane harvested came to 36.5mn tons vs the target of 39.7mn tons. On the macro front, GDP was reported at a meager 2.1% (from 7.7% in FY92), with the dip primarily caused by a 5.3% contraction witnessed in the agricultural sector, the current account deficit surging to 7.2% of GDP (from 2.8% in FY92) and the fiscal deficit coming in at 8.1% (from 7.5% in FY92). Interestingly, inflation tapered off at 9.8% (from 10.6% in FY92) and the policy rate was reduced to 15% from 17% in the previous fiscal year. The stock market since the floods hit in 1992, provided a record return of 67% within a span of 15 following months.

Flood impact – 2010: As highlighted in the USAID map on Page 3, the agricultural loss is likely to be less severe than caused by the 1992 floods. It is estimated that a total 1.48mn acres of agricultural land has been affected with the majority cotton producing area safe from the calamity. The national highways are still operational and hence, the supply of essential foods item is not likely to be significantly handicapped, as opposed to what was witnessed in 1992.

Economic indicators

	FY92A	FY93A	FY10A/E	FY11F
GDP (%)	7.7	2.1	4.1	3.5-4.0
Agriculture	9.5	(5.3)	2.0	2.5
Manufacturing	8.1	4.4	5.2	5.6
Comm. Producing	8.6	0.1	3.6	3.0
Services Sector	6.8	4.6	4.6	4.7
CPI	10.6	9.8	11.7	11.0
Exchange Rate	24.8	25.9	85.6	87.5
as % of GDP				
C/A Deficit	2.8	7.2	2.0	3.5-4.0
Fiscal Deficit	7.5	8.1	6.0	5.5-6.0
Dev. Expenditure	7.6	5.7	4.9	4.4

Source: SBP & JS Research

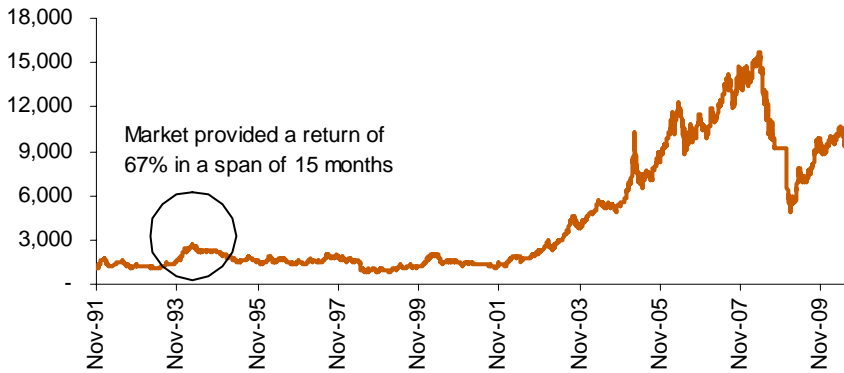
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To assess the losses to the industries, we have spoken to the management of key corporations in various sectors and all presented a relatively better situation and that they have been saved from major losses. There were only a few exceptions, the teleco's and PEPCO which foresee infrastructure losses. We expect GDP growth to remain in the range of 3.5-4.0% in FY11 as against the government's initial projection of 4.5%, with agricultural losses to be mitigated with the reconstruction activity. Additionally, we anticipate, the government will follow an expansionary fiscal policy and spend around Rs150bn on rehabilitation and reconstruction, which will raise the deficit projection by ~1% to 6%. Additional borrowing needed for this purpose will be achieved through loans from the SBP and a likely waiver will be sought from the IMF.

Stock Market

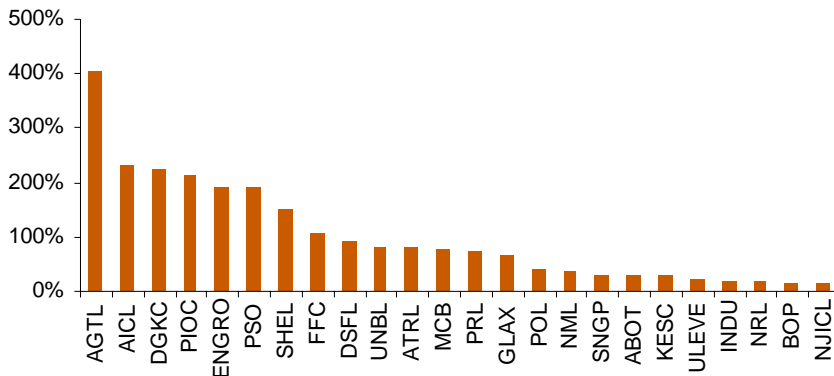
As highlighted above, the stock market provided record returns in the 15 months that followed the 1992 floods. Cements, Fertilizer, Agri-autos and Oil stocks had performed exceptionally (see graph below). We expect a similar kind of performance in the infrastructure related scrips (especially Cements) this time around as well. With minimal impact of floods expected on Energy assets and despite overplayed concerns of crop damage, we remain 'Over-weight' on E&P, Power, Textile, Cement and Fertilizer sectors. Our top picks include PPL, POL, PSO, Hubco, NML, Engro, DGKC and Lucky.

Historical performance of KSE-100 Index



Source: KSE

Key stock performances (Sep92-Dec93)

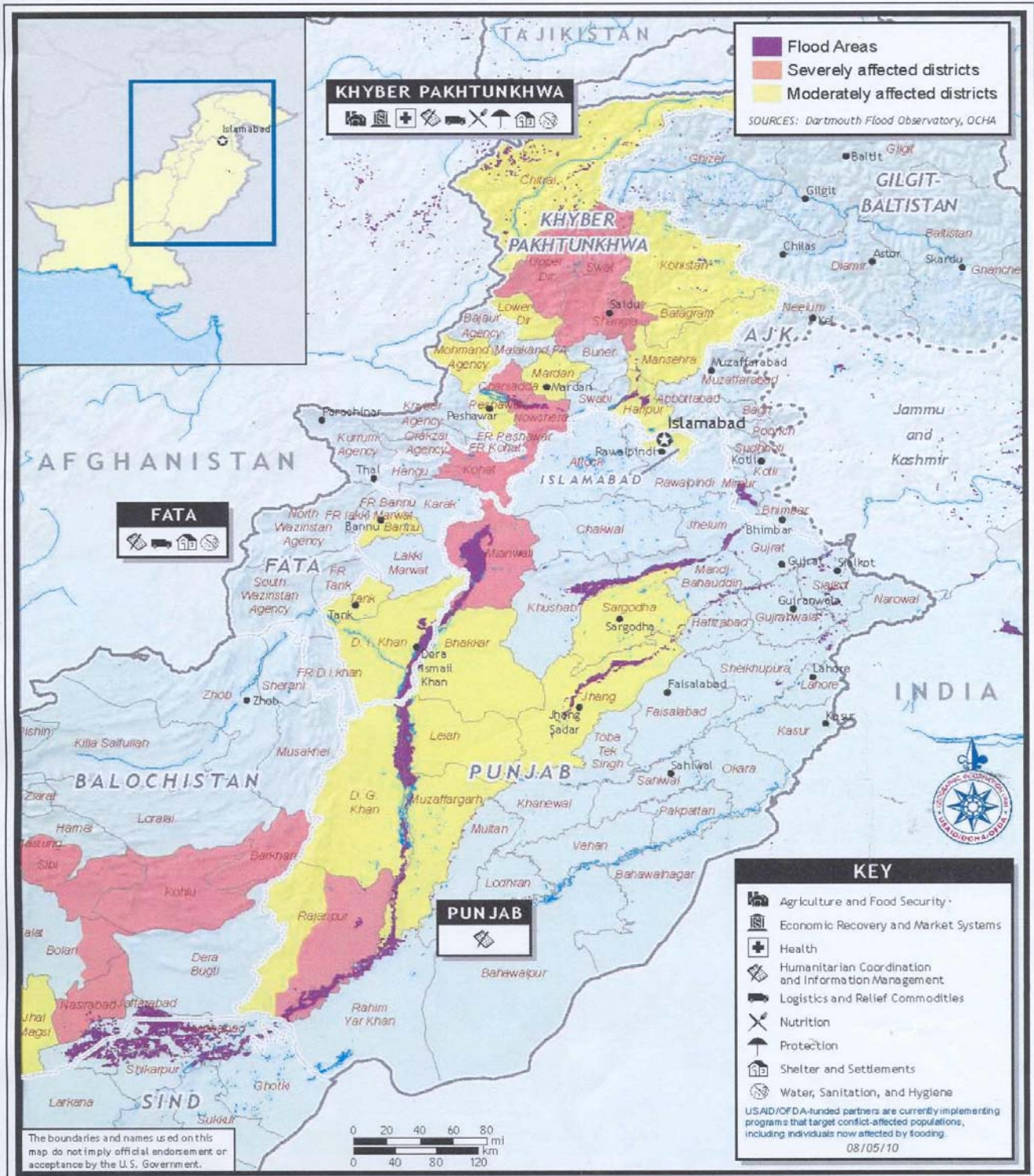


Source: KSE



USAID
FROM THE AMERICAN PEOPLE

ONGOING USAID/OFDA PROGRAMS FOR AFFECTED POPULATIONS IN PAKISTAN



Source: USAID

Corporate view on the flood

In light of this unfolding event, we have discussed the issues and damages caused by the flood with some the corporate businesses in various sectors and came up with the following:

Textile

Concerns felt over the cotton crop being severely affected by floods in the country appear to be exaggerated. The major districts that have been afflicted by this are Muzaffargarh, Dera Ghazi Khan and Rajanpur, whereas a significant portion of Pakistan's cotton belt is still safe from this havoc. According to experts, total cotton production for FY11 was expected to be around 14mn bales. However, initial impressions show that ~1mn bales are likely to be affected which would still translate into a growth of 2% from FY10. Moreover, as per our discussion with the managements of Nishat Mills Limited and Nishat Chunian Limited, cotton prices are expected to come down once supply from Punjab kicks in following this situation easing off. We currently have an 'Overweight' stance on the textile sector with a 'Buy' call on both NML and NCL.

Nishat Mills Limited: A major concern for the company is its AES power plants which have been swamped by floods and currently are not operational. The Force Majeure clause does not come into play in AES's case till WAPDA and PEPCO declare it so. We have assumed WAPDA will stop its capacity payments for 30 days which translates into a per share negative impact of Rs0.08 on the company's FY11F earnings.

Fertilizer Sector

Despite no short-term direct impact of floods on the fertilizer sector as sowing for the Rabi season starts in Sep-Oct period, the companies will experience the negative consequences of the inundation in the long term. Floods have left farmers in dismay over the damage caused to the crops which eventually will reduce their purchasing power in the coming months. Hence, we could see fertilizer offtake taking a hit in the remaining part of the year. As DAP is more sensitive to farmer income, we believe it to register a higher sales decline than urea. We however, do not rule out the possibility of urea prices coming down owing to lower farmer income, going forward as well.

At current levels, we maintain our 'Over-weight' stance on the sector. We recommend 'Buy' on FFC and Engro and maintain our 'Hold' stance on FFBL.

Cement

DG Khan Cement: As per our discussion with DGKC's management, the floods have not affected any of its plant and machinery on both sites and are fully operational. They expect sales to pick up within 15-20 days of the situation improving whereas exports to Afghanistan have not been affected. According to them, demand outlook appears robust in the long run but all depends on the government's willingness and ability to spend on reconstruction. Going forward, the company expects that cement prices could go up on the back of strong demand post the destruction caused by floods. Prices are likely to go up to Rs340 per bag from the present Rs315 per bag.

Lucky Cement: The Company's management has revealed that Lucky's northern plant in Pezu is unaffected. The company has seen its market share increase slightly in the upper part of the country and Afghanistan due to other companies'

plants encountering difficulties in dispatching cement. Lucky is also optimistic that demand in the long run should remain robust and prices will pick up in the short term.

We currently maintain our 'Buy' stance on both the scrips, with an 'Over-weight' stance on the sector.

Power

Kapco: Kapco's power plant is still operational as the facility is not directly affected by the floods. Resultantly, the company is not planning to declare Force Majeure clause on the plant. Just to clarify here that in case of a natural calamity, the capacity payments to the plant are paid only when WAPDA/PEPCO declares Force Majeure. In addition to this, since the plant is fully insured, the potential impact of any damage caused by the flood would be largely offset by its insurance claims.

Oil and gas exploration

POL: POL's management reveals that production from the recently discovered Bela is still suspended due to flooding, however, its impact is nominal on POL's earnings as the field was merely producing crude at an average of 140 barrels per day.

OGDC: Production from Nashpa is completely restored, while hydrocarbon production from Mela and Chanda has been reinstated at 50% of their pre-suspension level. On the other hand, production from Qadirpur field remains completely halted after one of SNGP's compression facilities has ceased to operate. However, the management reiterated that the field itself is not affected by the flood. Regarding the re-commencement of production flow from the field, the management expects it to come online in next 8-10 days if the weather condition improves. Based on our estimates a 10 day closure of the field will have an EPS impact of Rs0.09 and Rs0.04 on OGDC and PPL, respectively.

Monthly earnings impact of production stoppage

Fields	Production		Stake holders			Impact per month (Rs/share)		
	Oil (bpd)	Gas (mmcf)	OGDC	PPL	POL	OGDC	PPL	POL
Mela	5,110	16	56%	26%	0%	0.06	0.13	-
Chanda	2,400	-	72%	0%	0%	0.03	-	-
Nashpa	4,550	14	56%	26%	0%	0.06	0.11	-
Bela	139	2	0%	0%	100%	-	-	0.05
Qadirpur	835	460	75%	7%	0%	0.38	0.17	-

Source: JS Research

OMCs

Pakistan State Oil: According to the management, petrol sales have remained unaffected as most highways are still operational. However diesel sales are estimated to be 15-20% down due to curtailed agricultural activities. In addition, Furnace Oil (FO) sales could take a pinch as some of the power plants are flooded, for which PSO is the fuel supplier.

Gas Marketing

SNGPL: The company was primarily affected by the closure of its compression facility at the Qadirpur gas field owing to flooding, repair work on which is ongoing.

Damages to its distribution network though have yet to be precisely estimated, are expected by the management to be of a minor degree.

SSGC: Its infrastructure and gas fields remain unaffected by the floods, and therefore there has been no loss incurred yet.

Furthermore, operational assets of both the companies are insured and in the event of any damage thereof, would be covered by the relevant insurance companies. We currently have a 'Sell' stance on both SNGPL and SSGC.

Refineries

PARCO is the only refinery in the country which has suspended its operations as a precautionary measure to avoid any damages from the present catastrophe and disruption in the road infrastructure. However, the refinery is still supplying fuel via its three supply pipelines. The management believes this is a temporary outage and the refinery would be back online once the roads are revamped. As a result of this outage, other refineries situated in the region like Attock Refinery have been able to increase their capacity utilization levels.

Bank

Pakistan's banking space would face the repercussions of the overall economic dent from this devastation. More so, Agri finance (FY10 level at Rs248bn) could see potential bad debts following losses (both farming and non-farming) and expected slowed activity in FY11. However, we believe the damage would be manageable as most affected areas in K&P and Baluchistan only account for ~2.5% of the disbursed financing; with major flow directed towards Punjab (~86%). Indirect impact of various sectors being hurt by the flood, could lead to a fresh wave of new NPLs.

Segment wise Advances and NPLs

(Rs bn)	Dec-09			Mar-10		
	Loans	NPLs	NPL Ratio	Loans	NPLs	NPL Ratio
Corporate Sector	2,184	274	12.6	2,208	292	13.2
SMEs	359	79	22.1	336	83	24.7
Agricultural Sector	160	26	16.5	161	28	17.2
Consumer Sector	295	36	12.2	287	39	13.5
Commodity Financing	419	5	1.1	364	4	1.1
Staff Loans	74	1	1.2	75	1	1.3
Others	64	10	16.4	62	10	16.7
Total	3,555	432	12.2	3,494	457	13.1

Source: SBP

Going forward, we could see government borrowing emerge as a concern again, once relief efforts are in full swing. This could prolong the current situation of crowding out of private investment, putting an upward pressure in the interbank rate, in our view.

Telecom

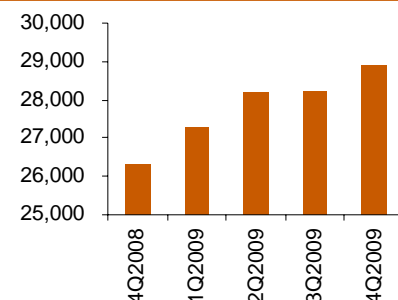
Telco's are among the worst hit companies from these floods, however lack of reflection in the stock market makes it a relatively less concern for investors. Although no official estimates have yet come in, the fixed line network and Cellular/ WLL cities have witnessed significant damage.

Agri disbursement by region

(Rs mn)	FY10	FY09
Punjab	213,507	196,097
Sindh	26,734	27,620
Khyber Pakhtunkhwa	6,519	7,910
Balochistan	577	552
Azad Kashmir	482	552
Gilgit-Baltistan	301	279
All Pakistan	248,120	233,010

Source: SBP

Total cellular sites in the country



Source: PTA

Various USF projects - both fiber optic and broadband - have too come to a halt with authorities currently undergoing damage assessment and provisional figures are expected to come in the next couple of weeks. Notably though, PTCL's fibre optic laying project with USF in Baluchistan has come to a halt.

Autos

Indus Motor: Gathering from the company's management, slow down in agricultural growth is likely to negatively impact demand of vehicles by 20-25% in the short term. Indus Motor and Honda Car will bear the brunt of this owing to a higher share of 1300CC (and above) vehicles in their product mix for which majority of the demand is derived from rural areas. However, in the long term the company views the demand shrinking by as much as 50% as reduced farmer liquidity owing to the floods will also not generate any replacement demand. Hence, we believe on the overall, the Auto sector would be negatively affected by this calamity.

Chemicals

LOTPTA: PSF operations are currently running at 90-95% utilization level according to LOTPTA's management. In the case of a higher than expected up tick in cotton prices, PSF operating rates would further improve on the back of higher consumption of PSF in blended yarn. This in turn would bode positive for LOTPTA as the company would be able to sustain its production at higher levels.

Engro Polymer and Chemical Limited: The management revealed that PVC's demand has become sluggish and may remain so until the flood recedes. However, historically it has been seen that the demand sharply picks up post a catastrophe amid reconstruction activities which will help mitigate the sales losses incurred because of the flooding.

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