

July 13, 2010

**Pakistan Market****SSGC: UFG reduction becomes top priority****MORNING BRIEFING**

KSE100 Index: Closing 9979.07 ↑ (+4.67)

SSGC has formally launched a much needed program to primarily focus on improving efficiency of its existing distribution network to contain the soaring UFG losses. The project spans over five years and its cost has been estimated at Rs25bn of which ~Rs9.8bn (US\$115mn) will be funded by the World Bank (WB). The rest will be arranged for, through commercial borrowing. The management has also indicated that UFG losses for FY10 have come around 8% and we have accordingly tweaked our FY10 UFG estimate for the period to 8.3% from 8.6% previously. Following this downward revision in the UFG assumption, our EPS estimate for FY10 now comes to Rs0.16 from a loss of Rs0.23 per share expected earlier. Taking into account the new project and following a discussion with the management, we have also adjusted our CAPEX assumption. The consequent change in earnings expectations raises our target price to Rs13 from Rs12 previously, with our Sell stance intact at current levels.

**Increase in CAPEX = Improvement in earnings**

UFG losses have plagued SSGC and eaten away its profits since OGRA enforced performance benchmarks for the gas utility companies in 2003. The management has thus prioritized its capital expenditure and intends to enhance the regular levels of CAPEX by approximately Rs5bn starting FY11 through FY15 to curb mounting UFG losses.

This would bode well for the company as its profitability will improve on two counts; (1) higher operating profits as these are tied to the level of CAPEX incurred and (2) expected reduction in penalties charged on excess UFG losses. On the flip side, finance cost will simultaneously rise as well as the project will primarily be financed by funds borrowed from the WB and commercial institutions. The company's internal fund generation would not suffice as it is dented by high finance costs owing to the circular debt issue in FY11 especially. This would thus, somewhat dampen the positive impact on earnings of intended higher CAPEX and lower UFG losses.

**SSGC: Revised earnings estimates**

Capex (Rs bn)	EPS (Rs)		
	FY10E	FY11F	FY12F
~3-4bn (original assum.)	(0.23)	0.59	0.83
~8-9bn	0.16	0.65	0.90

*Source: JS Research***SSGC targets UFG at 6% by end of FY15**

The management through this project aims to prevent the UFG losses from escalating and bring it down to 6% of total supplies by FY15. We had already assumed gradual improvement in UFG losses in our model but considering historical trends and remaining prudent we have projected these to come down to 7% instead, at the end of the project.

**Recommendation: 'Sell' maintained**

The stock is currently at a 27% premium to our revised target price of Rs13 (from Rs12 previously) trading at an FY11F PE of 25.4x. Furthermore, dividend payout during FY10 and FY11 appears to be a bleak possibility owing to the ongoing liquidity issues caused by the persisting circular debt. We therefore maintain our 'Sell' stance on the scrip.

angela.memon@js.com

92 (21) 111-574-111 (ext. 3097)

**Also in focus****Inflation ends at 11.73% in FY10**

With June's inflation at 12.69%, CPI for FY10 ceases at 11.73% down from 20.77% in FY09. The later part of FY10 witnessed substantial easing in inflationary pressures as evident from May and June's month-on-month statistics of 0.06% and 0.65%, respectively. The underlying inflation (ex-food & energy) was reported at 10.4% in June, lower, when compared to 15.9% a year ago. As majority of the pass-through's have already been done, we expect inflation to gradually move into the single digit terrain in 2HFY11. We expect average inflation for a full FY11 to be in the range of 9-10%.

**JS Global Capital Limited**

6th Floor, Faysal House, Main Shahrah-e-Faisal, Karachi

**Research:**

Tel: +92 (21) 32799005

Fax: +92 (21) 32800163

js.research@js.com

**Fixed Income Sales:**

Tel: +92 (21) 32799541-44

Fax: +92 (21) 32800165

tariq.usman@js.com

**Equity Sales:**

Tel: +92 (21) 32799513

Fax: +92 (21) 32800166

junaid.iqbal@js.com

**Corporate Finance:**

Tel: +92 (21) 32799005

Fax: +92 (21) 22800163

azhar.iqbal@js.com

**JS RESEARCH IS AVAILABLE ON BLOOMBERG, CAPITALIQ & THOMSON REUTERS**