

December 15, 2009

**Pakistan Market****NML: Impact of potential AES power acquisition****MORNING BRIEFING**

KSE100 Index: Closing 9280.16 ↑ (+242.86)

After initiating commercial operations of Nishat Power Limited, Nishat Mills (NML) has announced its entering into an agreement with AES Pakistan Holdco Limited to 'acquire a substantial majority stake in AES Lalpir (Pvt.) Limited and AES Pak Gen (Pvt.) Limited'. This indicates NML's commitment to diversify its exposure in the power sector. Though the transaction is in initial stages, based on certain assumptions, we have assessed the impact of this potential acquisition on NML's valuation running a sensitivity analysis.

**Combined generation capacity of 727MW**

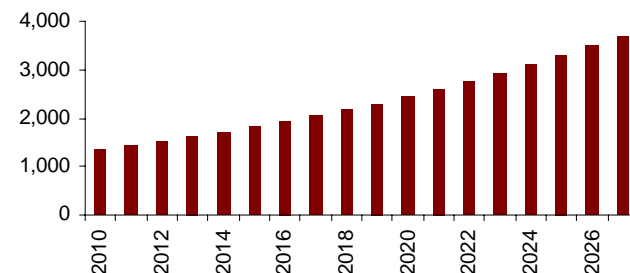
AES Lalpir and AES Pak Gen are RFO based oil fired power plants with name-plate capacities of 362MW and 365MW, respectively. The two projects are governed by the Power Policy of 1994 and were set up with an investment of US\$700mn with 25% equity contribution from the sponsors. Commercial operations of AES Lalpir commenced in Nov 1997 while AES Pak Gen begun commercial power generation three months later i.e. in Feb 1998. The Power Purchase Agreement for the two projects was set up for 30 years of which 18 years are still remaining.

**21% Rupee IRR on US\$100mn investment**

As per our discussion with the management, the preliminary acquisition cost estimate of a 100% stake in the two projects could stand in the vicinity of US\$100mn, which the company will arrange for as part of a possible investment consortium. In addition, the management indicated its plan of retaining the majority shreholding in the event of a succesful acquisition.

Assuming an investment of US\$100mn (Rs8.4bn) for a 100% stake, a remaining project life of 18 years and indexation with the US CPI & Rupee/US\$ parity (2.5% & 3.5% annually, respectively), the project would offer a Rupee IRR of around 21% to the new investors. Moverover, the Present Value (PV) of the cumulative dividend stream from the two projects is expected to stand around Rs10.3bn. Since, the exact percentage of NML's stake in the proposed deal has not yet

been finalized, we have performed a sensitivity analysis on NML's potential exposure in this venture on the company's valuation (see table).

**Graph: Expected dividend stream from AES (Rs mn)**

Source: JS Research

**Table: NML's Exposure & impact on valuation**

NML's Share in venture	50%	55%	60%
Tax adjusted PV of Dividends to NML (Rs bn)	4.6	5.1	5.5
Impact on valuation (Rs/share)	19.1	21.0	22.9

Source: JS Research

**Recommendation: 'Accumulate' at current levels**

We positively view NML's strategy of increasing its exposure in IPPs as it would reduce uncertainty in NML's bottom line due to stable dividend income contribution from company's investments in power projects. But since the development on this front is in early stages and further details are awaited, we have not yet incorporated any upside in our current valuation of NML. Nonetheless, amid positive expected cash flows from power segment and trading at FY10E and PBV of 8.5x and 0.6x, respectively, we recommend investors to accumulate NML at current levels.

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**Also in focus****Rupee at an all time low**

As per the commitments under the IMF program, the central bank has transferred payments for imports of crude oil to the commercial banks (effective Dec 14, 2009), which has added pressure on the Rupee. Following inflows from the IMF, Rupee had stabilised in the range of 83-83.50 over Oct-Nov. However, since the news has come in, Rupee has weakened by 70bps hitting an all time low of 84.3 yesterday. Rupee has depreciated by 6.2% this year to date compared to the 22.1% depreciation witnessed last year.

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