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Pakistan Market

SNGPL: Reinitiating coverage with a 'Sell' call

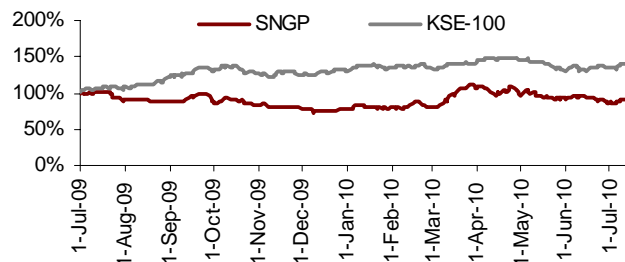
MORNING BRIEFING



KSE100 Index: Closing 10187.00 ↑ (+72.35)

SNGPL facing the brunt of the circular debt - as have others forming part of the energy chain - has witnessed downward pressure on its earnings especially in FY10. Up to 9MFY10, the bottomline has declined by 119%YoY to Rs445mn as financial charges skyrocketed and CAPEX levels were brought down. Owing to the latter event, the company was unable to contain its UFG losses (~8.3% in 9MFY10), which was another reason why earnings have been depressed. Evaluating these factors, we have updated our model and reinitiated our coverage on SNGPL with a 'Sell' call on the scrip and a target price of Rs21. The scrip is currently trading at an FY11F PE of 19.6x which is at a premium of 189% to the market. Historically, it has traded at a 3 year average PE of 14.7x - a 22.5% premium to the market, - which further supports our recommendation.

SNGP's relative performance to the market



Source: KSE

Circular debt inflates finance cost

Looking at the 9MFY10 results, a notable cause for concern in FY10 has been its financial cost which has soared by 619%YoY in 9MFY10 from Rs507mn, primarily owing to mark up charged on delayed payments to suppliers. We expect financial charges to rise further and come to around ~Rs4bn by June 2010. In addition, the company has also resorted to short term borrowing worth Rs995mn to meet its working capital requirements. With the inter-corporate debt issue yet

to be resolved, we expect finance costs to continue rising in FY11 mainly owing to anticipated commercial borrowing to finance CAPEX.

Slowdown in CAPEX visible

Worsening liquidity issues appear to have caused a slowdown in the company's CAPEX with Rs9.5bn incurred on the same in 9MFY10, which we believe, would cumulate to Rs11bn by June 2010. This is significantly lower relative to the last three years average CAPEX of Rs16bn per annum. For the period FY11-FY15 therefore, we have assumed SNGPL's CAPEX to remain in the vicinity of Rs11.5bn - Rs12bn. Our estimation is lower the historical average going forward because CAPEX had been abnormally high prior to FY10 because:

- 1) SNGPL had been focused on several mega projects for the purpose of expansion of its network which have now come to an end (funds for which had been given at very low rates)
- 2) From FY11 onwards, the company will have to borrow commercially at higher rates than before to finance its CAPEX

IP project and WB loan: Potential upside triggers

Materialisation of the Iran-Pak (IP) pipeline project would be a key earnings trigger for SNGPL through its stake in the IP pipeline project - costing US\$1.5bn to Pakistan.

Similarly, the World Bank (WB) has promised to grant a loan to the gas distribution companies to expend on improving efficiency of the national gas distribution network. If this project goes through, a reduction in UFG losses (currently expected at around 8.3% for FY10) coupled with increased CAPEX would boost earnings of the companies in the future.

Turnover tax for gas cos. likely to be revised down

The GoP in the FY11 budget had raised the turnover tax rate from 0.5% to 1%, which was a major negative for the gas marketing companies' earnings outlook. The managements of the two companies are confident however, of a reversal in this imposed rate to at least the previous level. Further, there has been positive newsflow from authorities of reducing it to

previous level. At present our earnings estimates are based on the assumption of a turnover tax rate of 0.5%. Following is a sensitivity table to reflect the impact on earnings assuming a 1% turnover tax rate.

Impact of possible turnover tax rates

Turnover Tax Rate	EPS (Rs)	
	FY11F	FY12F
0.5%	1.48	1.67
1.0%	(0.10)	0.06

Source: JS Research

Outlook:

The stock is currently trading at FY10E and FY11F PEs of 27.7x and 19.6x i.e. at premiums of 240% and 189% to the market, respectively. Further, the scrip is at a 38% premium to our target price of Rs21 hence; we have a 'Sell' stance on SNGPL. We do not expect the company to pay out any dividend in FY10 and till late FY11 at least owing to liquidity constraints stemming from the circular debt.

SNGP: Key valuations

	FY10E	FY11F	FY12F
EPS (Rs)	1.05	1.48	1.67
Price Earnings (x)	27.70	19.62	17.40
Price to Book (x)	0.95	0.91	0.86

Source: JS Research

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