

December 24, 2009

**Pakistan Market****NML: AES another feather in the cap****MORNING BRIEFING**

KSE100 Index: Closing 9302.92 ↓ (-29.55)

NML, these days is not short on positive news flow. After the recent commissioning of Nishat Power Limited (NPL) and announcement of the maiden Textile Policy by the government, the decision to invest in AES Lalpir (Pvt.) Limited and AES Pak Gen (Pvt.) Limited would be another ace in the pack for NML. The two projects with a cumulative capacity of 727MW would take the total capacity for the Group in excess of 1000MW, and provide NML with a more stable earnings stream, going forward. According to our estimates, investment in AES projects will have an incremental valuation impact of Rs13 per share after taking account of the cost of investment. Hence, we have revised our target price to Rs83 (Rs70 earlier) and upgraded our stance to 'Buy'. High cotton prices, a slowdown in export orders, any regulatory bottlenecks in the acquisition process and delays in the resolution of circular debt issue remain key risks to our thesis.

**Valuation: 18% upside to target price of Rs83**

The revision in our Sum-of-Parts target price is mainly premised on the fact, that the new acquisitions would add Rs13 per share to NML's valuation (taking account of cost of capital), translating into an 18% upside at current levels. The valuation share from NML's core business, stands at Rs40 whereas Rs30 per share is contributed by its already strong equity portfolio, comprising MCB and DG Khan. Though the scrip has performed admirably during the year (210% return year to date), the AES trigger is set to allow NML to continue posting healthy returns in the future.

The stock is presently trading at a respective FY11F PE and PBV of 5.9x and 0.7x. Given our revised target price of Rs83 and a significant discount of 47% on PBV to the market, we upgrade our stance on the scrip to 'Buy'.

**Acquisition to boost valuation by Rs13**

NML has announced plans to acquire shares of up to US\$60mn in AES Lalpir (Pvt.) Limited and AES Pak Gen (Pvt.) Ltd, as part of its diversification strategy in the power

sector. 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; 25% of the equity contributed by the sponsors.

Assuming equal investment in both projects, a US\$60mn (Rs5bn) equity stake implies approximately 46% share in each company. However, as per our discussions with the management, NML's share in the acquisition is likely to stand in the vicinity of 35%, translating into an acquisition cost of US\$45mn (Rs3.8bn). Based on the remaining project life of 18 years and indexation with the US CPI & Rupee/US\$ parity (2.5% & 3% annually, respectively), the investment is expected to offer an attractive IRR of ~25%. The Present Value (PV) of the cumulative dividend stream from the two projects is expected to stand slightly above Rs6.4bn

Using the sum-of-part valuation methodology, and valuing AES based on the PV of future cash flows, the investment is likely to add another Rs13 to our current fair value of Rs70.

**Dividend income to swell to Rs1.9bn in FY11**

While dividend income has always occupied an important share in NML's earnings profile, the earnings' mix is expected to witness a massive change starting FY11, amid dividend flows from NPL and AES. According to our estimates, the dividend income will increase to Rs1.9bn in FY11 from Rs599mn in FY09, taking the share in the total earnings to 83%. The swelling dividend stream will certainly reduce volatility in NML's earnings, going forward and will help NML to post a 3 year (2009-12) earnings CAGR of 42%.

**For more details please refer to our short report titled "NML: AES another feather in the cap" to be released shortly.**

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**Also in focus****IMF to release the fourth tranche of US\$1.2bn**

The IMF yesterday completed the third review under the stand-by arrangement for Pakistan, enabling the disbursement of the fourth tranche of US\$1.2bn. The fund also appreciated the structural reforms made by the government which have helped ease the macro imbalances. However, it also pointed out that low revenue collection and weak private sector off-take remain a concern to the overall recovery. We believe, arrival of the fourth tranche will help improve market sentiments, shore up reserves and ease the pressure on the Rupee/US\$ parity.

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