



Sui Southern Gas Company Limited

Ratings (February 2006)

Secured TFCs

	New	Previous
Tranche - I PKR 1.0 bln	A1+*	AA
Tranche - II PKR 1.25 bln	AA	AA

* Short-term rating has been assigned, pending full redemption in June 2006.

Summary Data

	FY 05	FY 04
Total Assets (Rs mln)	37,682	31,837
Average net operating fixed assets	16,229	15,061
Revenues (Rs mln)	52,703	44,800
Net Income (Rs mln)	1,012	997
EBITDA (Rs mln)	4,252	4,108
ROE (%)	9.8	10.1%
Net Debt/ EBITDA (yr)	1.8	0.8
EBITDA/ Net Interest (x)	8.7	6.9
Total Debt/ Equity (%)	85.7	61.4

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TFC Issues: The first tranche of PKR 1,000mln and 2nd tranche of PKR 1,250 mln of the secured TFCs are in issue. One installment of PKR 166.53mln, and three installments of PKR 208.17mln each, are currently outstanding against the two issues respectively. The tenor of both issues is five years and the coupon rate is pegged to the SBP discount rate. While profit is payable semi-annually, principal redemption began in the year 2003 and 2004 respectively. The TFCs are secured by an exclusive equitable mortgage of the building housing the company's corporate offices and a *pari passu* charge on all present and future machinery & equipments. Tranche-I is due for full redemption in June 2006.

Assessment Rating Rationale

- The TFC ratings reflect SSGC's inherently low financial and business risks. The low risk profile is a consequence of the GoP-guaranteed EBIT of 17% on its average net operating fixed assets, which continue to grow in pursuance of the ongoing expansion in the transmission and distribution systems. The ratings also take into account the maintained financial coverages and adequate liquidity.
- GoP has recently shown its intention to divest 51% shareholding along with management control of both SSGC and SNGPL, and the Privatization Commission has invited EoIs in this regard. A consortium led by PWC is advising the GOP for the proposed transactions. As the company has already paid off the ADB loan that covenanted the current 17% return on net operating fixed assets, and pending privatization of the two Sui's, OGRA is currently working on a revised formula for the guaranteed return, and a new tariff regime. Despite the pending uncertainties relating to the modus operandi of the privatization process, developments in the return formula, and the time frame involved, the company's capacity to repay its obligations during the remaining tenor of the rated TFCs, in PACRA's opinion, is likely to remain unaffected.
- During FY2005, the gas sales registered an increase of 6% in volume and 15% in value, on the back of increased demand supplemented by the trend of shift in energy mix within the country. Nevertheless, with the major constituent of the company's cost structure – cost of gas – remaining beyond the company's control, the operating margin was narrower owing to a disproportionate increase in wellhead prices of gas relative to the gas tariffs. Although net operating assets saw a substantial growth, the effects of averaging out and a higher depreciation charge, along with adjustments of certain items by OGRA, allowed for only a small increase in the guaranteed portion of EBIT. Meanwhile, the lower financial charges as a result of effective reprofiling of borrowings, alongwith healthy revenues from Jamshoro Joint Venture Limited, helped the company in absorbing all of the negative impact caused by OGRA's disallowances.
- Going forward, the company's massive capex plans are expected to augment the profitability of the company, particularly if the EBIT returns continue to be based on net operating assets. Moreover, the company has put in place a UFG control program, and by targeting a higher efficiency level, the company hopes to minimize the effect of related disallowances in the bottom line. Meanwhile, the positive GDS (gas development surcharge) is likely to continue to augment the liquidity of the company.
- The YoY distortions in the interest coverage and debt payback ratios are transitory, and emanate from the acquisition of a PKR 3bln loan near the year-end. Given the high targets for capex, the company's borrowings increased substantially during FY2005. Nevertheless, the company remains reasonably well capitalized to allow for additional borrowings to support the high capex targets. Furthermore, the incremental investment in the operating assets is expected to be instrumental in enhancing internal cash generation. Although future capex envisages accelerated growth in the medium to long term, any unforeseen delay is unlikely to impair the company's capacity to service its TFC obligations.
- Given that the Government of Pakistan (GoP) continues to own/control more than 3/4th of the company's shareholding, and major policy decisions remain subject to GoP's approval, state support is expected to be forthcoming, should this be necessary.

Background

- Sui Southern Gas Company Limited (SSGC) was formed in 1989 as a result of a series of mergers. It continues to enjoy a monopoly in transmission and distribution of gas in its franchise area comprising Sind and Balochistan provinces. SSGC is currently catering to the gas requirements of over 2.3 million customers in power, domestic and industrial sectors. The government divested nearly 10% of the company through stock market in FY04. In January 2006, the Privatization Commission has invited EoIs to further divest 51% GOP shareholding in SSGC.
- The company continues with the second phase of the Gas Infrastructure Rehabilitation and Expansion Project (GIREP II). This is to further expand SSGC's distribution and transmission network by about 50% within its franchise area. The revised cost of the project is PKR43bn and it will cover the period 2004-2009. Meanwhile, GOP has also approved the plan in principle to establish the first transnational pipeline project through Inter State Gas Systems Limited (ISGSL), a joint venture of SSGC and SNGPL. However, any incremental capex for linking the proposed pipeline with SSGC's existing distribution system have not been budgeted so far. Furthermore, the company also intends to participate in Pakistan's first integrated LNG import project. Details including the extent of equity participation by SSGC, however, remain to be finalized. Should the project go through successfully, the company is expected to have additional 300 MMCFD of gas available in its system by 2009-2010.