

## Sui Southern Gas Company Limited (SSGC)

### RATINGS (JAN 2008)

#### SUI SOUTHERN GAS COMPANY LIMITED

Entity	New	Previous
Long Term	AA-	-
Short Term	A1+	-

  

Sukuk		
PKR 4,700mln	AA	-

### FINANCIAL DATA

	PKR (mln)	
	30-Jun-07	30-Jun-06
Total Assets	61,919.9	47,079.7
Equity	9,738.9	10,341.5
Return on Net Operating Assets	3,737.2	3,168.4
Net Income	290.4	891.7
Gross Margin %	8.6	10.1
ROA (%)	0.5	2.1
ROE (%)	2.9	8.6
EBIDTA	5,306.6	5,380.4
Total Debt / Equity (%)	162.9	110.3

### ANALYSTS

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**Sukuk Issue:** The company has issued a privately placed Sukuk of PKR 4,700mln to re-profile part of its debt obligations and finance its capex requirements. The Sukuk issue is for a tenor of 5 years (with 2 and a half years grace period) and carries a profit at the rate of 3-months KIBOR plus 20bps, payable quarterly in arrears. The Musharaka investments will be repurchased in ten consecutive quarterly installments commencing from the 33<sup>rd</sup> month after the date of first contribution. The instrument is secured by the way of first exclusive charge over Head Office building and Karachi Terminal land of the company with 25% margin.

### ASSESSMENT

- The ratings reflect SSGC's low financial and business risks. The low risk profile emanates from the GoP-guaranteed return of 17% on its net average operating assets, which continue to grow in pursuance of the company's aggressive network expansion plan. The ratings also take into account the company's strong cash flows, sound financial coverages and adequate liquidity. Due to the capital-intensive nature of the industry and government regulations, SSGC is likely to maintain its monopoly position in its area of franchise (Sindh and Balochistan).
- SSGC's profitability remains dependent on the quantum of average operating assets less the deferred credit amount. Although net operating assets witnessed a substantial increase in FY07, the adjustments made by Oil and Gas Regulatory Authority (OGRA) on certain items and higher unaccounted for gas (UFG) losses allowed only a limited increase in the guaranteed portion of earnings. These adjustments – including disallowance of around PKR 1,158mln against UFG losses – alongwith higher tax charges due to deferred taxes and implications for prior years, and increase in financial charges because of expansion related borrowings, affected profitability adversely.
- During FY07, despite strong domestic demand, the volumetric increase in gas sales was around 5.6%, an outcome of limited increase in availability of natural gas. Gas sales depicted 11% growth in value terms as compared to 26% increase in the previous year (FY06), mainly on the back of relatively higher international oil prices in that year, as domestic gas prices are directly linked with international oil prices. The cost of gas remains the major component of the company's cost structure (around 77%). As the impact of change in gas prices is transferred to consumers with a time lag, the company's operating margins remain under pressure due to the recent rising trend in gas prices. Nevertheless, SSGC was able to curtail transmission and distribution costs and enhance operational efficiency.
- The company maintained high level of capital expenditure during FY07 and 1QFY08 (FY07: PKR 8,600mln, 1QFY08: PKR 2,000mln). The company is targeting PKR 10,000mln capital expenditure during FY08. The resulting expansion in company's network is expected to have a positive impact on profitability.
- The main area of concern for SSGC is higher level of UFG losses. The company has launched a UFG control program, and by improving its transmission and distribution operations, SSGC hopes to minimize the effect of related disallowances by OGRA. The management has also taken several technological initiatives to enhance the company's overall operational efficiency.
- Although there was a significant increase in gearing in FY07, mainly to support the company's capital expenditure, coverages remained strong. SSGC has fully paid ADB loans and the company is issuing a sukuk to re-profile part of its existing debt and finance its capital expenditure requirements. The sukuk issue, with its competitive pricing, is expected to have a positive impact on the financial cost. SSGC enjoys favorable credit terms with its suppliers as reflected by its net cash cycle surplus. This enables the company to adequately manage its working capital requirements.
- The energy demand in Pakistan is expected to remain strong. However, on the supply side, the country is facing acute shortage of gas. GoP has taken various initiatives to improve gas availability for domestic usage. In this regard, the company would benefit from proposed Iran-Pakistan-India (IPI) pipeline project due to the geographic location of its network. SSGC is also facilitating the GoP in US\$ 400mln LNG import handling terminal. The company is considering taking equity stake in the project. This will not only boost availability of gas for distribution but will also help SSGC to diversify its asset base.

### KEY RATING DRIVERS

- The ratings are dependent on the effective execution of the company's strategy to control UFG losses. Uninterrupted availability of natural gas for the company's expanding network is also a critical factor. OGRA is working on a revised formula for the guaranteed return. The new formula is aimed at providing incentives for higher efficiency. However, the exact framework of the revised formula is yet to be finalized. Any negative implications on the company's profitability under the revised formula would have an adverse impact on the ratings, though such development does not seem probable.

### PROFILE

- Sui Southern Gas Company Limited (SSGC), formed in 1989 as a result of a series of mergers, is an integrated gas company with transmission and distribution operations in its franchise area comprising Sindh and Balochistan provinces. SSGC is currently catering to the gas requirements of around 1.9 million customers in domestic, commercial and industrial sectors with a network that spans over 30,000 kms. The government divested nearly 10% of the company through stock market in FY04. Currently, GoP has around 60% stake in the company, whereas, 16% is owned by individuals and rest by various corporate and financial institutions. The company was on the privatization agenda. However, recently, the privatization of SSGC has been put on hold. During the current year, Mr. Azim Iqbal Siddiqui was appointed as the CEO of the company. Mr. Siddiqui has been associated with SSGC for over thirty years and served the company in various managerial capacities. His last designation was Senior General Manager of customer services.
- The company is implementing the third 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 PKR 46,000mln and it is expected to be completed by 2009.