The Pakistan Credit Rating Agency Limited

Rating Report

Sui Northern Gas Pipelines Limited

Report Contents

Rating History

Dissemination Date	Long Term Rating	Short Term Rating	Outlook	Action	Rating Watch
06-Nov-2020	AA-	A1	Stable	Maintain	-
28-Dec-2019	AA-	A1	Stable	Maintain	YES
28-Jun-2019	AA-	A1	Stable	Maintain	YES
31-Dec-2018	AA-	A1	Stable	Maintain	YES
30-Jun-2018	AA-	A1	Stable	Maintain	-
30-May-2017	AA-	A1	Stable	Maintain	-
04-May-2016	AA-	A1	Stable	Maintain	-
04-May-2015	AA-	A1	Rating Watch(-ve)	Downgrade	-

Rating Rationale and Key Rating Drivers

SNGPL's enjoys high ratings due to its strategic importance as country's largest gas utility company. The business profile of the company draws strength from its established franchise network, and guaranteed return on its net operating assets. In last few years, the company has witnessed improvement in its profitability due to ROA on RLNG infrastructure and on account of substantial reduction in UFG losses however during FY19; SNGPL witnessed increase in UFG disallowance amount which resulted in reduction in the growth in profit margins. Increased mark up rates also contributed adversely in the growth of profits from prior years. SNGPL is part of Re-gasified Liquid Natural Gas (RLNG) supply chain – which constitutes ~74% of gross sales in FY19, related ROA on which also contributed in profitability of the company over the years . It is notable that operating profit witnessed significant improvement and the finance cost diluted the net profits. With decline in interest rates profitability is expected to take positive impact going forward. The company has pursued a multi-dimensional framework to sustainably reduce the absolute quantum of un accounted for gas and percentage proportion. Consequent to UFG study conducted by OGRA and revision of UFG benchmark calculation, the effective UFG benchmark for the company was 6.92% for FY19; yet the company's delta (actual vs. allowed) followed the increasing trend over the period. Further, the company, being part of circular debt, has significant receivables and payables on its balance sheet. Though working capital cycle is being managed through augmented short term borrowings which might create liquidity challenge for the company in future. It is also pertinent to mention that as per half yearly auditor's review report for FY 20, the modified audit opinion on Financial Statements FY-2019 has been unmodified in half yearly statements FY20. Projects were largely debt financed. OGRA has allowed guaranteed return on LNG pipeline infrastructure. Hence, incremental cashflows are supplementing SNGPL's financial risk profile. Going forward, accumulating figures relating to differential margins / tariff adjustments, settlement of inter-corporate claims & circular debt issues will remain critical.

Meanwhile, ratings continue to draw comfort from sovereign ownership of the company. Ratings are dependent on the management's ability to prudently manage its financial risk profile, particularly post attainment of significantly increased credit lines to support working capital cycle.

Disclosure

Name of Rated Entity	Sui Northern Gas Pipelines Limited
Type of Relationship	Solicited
Purpose of the Rating	Entity Rating
Applicable Criteria	Methodology | Corporate Ratings(Jun-20),Methodology | Correlation Between Long-Term And Short-Term Rating Scale(Jun-20),Criteria | Rating Modifier(Jun-20)
Related Research	Sector Study | Distribution | Gas(Jun-20)
Rating Analysts	Anam Waqas | anam.waqas@pacra.com | +92-42-35869504

Profile

Legal Structure Sui Northern Gas Pipelines Limited (SNGPL), established in 1963, is the largest integrated gas company in Pakistan. The company is engaged in the business of the purchase, transmission, distribution and supply of natural gas.

Background SNGPL is currently catering to the gas requirements of ~6.7mln customers in the domestic, commercial and industrial sectors with a transmission and distribution network that spans 139,055KM. The company has expanded its activities as an Engineering Procurement and Construction Contractor to undertake the planning, design, and construction of pipelines, both, for itself and other organizations.

Operations The company is engaged in the business of the purchase, transmission, distribution and supply of natural gas. SNGPL's system, based in Punjab, Khyber Pakhtunkhwa (KPK), and Azad Jammu & Kashmir (AJK), caters to the natural gas requirements of the majority (~6.727mln customers) of the country's consumers.

Ownership

Ownership Structure The company is majority (51%) owned by Government of Pakistan (GoP) including ~15% through public sector companies and Corporations.

Stability As the Company is majorly owned by GoP, ownership structure is likely to remain same in the foreseeable future.

Business Acumen The business acumen of the sponsor, being Government of Pakistan, is considered strong.

Financial Strength SNGPL being of strategic importance - the willingness and ability of sponsor to support is likely to come in case of the need.

Governance

Board Structure The overall control of the company vests in eleven member board. The board comprises Managing Director (MD) and ten non-executive directors including five independent members. The board has witnessed frequent changes owing to political re-shuffling; the risk remains. Ms. Roohi Raees Khan, Chairman of the board, joined the company on 20th November, 2019.

Members' Profile The board members have a good mix of government and private sector exposure. However, majority of BoD members have non-industry related experience.

Board Effectiveness The board has constituted five committees, namely (i) Human Resource and Nomination, (ii) Audit, (iii) Finance and Procurement, (iv) Unaccounted for Gas (UFG) Control, (v) Risk Management. This ensures effective oversight of the company's affairs and strengthening the board's governance role.

Financial Transparency M/s, EY Ford Rhodes, was the external auditor of the company. They gave qualified opinion on the company's Annual financial statements FY,19. It is pertinent to mention that half yearly auditor's review report for FY 20, the modified audit opinion on financial statements FY 2019 has been unmodified in half yearly statements FY20.

Management

Organizational Structure The Company has a well-defined and tall organizational structure ensuring clear segregation of duties and relatively low reliance on a single individual. The organizational structure of the company is currently divided into twelve functional departments including internal audit.

Management Team Mr. Amer Tufail – Deputy Managing Director Operations – took additional charge of Managing Director (MD) & CEO during FY19. Going forward, stability in senior management is considered important.

Effectiveness Operational infrastructure requires regular capital expenditure.

MIS SNGPL deploys oracle based Enterprise Resource Planning (ERP) system since 2006; it provides an integrated view of business processes.

Control Environment The ERP system includes modules of i) General Ledger, ii) Accounts Payable, iii) Accounts Receivables, iv) Cash Management, v) Fixed Assets, vi) Inventory, vii) HR, viii) Payroll, and ix) Purchasing.

Business Risk

Industry Dynamics Currently, there are two gas distribution companies – SNGPL and SSGC – operating in Pakistan. Pakistan has an extensive gas network of over 12,971km transmission, 139,827km distribution and 37,058 services gas pipelines to cater the needs of more than 9.6mln consumers countrywide as on end-Nov19. Gas utilities earn a guaranteed return (before income tax, interest and other charges on debt and after excluding interest, dividends and other non-operating income) on its average net operating fixed assets (SNGPL: 17.43%, SSGC: 17%), a higher level of capex has a direct impact on the operating profit of the company. To overcome the gas shortage in the country ,companies have transmitted imported RLNG to meet the consumption needs while taking initiatives to increase local exploration activities.

Relative Position Since Apr16, OGRA allowed LNG projects to be part of the net operating asset base; this has significantly increased the operating assets base of the company and returns thereof (Average operating assets: end-Mar20: PKR 151.14bln; end-Jun19: PKR 152.2bln).

Revenues During FY19, growth of ~13% on YoY basis (FY19: 755,098mmcfd; FY18: 670.644mmcfd); a factor of inclusion of RLNG into the system on the back of reduction in net gas production. SNGPL is presently in process of laying down gas pipelines for LNG in three phases. All phases have been completed till FY17 wherein extensive Phase-4 - 30" / 24" dia x 149 KM long spurs was laid for supply of RLNG to Power Plants i.e. Bhikki, Balloki, Haveli Bahadur Shah and Nandipur. Furthermore; 24" dia x 93 KM long pipeline is being late for supply of RLNG to Punjab Power Plant near Trimmu District Jhang during FY19. Company puts coordinated efforts to successfully implement its UFG Reduction Plan which resulted in significant reduction of UFG losses (UFG losses %age: end-Jun17: 8.07%, end-Dec16: 7.76%; end-Jun16: 9.21%; end-Jun15: 10.97%); though above the benchmark of 4.5%. Consequent to UFG study conducted by OGRA and revision of UFG benchmark calculation, the UFG percentage of the company has increased; yet the company's delta (actual vs. allowed) is same. Volumetric analysis reveals mix tilted towards indigenous gas 52% (FY16: 70%) while increasing trend witnessed in RLNG on account of commencement and utilization of LNG projects.

Margins During FY19, SNGPL's margin depicted declining trend over the years. Gross Profit margin reported as (FY19: 4.7%; FY18: 5.4%), Operating Profit reported slight decline on account of growth in other operating income and stood at (FY19: 2.8%; FY18: 2.9%). However due to hike in interest rates, finance cost grew sharply thus Net Profit margins were dragged down and reported as (FY19: 0.9%; FY18: 2.2%).

Sustainability Going forward, the finalization of quarterly statements post FY19 & financial statements for the year end June, 2020 is of vital importance. It is also pertinent to mention OGRA determines company's final revenue requirement and company's final accounts are subject to finalise by OGRA for publication. It is expected that after OGRA's determination, the company will be able to complete the remaining formalities within 45 days including statutory period of 21 days required to convene the Annual General Meeting.

Financial Risk

Working Capital In recent years, the circular debt issue has weakened the liquidity position. During FY19, company managed the circular debt issue by delaying its payments to gas suppliers resulting in an increase in trade payables. Resultantly, net cash cycle increased to (69) days at end-Jun19 from (55) days at end-Jun18. 8.1.1 SNGPL liquidity position at end-Jun19 improved slightly on the back of differential margin recoverable (PKR ~185bln); however liquidity profile remained stretched. The company has a continued feature of excess short term borrowings (STBs) however remained manageable when compared with net current assets (end-Jun19: ~PKR 19bln, end-Jun18: ~PKR 2bln, end-Jun17: ~PKR 0.1bln).

Coverages During FY19, operating cashflows (FCFO) increased by 14% on account of increased EBITDA. Finance cost witnessed significant growth on the back of peaked interest rate environment. Resultantly, interest coverage deteriorated YoY (end-Jun19: 8.4x, end-Jun18: 11.1x). Similarly; debt service coverage ratios exhibited declining trend (end-Jun19: 12.1x, end-Jun18: 2.8x) on account of subdued operational performance.

Capitalization Capital structure has become less leveraged over the years (debt to debt plus equity ratio: end-Jun19: ~79%, end-Jun18: ~78%, end-Jun17: ~89%) . Whilst, during FY19 reduced profitability form comparative period however significant increased reserves have supported the equity to stood at (end-Jun19: PKR 21bln; end-Jun18: PKR 18bln; end-Jun17: PKR 11bln). Going forward, profitability will remain under pressure owing to resolution of inter-corporate circular debt and higher gas prices by Govt. of Pakistan.

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Financial Summary

PKR mln

Sui Northern Gas Pipelines Limited	Jun-19	Jun-18	Jun-17	Jun-16
Dsitribution Gas	12M	12M	12M	12M
A BALANCE SHEET				
1 Non-Current Assets	204,751	194,058	167,076	139,483
2 Investments	-	-	-	-
3 Related Party Exposure	5	5	5	5
4 Current Assets	424,626	267,094	157,105	112,226
a Inventories	*9,007*	*31,405*	*10,271*	*967*
b Trade Receivables	*157,573*	*66,315*	*57,817*	*57,880*
5 Total Assets	629,382	461,157	324,187	251,714
6 Current Liabilities	405,482	265,155	156,948	126,109
a Trade Payables	*340,969*	*208,857*	*109,966*	*95,126*
7 Borrowings	79,678	66,394	56,227	37,825
8 Related Party Exposure	-	-	-	-
9 Non-Current Liabilities	123,179	110,931	100,417	84,082
10 Net Assets	21,042	18,677	10,596	3,698
11 Shareholders' Equity	21,042	18,677	10,596	3,697
B INCOME STATEMENT				
1 Sales	754,538	503,782	346,308	250,647
a Cost of Good Sold	*(718,742)*	*(476,786)*	*(326,610)*	*(246,424)*
2 Gross Profit	35,796	26,997	19,699	4,222
a Operating Expenses	(14,339)	(12,249)	(12,072)	(11,635)
3 Operating Profit	21,457	14,748	7,626	(7,413)
a Non Operating Income or (Expense)	*15,469*	*11,533*	*10,263*	*8,774*
4 Profit or (Loss) before Interest and Tax	36,926	26,282	17,890	1,361
a Total Finance Cost	*(25,777)*	*(10,806)*	*(5,351)*	*(1,501)*
b Taxation	*(4,073)*	*(4,354)*	*(3,925)*	*264*
6 Net Income Or (Loss)	7,076	11,121	8,614	124
C CASH FLOW STATEMENT				
a Free Cash Flows from Operations (FCFO)	*57,307*	*50,808*	*40,189*	*20,301*
b Net Cash from Operating Activities before Working Capital Changes	*55,397*	*45,848*	*36,527*	*17,870*
c Changes in Working Capital	*(38,058)*	*(6,258)*	*(14,384)*	*(6,659)*
1 Net Cash provided by Operating Activities	17,339	39,590	22,142	11,211
2 Net Cash (Used in) or Available From Investing Activities	(27,832)	(41,582)	(38,742)	(30,476)
3 Net Cash (Used in) or Available From Financing Activities	(14,930)	2,433	18,464	19,636
4 Net Cash generated or (Used) during the period	(25,423)	440	1,864	372
D RATIO ANALYSIS				
1 Performance				
a Sales Growth (for the period)	49.8%	45.5%	38.2%	--
b Gross Profit Margin	4.7%	5.4%	5.7%	1.7%
c Net Profit Margin	0.9%	2.2%	2.5%	0.0%
d Cash Conversion Efficiency (EBITDA/Sales)	7.1%	8.1%	8.8%	6.8%
e Return on Equity (ROE)	35.6%	76.0%	120.5%	3.4%
2 Working Capital Management				
a Gross Working Capital (Average Days)	64	60	67	84
b Net Working Capital (Average Days)	-69	-55	-41	-54
c Current Ratio (Total Current Assets/Total Current Liabilities)	1.0	1.0	1.0	0.9
3 Coverages				
a EBITDA / Finance Cost	7.9	9.0	8.9	9.8
b FCFO / Finance Cost+CMLTB+Excess STB	2.1	2.8	4.2	1.1
c Debt Payback (Total Borrowings+Excess STB) / (FCFO-Finance Cost)	1.2	1.4	1.5	2.8
4 Capital Structure (Total Debt/Total Debt+Equity)				
a Total Borrowings / Total Borrowings+Equity	79.1%	78.0%	84.1%	91.1%
b Interest or Markup Payable (Days)	0.0	0.0	0.0	0.0
c Average Borrowing Rate	9.3%	7.5%	7.2%	4.6%

Credit Rating

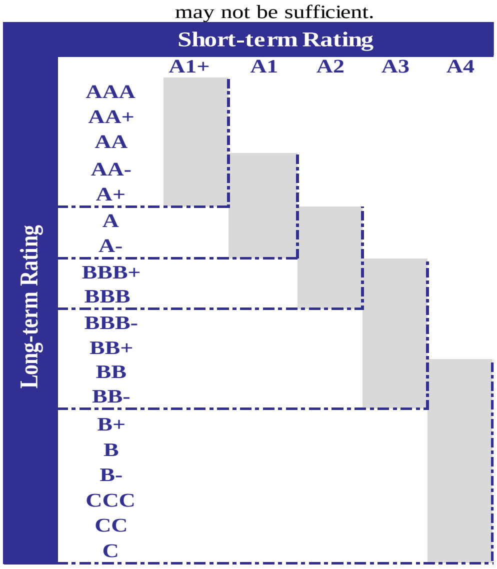
Credit rating reflects forward-looking opinion on credit worthiness of underlying entity or instrument; more specifically it covers relative ability to honor financial obligations. The primary factor being captured on the rating scale is relative likelihood of default.

Long-term Rating

Scale	Definition
AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments
AA+ AA AA-	**Very high credit quality.** Very low expectation of credit risk. Indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A+ A A-	**High credit quality.** Low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be vulnerable to changes in circumstances or in economic conditions.
BBB+ BBB BBB-	**Good credit quality.** Currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity.
BB+ BB BB-	**Moderate risk.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic or business changes over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**High credit risk.** A limited margin of safety remains against credit risk. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.
CCC CC C	**Very high credit risk.** Substantial credit risk "CCC" Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. "CC" Rating indicates that default of some kind appears probable. "C" Ratings signal imminent default.
D	Obligations are currently in default.

Short-term Rating

Scale	Definition
A1+	The highest capacity for timely repayment.
A1	A strong capacity for timely repayment.
A2	A satisfactory capacity for timely repayment. This may be susceptible to adverse changes in business, economic, or financial conditions.
A3	An adequate capacity for timely repayment. Such capacity is susceptible to adverse changes in business, economic, or financial
A4	The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions. Liquidity may not be sufficient.



**The correlation shown is indicative and, in certain cases, may not hold.*

Outlook (Stable, Positive, Negative, Developing) Indicates the potential and direction of a rating over the intermediate term in response to trends in economic and/or fundamental business/financial conditions. It is not necessarily a precursor to a rating change. 'Stable' outlook means a rating is not likely to change. 'Positive' means it may be raised. 'Negative' means it may be lowered. Where the trends have conflicting elements, the outlook may be described as 'Developing'.

Rating Watch Alerts to the possibility of a rating change subsequent to, or, in anticipation of some material identifiable event with indeterminable rating implications. But it does not mean that a rating change is inevitable. A watch should be resolved within foreseeable future, but may continue if underlying circumstances are not settled. Rating watch may accompany rating outlook of the respective opinion.

Suspension It is not possible to update an opinion due to lack of requisite information. Opinion should be resumed in foreseeable future. However, if this does not happen within six (6) months, the rating should be considered withdrawn.

Withdrawn A rating is withdrawn on a) termination of rating mandate, b) the debt instrument is redeemed, c) the rating remains suspended for six months, d) the entity/issuer defaults., or/and e) PACRA finds it impractical to surveill the opinion due to lack of requisite information.

Harmonization A change in rating due to revision in applicable methodology or underlying scale.

Surveillance. Surveillance on a publicly disseminated rating opinion is carried out on an ongoing basis till it is formally suspended or withdrawn. A comprehensive surveillance of rating opinion is carried out at least once every six months. However, a rating opinion may be reviewed in the intervening period if it is necessitated by any material happening.

Note. This scale is applicable to the following methodology(s):

Entities
a) Broker Entity Rating
b) Corporate Rating
c) Financial Institution Rating
d) Holding Company Rating
e) Independent Power Producer Rating
f) Microfinance Institution Rating
g) Non-Banking Finance Companies (NBFCs) Rating

Instruments
a) Basel III Compliant Debt Instrument Rating
b) Debt Instrument Rating
c) Sukuk Rating

Regulatory and Supplementary Disclosure
(Credit Rating Companies Regulations,2016)

Rating Team Statements
(1) Rating is just an opinion about the creditworthiness of the entity and does not constitute recommendation to buy, hold or sell any security of the entity rated or to buy, hold or sell the security rated, as the case may be | Chapter III; 14-3-(x)

2) **Conflict of Interest**
i. The Rating Team or any of their family members have no interest in this rating | Chapter III; 12-2-(j)
ii. PACRA, the analysts involved in the rating process and members of its rating committee, and their family members, do not have any conflict of interest relating to the rating done by them | Chapter III; 12-2-(e) & (k)
iii. The analyst is not a substantial shareholder of the customer being rated by PACRA [Annexure F; d-(ii)] Explanation: for the purpose of above clause, the term "family members" shall include only those family members who are dependent on the analyst and members of the rating committee

Restrictions
(3) No director, officer or employee of PACRA communicates the information, acquired by him for use for rating purposes, to any other person except where required under law to do so. | Chapter III; 10-(5)
(4) PACRA does not disclose or discuss with outside parties or make improper use of the non-public information which has come to its knowledge during business relationship with the customer | Chapter III; 10-7-(d)
(5) PACRA does not make proposals or recommendations regarding the activities of rated entities that could impact a credit rating of entity subject to rating | Chapter III; 10-7-(k)

Conduct of Business
(6) PACRA fulfills its obligations in a fair, efficient, transparent and ethical manner and renders high standards of services in performing its functions and obligations; | Chapter III; 11-A-(a)
(7) PACRA uses due care in preparation of this Rating Report. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. PACRA does not, in every instance, independently verifies or validates information received in the rating process or in preparing this Rating Report.
(8) PACRA prohibits its employees and analysts from soliciting money, gifts or favors from anyone with whom PACRA conducts business | Chapter III; 11-A-(q)
(9) PACRA ensures before commencement of the rating process that an analyst or employee has not had a recent employment or other significant business or personal relationship with the rated entity that may cause or may be perceived as causing a conflict of interest; | Chapter III; 11-A-(r)
(10) PACRA maintains principal of integrity in seeking rating business | Chapter III; 11-A-(u)
(11) PACRA promptly investigates, in the event of a misconduct or a breach of the policies, procedures and controls, and takes appropriate steps to rectify any weaknesses to prevent any recurrence along with suitable punitive action against the responsible employee(s) | Chapter III; 11-B-(m)

Independence & Conflict of interest
(12) PACRA receives compensation from the entity being rated or any third party for the rating services it offers. The receipt of this compensation has no influence on PACRA´s opinions or other analytical processes. In all instances, PACRA is committed to preserving the objectivity, integrity and independence of its ratings. Our relationship is governed by two distinct mandates i) rating mandate - signed with the entity being rated or issuer of the debt instrument, and fee mandate - signed with the payer, which can be different from the entity
(13) PACRA does not provide consultancy/advisory services or other services to any of its customers or to any of its customers' associated companies and associated undertakings that is being rated or has been rated by it during the preceding three years unless it has adequate mechanism in place ensuring that provision of such services does not lead to a conflict of interest situation with its rating activities; | Chapter III; 12-2-(d)
(14) PACRA discloses that no shareholder directly or indirectly holding 10% or more of the share capital of PACRA also holds directly or indirectly 10% or more of the share capital of the entity which is subject to rating or the entity which issued the instrument subject to rating by PACRA; | Reference Chapter III; 12-2-(f)
(15) PACRA ensures that the rating assigned to an entity or instrument is not be affected by the existence of a business relationship between PACRA and the entity or any other party, or the non-existence of such a relationship | Chapter III; 12-2-(i)
(16) PACRA ensures that the analysts or any of their family members shall not buy or sell or engage in any transaction in any security which falls in the analyst's area of primary analytical responsibility. This clause shall, however, not be applicable on investment in securities through collective investment schemes. | Chapter III; 12-2-(l)
(17) PACRA has established policies and procedure governing investments and trading in securities by its employees and for monitoring the same to prevent insider trading, market manipulation or any other market abuse | Chapter III; 11-B-(g)

Monitoring and review
(18) PACRA monitors all the outstanding ratings continuously and any potential change therein due to any event associated with the issuer, the security arrangement, the industry etc., is disseminated to the market, immediately and in effective manner, after appropriate consultation with the entity/issuer; | Chapter III | 18-(a)
(19) PACRA reviews all the outstanding ratings on semi-annual basis or as and when required by any creditor or upon the occurrence of such an event which requires to do so; | Chapter III | 18-(b)
(20) PACRA initiates immediate review of the outstanding rating upon becoming aware of any information that may reasonably be expected to result in downgrading of the rating; | Chapter III | 18-(c)
(21) PACRA engages with the issuer and the debt securities trustee, to remain updated on all information pertaining to the rating of the entity/instrument; | Chapter III | 18-(d)
Probability of Default
(22) PACRA´s Rating Scale reflects the expectation of credit risk. The highest rating has the lowest relative likelihood of default (i.e, probability). PACRA´s transition studies capture the historical performance behavior of a specific rating notch. Transition behavior of the assigned rating can be obtained from PACRA´s Transition Study available at our website. (www.pacra.com). However, actual transition of rating may not follow the pattern observed in the past | Chapter III | 14-(f-VII)
Proprietary Information