The Pakistan Credit Rating Agency Limited

SUI NORTHERN GAS PIPELINES LIMITED

	NEW [MAY-16]	PREVIOUS [MAY-15]
Entity		
Long Term	AA-	AA-
Short Term	A1	A1
Outlook	Stable	Rating Watch (-ve)

REPORT CONTENTS

MAY 2016

Profile & Ownership

- SNGPL, established in 1963, is engaged in the business of the purchase, transmission, distribution and supply of natural gas
- Operating with a transmission and distribution network of 105,118km, SNGPL serves ~5mln customers spread across Punjab, Khyber Pakhtunkhwa, and Azad Jammu & Kashmir
- SNGPL is majority (54%) owned by Government of Pakistan including ~23% through public sector companies and Corporations

Governance

- SNGPL has fourteen-members board including the MD; thirteen members are non-executive including six independent directors
- Board members possess good mix of skill set

Management and Operational Risk

- Mr. Amjad Latif (DMD Operations) assumed additional charge of MD in Mar16; frequent changes at MD position
- Tall organization structure: adequately long associated professional and experienced management team
- Operational infrastructure requires regular capital expenditure
- Deploys oracle based ERP: comprehensive MIS reporting mechanism

Performance

- In Nov15, OGRA approved Final Revenue Requirements for three years; FY13 to FY15. The decision significantly impacted the company's profitability as UFG losses (FY15: 11.0%, FY14: 10.6%, FY13: 11.2%) remained significantly higher than the benchmark (4.5%)
- However, partial provisional allowance for claimed UFG volume in law and order and pilfered volume by non-consumer provided some respite
- Net operating assets witnessed YoY increase (~10%) during FY15 resulting in higher guaranteed returns on YoY basis
- Reduction in UFG volume translated into lower UFG disallowance (FY15: PKR 11,639mln; FY14: PKR 12,262mln); though remained significantly high. The company reported lower loss before tax (FY15: PKR 3.4bln; FY14: PKR 5.5bln) on YoY basis
- SNGPL is presently in process of laying down gas pipelines for LNG in two phases. Phase-1 (111KM at a cost of ~PKR 18bln) is majority completed (82km at end-Mar16) and Phase-II (762KM at a cost of PKR 55bln, expected completion FY17) is also underway
- In Apr16, OGRA allowed LNG projects to be part of the net operating asset base; this will significantly increase the guaranteed upon completion of the project

Financial Risk

- In recent years, the circular debt issue has weakened the liquidity position as the receivables surged; SNGPL managed the circular debt issue by delaying its payments to gas suppliers resulting in an increase in trade payables
- Coverages remained strong (debt service coverage: end-Mar16: 5.6x, end-Jun15: 3.8x)
- Due to high UFG disallowance equity has eroded (~PKR 18bln) significantly post FY12. Resultantly, leveraging has significantly increased (debt to debt plus equity ratio: end-Mar16: ~88%)
- Going forward, debt level is expected to increase significantly owing to debt financed LNG phase-II project; coverages are likely to be adequate owing to rise in project related return

Rating Rationale

In Nov15, OGRA - the regulator - finalized the outstanding revenue requirements (FRR) for SNGPL. OGRA, while determining its benchmark rate for Unaccounted For Gas (UFG) losses at 4.5%, allowed certain allowances in line with the Economic Coordination Committee guidelines. SNGPL has issued its financial statements (FY13-FY15) incorporating the same. Hence, Rating Watch has been removed.

The ratings reflect SNGPL's 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. The decision of OGRA, regarding performance benchmark, significantly impacted the company's profitability as UFG losses remained significantly higher than the benchmark. However, provisional allowance of certain claims regarding UFG volume in law affected arears and pilfered volume by non-consumer by OGRA has provided some relief. Final resolution of the matter is pending till completion of UFG impact study and subsequent decision by Supreme Court. SNGPL is part of Re-gassified Liquid Natural Gas (RLNG) project. The company is near completion of Phase-I, while Phase-II is also underway. Both projects are 100% debt financed. Cumulative UFG disallowance toll on bottomline coupled with debt-driven capex has adversely impacted the company's financial risk profile; equity base has squeezed notably. Nevertheless, debt service coverages remain adequate. Moreover, OGRA in its off-late decision has allowed guaranteed return on LNG pipeline infrastructure. With notable financial impact, this would help relieving pressure from the company's financial risk; thus adequate coverages over debt repayment period. SNGPL remains a part of circular debt (net payable position: PKR 8bln at end-Apr16). Resolution of the same remains dependent on GoP's decision. Meanwhile, ratings continue to draw comfort from sovereign ownership structure of the company.

Key Rating Drivers

Ratings are dependent on the management's ability to prudently manage its financial risk profile, particularly post acquisition of LNG related debt. Bringing down UFG loss volume to support bottomline is important. Meanwhile, any unfavorable decision by the regulator in defined areas negatively impacting the entity's risk profile will have rating implications.

The Pakistan Credit Rating Agency Limited **Financials (Summary)**

PKR mln

SNGPL

BALANCE SHEET	31-Mar-16	30-Jun-15	30-Jun-14	30-Jun-13
Non-Current Assets	**125,933**	**116,750**	**106,827**	**100,916**
Investments (Incl. associates)	**5**	**5**	**5**	**5**
Equity	5	5	5	5
Debt	-	-	-	-
Current Assets	**111,955**	**95,022**	**65,159**	**63,279**
Inventory	1,147	1,030	948	1,075
Trade Receivables	58,647	64,622	56,572	54,462
Others	52,161	29,370	7,639	7,742
Total Assets	**237,893**	**211,777**	**171,991**	**164,200**
Debt	**26,535**	**17,282**	**10,253**	**9,940**
Short-term	992	142	977	1,000
Long-term (Inlc. Current Maturity of long-term debt)	25,544	17,140	9,276	8,940
Other short-term liabilities	130,420	116,578	88,141	81,014
Other Long-term Liabilities	77,362	74,344	67,529	63,214
Shareholder's Equity	**3,575**	**3,573**	**6,068**	**10,033**
Total Liabilities & Equity	**237,893**	**211,777**	**171,991**	**164,200**

INCOME STATEMENT	9MFY16	Annual	Annual	Annual
Turnover	**179,762**	**212,521**	**220,761**	**205,662**
Gross Profit	5,575	2,146	634	(15,351)
Net Other Income	4,223	7,768	6,362	11,100
Financial Charges	(1,124)	(1,647)	(1,710)	(2,160)
Net Income	**1**	**(2,494)**	**(3,965)**	**(9,749)**

Cashflow Statement				
Free Cashflow from Operations (FCFO)	16,745	16,961	16,811	1,041
Net Cash changes in Working Capital	(8,003)	(3,297)	(470)	18,150
Net Cash from Operating Activities	7,733	12,008	14,158	18,139
Net Cash from InvestingActivities	(16,466)	(18,913)	(14,909)	(14,214)
Net Cash from Financing Activities	8,382	7,815	286	(4,084)

Ratio Analysis				
Performance				
Turnover Growth	20.2%	-3.7%	7.3%	-5.1%
Gross Margin	3.1%	1.0%	0.3%	-7.5%
Net Margin	0.0%	-1.2%	-1.8%	-4.7%
ROE	0.1% *	-77.0%	-66.8%	-194.3%
Coverages				
Interest Coverage (FCFO/Gross Interest)	14.9	10.3	9.8	0.5
Debt Coverage (TCF/(Gross Interest+CMLTD+Uncovered Total STB))	0.9 *	0.7	0.6	0.1
Debt Coverage (TCF / (Gross Interest+CMLTD))	5.6 *	3.8	3.8	0.3
Debt Payback (Total LT Debt Including UnCovered Total STBs) / (FCFO- Gross Interest)	2.2 *	2.5	2.2	-24.7
Liquidity				
Net Cash Cycle (Inventory Days + Receivable Days - Payable Days)	-37.9	5.6	21.6	31.2
Capital Structure (Total Debt/Total Debt+Equity)	88%	83%	63%	50%

*annualized

STANDARD RATING SCALE & DEFINITIONS

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 Ratings

AAA	**Highest credit quality.** Lowest expectation of credit risk. Indicate exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.
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-	**Speculative.** Possibility of credit risk developing. There is a possibility of credit risk developing, particularly as a result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met.
B+ B B-	**Highly speculative.** Significant 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	**High default 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 Ratings

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 conditions.

B: The capacity for timely repayment is more susceptible to adverse changes in business, economic, or financial conditions.

C: An inadequate capacity to ensure timely repayment.

Rating Watch
Alerts to the possibility of a rating change subsequent to, or in anticipation of, a) some material identifiable event and/or b) deviation from expected trend. But it does not mean that a rating change is inevitable. Rating Watch may carry designation – Positive (rating may be raised, negative (lowered), or developing (direction is unclear). A watch should be resolved with in foreseeable future, but may continue if underlying circumstances are not settled.

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'.

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) cessation of underlying entity, c) the debt instrument is redeemed, d) the rating remains suspended for six months, or e) the entity/issuer defaults.

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Regulatory and Supplementary Disclosure

Rated Entity

Name of Rated Entity Sui Northern Gas Pipelines Limited
Sector Utilities
Type of Relationship Solicited

Purpose of the Rating: Independent Risk Assessment

Rating History

Dissemination Date	Long Term	Short Term	Outlook	Action
5-May-16	AA-	A1	Stable	Maintain
5-May-15	AA-	A1	RW(-ve)	Downgrade
25-Jun-14	AA	A1+	RW(-ve)	Maintain
23-May-13	AA	A1+	RW(-ve)	Maintain
28-Jan-13	AA	A1+	RW(-ve)	Maintain

Methodology: Corporate Rating Methodology
Sector Research: Gas Utilities - Viewpoint | May-16

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Rating Team Statement

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