

## Company update

Oil and Gas Marketing Companies

Sui Northern Gas Pipelines Limited

## SNGP; Bumper earnings amid WACC revision

We reiterate our BUY call for Sui Northern Gas Pipelines Limited (SNGP) with our DCF-based Dec'23 target price set at PKR 69.48/share. At current levels, the scrip offers an upside of 68%. Our conviction on the scrip stems from i) re-rating of WACC to higher levels owed to a massive jump in interest rates, ii) lower levels of disallowed UFG (forecast at ~PKR 5.3bn over the next 5 years compared to previous 5-year average of PKR 7.1bn) led by significant improvement in gas losses post implementation of OGRA's UFG control target, and iii) lower quantum of buildup in gas circular debt post hike in gas prices effective Jan'23.

**Upwards revision in WACC:** SNGP operates under a guaranteed fixed return covenant (WACC of 16.6% applicable on assets at present), set by the Regulator (Oil and Gas Regulatory Authority). Although fixed for 3 years, the WACC automatically re-sets if it changes by +2% or -2%. Given a drastic jump in SBP's policy rate this year, and hence the 6 months KIBOR used to determine the cost of debt, the differential in WACC has been breached by over 6%. Therefore, since WACC becomes applicable from the following year, we estimate the WACC for FY24 at 22.9% (average of the year of breach and subsequent year i.e., FY23 and FY24 in this case). We believe this practice will mimic FY21, whereby the change in WACC breached 2% after the State Bank undertook many rate cuts in the aftermath of COVID-19. As a result, WACC was revised downwards for FY22 to 16.6% against 17.4% previously. We estimate a positive impact of a 1% jump in WACC at a massive PKR 1.3bn (EPS: PKR 2.09) per annum on SNGP. Therefore, our projections suggest this will propel earnings in FY24 by 60% YoY. However, we do highlight that once inflation starts tapering off, and interest rate cuts come into play starting second half of FY24, WACC will once again adjust downwards by nearly 5% (which will be reflected in FY26 earnings). Although, it will still be higher than the current level of 16.6%. Please find the table below.

### Exhibit: WACC Calculation

	Initial	FY21a	FY22a	Changed for FY22	FY23e	FY24f	To be changed for FY24
KSE-100 Return <sup>^</sup>	28.3%	14.2%	10.8%		11.7%	15.5%	
RFR <sup>^</sup>	12.5%	11.8%	11.7%		12.0%	11.3%	
Beta (Fixed)*	1.30	1.30	1.30		1.30	1.30	
Risk premium**	11.0%	7.0%	7.0%		7.0%	7.0%	
Cost of equity	26.8%	20.9%	20.8%		21.1%	20.4%	
Cost of debt***	8.3%	9.4%	12.9%		20.5%	20.0%	
WACC****	17.4%	15.4%	17.8%	16.6%	23.3%	22.6%	22.9%
Change		-2.0%			6.7%		

Source (s): AHL Research

<sup>^</sup>15yr avg. market return, <sup>^</sup>10yr avg. of 20yr PIB, \*1.3 beta has been fixed for SNGP / SSGC

\*\*15yr market return vs. RFR, Cap set at 11%, Floor set at 7%

\*\*\*6 months KIBOR + 2%, Average of last 12 months

\*\*\*\*30% Equity stake, 70% Debt stake fixed

## SNGP

### Summary Data

Target Price (Dec'23)	69.5
Last Closing	40.9
Upside (%)	69.8
Shares (mn)	634
Free float (%)	45
Market Cap. (PKR mn)	25,946
Market Cap. (USD mn)	115

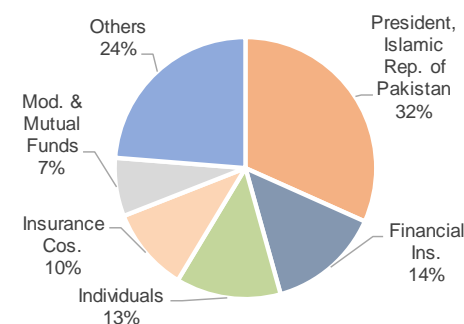
### Recommendation

**BUY**

### Price Performance

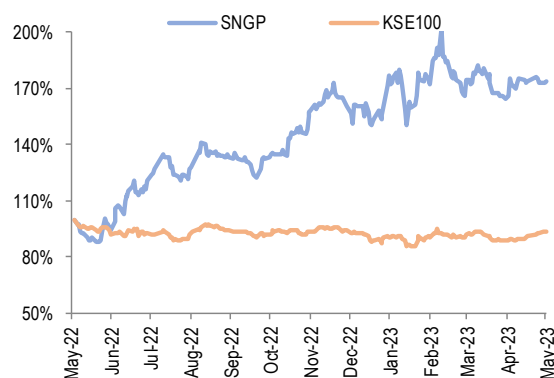
	3M	6M	12M
Return (%)	1.2	9.9	73.9
Avg. Volume (000)	3,449	3,510	3,153
ADTV (mn) - PKR	148	144	120
ADTV (000) - USD	538	577	511
High Price - PKR	47.4	47.4	47.4
Low Price - PKR	38.6	35.3	20.7

### Shareholding Pattern



Source: Company Financials, AHL Research

### Relative Performance



Source: Bloomberg, AHL Research

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May 5, 2023

**UFG curtailment plan shows promising results:** The Regulator had formed a 3-year plan to curtail gas losses of SNGP. As a result, the company began robustly investing in technology and digitization (new transformation and distribution systems). Moreover, better UFG mapping through the new GIS (Geographic Information System), which has to be fully installed within CY23, will help identify leakages and gas theft and further curtail UFG. Therefore, we forecast UFG volume in the next 5 years to average at 26,000mmcf (disallowed UFG of PKR 5.3bn) against 43,000mmcf (PKR 7.1bn) in the past 5 years.

**Some curtailment in the mounting gas circular debt:** Gas sector circular debt, at over PKR 1.6trn, reached these perilous levels primarily due to i) delays in tariff determination and notification, and ii) insufficient revenue recovery from the government and private consumers. Albeit, one of the key pre-requisites for the ongoing ninth review of the IMF was to curb further accumulation in the gas circular debt. Therefore, effective Jan'23, the incumbent government raised gas prices across the board. This we believe, will relieve some pressure off of the balance sheet, at least by the end of this fiscal year.

**FY23 earnings to show some consolidation; forward earnings growth and DY attractive:** We await full year earnings of FY22, projected at PKR 12.7bn (translating to north of PKR 20/share) and a final dividend of PKR 5.5/share. Meanwhile we are also drawing close to FY23, whereby we estimate a consolidation in earnings to PKR 10.0bn (EPS: PKR 15.83). This slow down can be attributable to two key factors: surge in the weighted average cost of gas amid higher international oil prices and PKR depreciation, which means the quantum of disallowed UFG is set to climb higher, as well as a sharp increase in SBP's policy rate, which added further downwards pressure to the company's bottom-line. Albeit, we expect SNGP to maintain its payout at 40% and announce a dividend of PKR 6.00/share in FY23. One year on, due to WACC revision explained earlier, our estimates suggest earnings will clock-in at PKR 16.0bn (EPS: PKR 25.26) in FY24, whereas the scrip offers an attractive dividend yield of 24% (DPS: PKR 10.00/share).

### Exhibit: Ratio Analysis

		2021a	2022e	2023f	2024f
Earnings per share	PKR	17.32	20.05	15.83	25.26
Dividend per share	PKR	7.00	8.00	6.00	10.00
Book value per share	PKR	53.96	67.01	74.84	94.10
Price to Earning	x	2.80	1.71	2.61	1.64
Price to Book	x	0.90	0.51	0.55	0.44
Dividend Yield	%	14.41	23.38	14.53	24.21

Source (s): Company Financials, AHL Research

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**Equity Research Ratings**

Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as Dec 2023 for Target Price. In addition, return excludes all type of taxes. For more details, kindly refer the following table;

Rating	Description
BUY	Upside* of subject security(ies) is more than +15% from last closing of market price(s)
HOLD	Upside* of subject security(ies) is between -15% and +15% from last closing of market price(s)
SELL	Upside* of subject security(ies) is less than -15% from last closing of market price(s)

**Equity Valuation Methodology**

AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- **Discounted Cash Flow (DCF)**
- **Dividend Discount Model (DDM)**
- **Sum of the Parts (SoTP)**
- **Justified Price to Book (JPTB)**
- **Reserved Base Valuation (RBV)**

**Risks**

The following risks may potentially impact our valuations of subject security (ies);

- **Market risk**
- **Interest Rate Risk**
- **Exchange Rate (Currency) Risk**

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