



## ***NEL: More Value Than Meets The Eye***

Closer scrutiny of the financial results of National Enterprises Limited (NEL) reveals that the only factor that held them back from achieving an EPS of \$1.00 by their March 2008 year-end was the poor performance of National Flour Mills (NFM) – one of NEL's investee companies.

NEL is a holding company for five investee companies: NFM, Telecommunications Services of Trinidad and Tobago (TSTT), Trinidad Nitrogen Company (Tringen), NGC NGL and NGC LNG; it has no business operations of its own. Thus, NEL's source of cash for dividend payments is solely dependent on the dividends paid by each investee company – a factor that is completely dependent on the performance of each of the various investee companies.

In order to get a better understanding of NEL's bottom-line, investors must note that of the five investee companies, four have a different financial year end to that of NEL, save TSTT whose year end runs concurrently with that of NEL. When producing their audited financials, NEL uses the most recent audited accounts of the respective investee company. For instance, NFM's fiscal year ends in December while NEL's fiscal year ends in March. What this means in terms of reporting is that when it comes time for NEL to report at the end of March, they only take into consideration NFM's performance up until the previous December. The case is the same for Tringen, NGC LNG and NGC NGL.

Why is this an important point to note? There have been significant changes in the commodity market since the beginning of 2008 which would not be reflected in NEL's results as at March 2008. Let's look at the various investee companies:

### **Tringen**

Tringen produces anhydrous ammonia for the export markets; at present ammonia is selling at record high prices in all major markets. The average price of ammonia free on board for the Caribbean year-to-date is US\$521/ tonne – a stunning 69% increase over the same period last year. Ammonia prices are expected to maintain current levels for the rest of the year. However, the increase in ammonia prices were not reflected in Tringen's contribution to NEL's results as at March 2008, because of the difference in fiscal year ends. NEL will reap the benefits of these high ammonia prices when they report half-yearly results later this year. We expect that Tringen's contribution to NEL's bottom line will be quite substantial this year, significantly pushing up NEL's EPS and dividends.

### **NGC LNG**

The global LNG market is expected to remain strong going forward. Natural gas prices have been steadily climbing since the beginning of 2008 – price increases which will be reflected in NEL's next set of audited results. Several factors have contributed to the escalation in LNG prices, including high oil prices and a growth in consumption. In addition to this, natural gas is more frequently being used in power generation since it burns much cleaner than other fuels. These drivers are

expected to continue for the next couple of years, increasing the price pressures on natural gas. For the sake of comparison, the average Henry Hub spot price for 2008 year-to-date is US\$10.08 / MMBtu – this represents a 45% increase over the average spot price in 2007. The expectation is that the spot price will average just over \$11 / MMBtu in 2008, and increase further in 2009.

### **NGC NGL**

NGC NGL owns a 51% interest in Phoenix Park Gas Processors Limited (PPGPL), whose plant is designed to extract natural gas liquids (propane, butane and natural gasoline) from raw natural gas. The global market for liquefied petroleum gas (LPG) (a mixture of propane and butane) has been growing steadily over the years. The average price of North American Spot LPG (Mont Belvieu) year-to-date is US\$242.87/ gallon – a 60% increase over the price in the same period last year. The global demand for the product is expected to grow steadily over the next five years. These factors bode well for PPGPL as their major markets are export markets. PPGPL is also currently in the process of increasing their production capacity in Point Lisas.

### **NFM**

In both fiscal 2006 and 2007, NFM experienced after-tax losses. The advent of competition (Nutrimix Flour Mills) led to what may be described as the downfall of NFM within the last few years. This year, there are a couple things that may work in NFM's favour. Firstly, the closure of their only local source of competition, which once again leaves NFM as the only option for consumers, will augur well for NFM.

Adding further fuel to the fire, NFM has announced yet another increase in the price of its flour – the fourth increase in the staple since the beginning of 2008. NFM officials have attributed this increase to the higher cost of wheat in the global market place. While it is true that wheat advanced significantly in the first three months of 2008, it must also be noted that the commodity experienced a 40% decline between March and May. While wheat has experienced upward movements since then, currently the price of the commodity is still 29% lower than its high earlier this year. Therefore, it is our belief that the increases that NFM are passing on to the consumers can only lead to increased margins for them in 2008, as they had the opportunity to average down on the price of the raw material. NFM could therefore be in a better position to realize either a breakeven or small-profit this year.

### **TSTT**

TSTT's monopolistic days have ended – they were recently faced with competition in the form of Digicel. In fiscal 2007, TSTT reported an after-tax loss for the first time in history. Naturally this had a significant negative impact on NEL's results that year. A major reason for this loss is the way in which TSTT accounted for expenses regarding their cellular phone towers. For fiscal 2008 (ending March), TSTT returned to profitability reporting an after-tax profit of \$160 million which had a positive influence on NEL's bottom-line. Going forward, TSTT will face additional competition due to the launch of Flow. This additional competition should provoke TSTT to increase their efficiency, strengthen their customer relationships and differentiate their services from those of their competitors. Though it is unlikely that they will experience a loss in fiscal 2009, their growth will probably be minimal and TSTT must move forward with caution in order to preserve profitability.

So in a nutshell, what does this mean for shareholders of NEL and potential investors? Basically we can expect very strong results from NEL this fiscal year ending March 2009. Current and forward looking market conditions will lead to growth and profitability for most of the investee companies.

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NEL is currently trading at \$12 a share and has already advanced about 68% since the beginning of 2008. Based on the positive outlook and growth prospects for its investee companies, we expect increased earnings this year for the holding company. NEL is trading at a forward PE multiple of about 11 times, suggesting that it is still relatively cheap when compared to the market PE of about 16 times. Based on these projections, NEL is currently trading at an expected dividend yield of about 8%. It is therefore still a very good buy for potential investors. Valuation methods such as the P/E model and the dividend discount model produce a fair value of \$14.22 for NEL.

**\*\* Please note that all figures are as at the time of writing this article on 3 July 2008.**

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### ***Current Happenings in Local and International Markets:***

- Stock Market activity declines
  - Flour rises by 24%
  - NEL records net profit of \$511.4 million
  - Gas subsidy expected to increase by year's end
  - Standard & Poor's affirms Petrotrin's rating
  - Jamaica: Expect higher gas prices
  - BSE to trade over the counter
  - Most U.S. Stocks Fall, Capping Fifth Weekly Loss
  - Most Asian Stocks Drop on Record Oil; worst half since 1992
  - European Stocks Fall; British Airways, Anglo American, B&B Drop
  - U.S. Economy: Employers Cut Payrolls for Sixth Month
  - Broad Says U.S. Economy in Worst Recession Since World War II
  - Dow Average's Drop Into Bear Market May Signal Losses
  - European Bonds Drop on Bets ECB Will Signal Rates to Go Higher\
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**Table 1: Regional Market Performance (as at 3 July 2008)**

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	1,154.62	0.57	1.07	17.29	25.63
All Trinidad	1,516.85	1.26	2.57	25.72	31.56
JSE Index	109,729.17	0.08	-1.08	2.06	22.50
JSE Select	3,057.91	1.39	-2.71	5.18	28.77
All Jamaica	111,264.33	1.09	-2.21	5.10	25.78
BSE Composite	1,077.04	0.03	1.92	4.69	13.46

**Table 2: International Market Performance (as at 3 July 2008)**

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	1,262.90	-1.58	-8.33	-12.73	-17.18
Nasdaq Composite	2,245.38	-3.27	-9.48	-13.96	-15.11
Dow Jones Industrial	11,288.53	-1.44	-8.98	-13.46	-16.86
German Dax	6,353.74	-1.64	-9.48	-20.07	-21.08
FTSE 100	5,476.60	-0.75	-9.59	-14.65	-17.52
Nikkei 225	13,265.40	-4.03	-6.64	-13.34	-26.91
Hang Seng	21,242.78	-5.40	-12.85	-22.92	-4.10
Eurostoxx	3,330.90	-1.05	-10.88	-23.24	-26.19

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