



Dark Clouds Ahead for NEL?

National Enterprises Limited (NEL) reported solid results for the fiscal year ended 31 March 2009. With earnings per share (EPS) of \$1.32, the company reported earnings growth of 48.3% over the previous year. However, shareholders and potential investors should pay close attention to these results before getting overly excited as our opinion is that NEL will not enjoy such outstanding growth in the next fiscal year.

NEL is a holding company for five investee companies: National Flour Mills (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 of 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.

This is a very important point to take into consideration when forecasting NEL's profits since there have been significant changes in the commodities markets. These markets directly influence the results of the investee companies which would not have been reflected in NEL's most recent results.

For instance, Tringen (a company which produces anhydrous ammonia for export markets) recently announced a decline in profits of 74% for the half year to June 2009, compared to the same period last year. This is a direct result of the drastic decline in ammonia prices on the international markets late in 2008, and the lack of recovery of these prices so far for 2009. In fact, ammonia prices are actually significantly lower now than they were one year ago. The year-to-date average ammonia price is approximately 50% lower than the average price during 2008. The outlook for the rest of the year is that ammonia prices are not likely to recover, and as such the current trend in Tringen's profits is expected to continue.

Much like Tringen, both NGC LNG and NGC NGL will most likely report significantly lower profits during fiscal 2009. Unlike the first half of last year, the global situation as related to natural gas and natural gas liquids is very bearish – prices of these commodities have trended down sharply. The average price of Henry Hub natural gas year-to-date is approximately 56% lower than that of 2008, and natural gas liquids have followed a similar trend. Current market conditions are such that global

supply of natural gas grossly outstrips the demand for the product, so much so that there isn't sufficient global storage capacity for the natural gas product.

Although there is no definitive sign that there will be any sustained natural gas price recovery before the end of this year; there is a possibility that some of the abundant supply of natural gas will be consumed during the upcoming winter months. Nevertheless there is little expectation of a true recovery of the prices of these commodities in the short term. As such, we are of the opinion that the profitability of NGC and its subsidiaries will be negatively affected. Additionally, though it will not affect the performance of NGC during fiscal 2009, it is important to note that as of next year NGC will no longer benefit from the tax holiday the company enjoyed in the past. Going forward, the additional tax expense will most likely lower future profit levels and by extension, dividends paid to NEL.

In terms of TSTT, the company experienced a mere 2.3% increase in sales year-on-year, but their profits were boosted by two non-recurring items, namely reduced depreciation expenses and an impairment reversal, amounting to \$263 million. TSTT operates in a mature market and faces the ever increasing competition arising in the form of Flow and Digicel, with both proving to be real threats to TSTT's market share. As businesses and individuals continue to feel the pinch of the tough economic climate, TSTT's sales and profits may be further threatened. They must therefore continue to focus on increasing efficiencies, building customer relationships and prove themselves as the best provider in order to maintain market share and profitability. On another note, the telecommunications giant has plans of widening its product line to include the delivery of cable television through fiber optic lines thus providing more diversified services to its customers; this however will require significant amounts of investments and TSTT may not reap the benefits of this venture in the short-term.

NFM, the fifth contributor to NEL's after-tax profits, is expected to remain relatively flat this year, with the possibility of a break-even performance. The only true upside for the company is that of increased efficiencies through cost containment. Therefore, we don't expect any major contribution to the bottom-line from NFM this year.

For fiscal 2009, Tringen and TSTT were the two major contributors to NEL's profitability, accounting for approximately 48% and 26% of the pre-tax profits, respectively. NGC NGL and NGC LNG contributed about 15% and 11% respectively. As a major driver of past profitability, the bleak outlook for Tringen does not bode well for the upcoming results of NEL; and the 132% increase in TSTT's pre-tax profits is not likely to be duplicated next year. NGC LNG and NGC NGL are also faced with challenges related to commodity prices, and NFM will probably not experience any significant growth this year. NEL's results will surely not be as bountiful next year as they were this year.

NEL is currently trading at \$6.10, down 7.6% since the beginning of 2009. Taking into consideration the negative growth outlook for its investee companies, we expect significantly decreased earnings this year for the holding company. Though NEL is trading at a comparably low trailing P/E ratio of 4.6 times, the forward looking prospects are not good. Based on our projections, NEL is trading at a forward PE ratio of 8.1 times, and is fairly valued at \$5.84. Our recommendation for the stock is now a sell, as capital appreciation seems unlikely for the near future, and the only form of gains may be through dividends and that too we expect to decline.

Table 1: Regional Market Performance (as at 27 August 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	784.11	0.57	0.33	-6.98	-30.67
All Trinidad	1,094.59	1.04	0.38	-5.21	-27.51
JSE Index	80,300.52	0.16	0.26	0.19	-25.14
JSE Select	1,796.75	-1.42	0.92	-9.47	-39.41
All Jamaica	65,685.45	-1.29	0.59	-11.23	-39.42
BSE Composite	845.86	0.28	0.28	-8.04	-21.19

Table 2: International Market Performance (as at 27 August 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	1,030.98	2.34	4.97	14.14	-19.56
Nasdaq Composite	2,027.73	1.94	3.04	28.58	-14.89
Dow Jones Industrial	9,580.63	2.47	5.18	9.16	-16.71
German Dax	5,470.33	3.00	4.17	13.72	-13.46
FTSE 100	4,869.35	2.37	6.18	9.81	-11.92
Nikkei 225	10,473.97	0.87	3.82	19.74	-17.87
Hang Seng	20,242.75	-0.42	-0.04	40.70	-5.69
DJ Eurostoxx	2,777.62	4.28	6.77	13.30	-15.81

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