

## PkR200bn Clearance will be slow in moving stocks

- Following-on from our note published when PkR200bn in circular debt payments was under consideration by the ECC on Nov 27th'18, we stand by our estimates of HUBC/KAPCO/PSO receiving PkR38/29/50bn in clearance payments, likely diverted to paying off dues and curtailing borrowing.
- Taking cues from the June'13 PkR480bn clearance, we demark IPPs (HUBC, KAPCO) and OMC (PSO, SHEL, APL) price performance 15/30/45/60 days after the date of announcement (June 12th) followed by the date of disbursement (June 22nd), where both sectors are seen performing after 30-45 day window.
- The mechanism for disbursement is more delicate this time, with funds being raised through GoP backed, SLR eligible Sukuks (through a consortium of Islamic Banks, term-sheets indicate floating rate of 6M KIBOR + 1%) with payments likely to be sourced through the Central Power Purchasing Authority.
- The diversion of funds for new venture based CAPEX (HUBC) and retiring payables and short term borrowings is likely to keep a lid on payouts, while realization of un-booked penal income could lift profitability for PSO.
- On a broader note, key concerns regarding DISCO performance and crucial transmission CAPEX need to be addressed, while policy dissonance (statement by Commerce Advisor) keep a cloud of uncertainty over the space in the long term.

**Jun'13 clearance took a month or longer to lift stocks:** Taking cues from Jun'13 circular debt clearance, first announced by FM Dar in his FY14 budget speech (on June 12th) and later disbursed by the ECC (on June 22nd), we demark price performance over 5/15/30/45/60 days after both dates for listed IPPs (HUBC, KAPCO) and OMCs (PSO, SHEL, APL). The relatively long term nature of price movements across sectors, with IPP stock performance seen during 30/45 days after announcement/disbursement date averaging 4.83/4.17% while OMC scrips moved 3.15/4.24% on average 30/60 days after announcement/disbursement of circular debt funds. Interestingly, major price performance happened 6M before the actual disbursement.

**New venture outlays take precedence over payouts:** New ventures and pending equity flows for associated project/investment outlays could deliver greater long term returns for the space, where HUBC is in the running for profitability escalations filtering through to higher payouts. On the flipside, the re-emergence of circular debt (now at PkR1.42trn) followed by mixed signals on a mechanism to tackle the systemic challenges posed by accruals, followed by bleak near-term outlook for payouts (worsened by near term outlays) could keep pressure on IPPs.

**Un-booked penal income is a cherry on top:** Some portion of approved disbursements will be accounted for under penal income to be recorded by fuel suppliers, under individual terms of their FSAs. To recall, delayed fuel payments by HUBC/KAPCO bear additional levy of DR + 2%, with varied terms across various IPPs. These payments (average PkR4.8bn annually between FY15-18) to PSO account for additional sweeteners to our assumption (PkR3.6bn on average for FY19-23F) where current forecasts accommodate a more tapered disbursement of fuel payment dues to PSO. Based on the current disbursements, over the medium term, any clearance could lift other income routed through un-booked penal income (at ~PkR22bn as of 1QFY19).

**Outlook:** Deteriorating volumetric outlook for POL products and expected inventory losses in upcoming earnings read could dampen OMC stocks. On a broader note, an effective roadmap for reforming DISCOs, prioritizing transmission CAPEX (2.8% of total units generated lost during transmission during FY18) and migrating older, inefficient IPPs (tolling agreements) remains absent. Without these concrete developments, resolution of circular debt remains unlikely, warranting investor apprehension towards the space. Of all players involved, banks can be seen to be in a win-win situation, benefiting from high returns (floating, pegged to KIBOR) over longer tenors, with additional benefit of SLR eligibility potentially reducing the impact on CAR. From a larger lens, policy dissonance seems ripe, where recent statement by Commerce Advisor keeps a cloud of uncertainty over the space in the long term.

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### Stock Performance Days After Disbursement

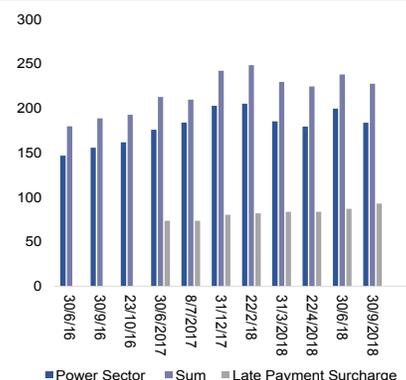
Stock	5	10	15	30
HUBC	-1.7%	-5.0%	-2.6%	7.7%
KAPCO	2.5%	0.0%	-0.4%	2.0%
	0.4%	-2.5%	-1.5%	4.8%
SHEL	-1.7%	-12.3%	-11.2%	-2.1%
APL	0.9%	-2.3%	-0.7%	3.3%
PSO	1.2%	-2.8%	0.8%	8.3%
	0.1%	-5.8%	-3.7%	3.2%

### Stock Performance Days After Disbursement

Stock	5	10	15	30	45	60
HUBC	-2.0%	-5.7%	-5.2%	-3.2%	4.5%	2.8%
KAPCO	-3.9%	-7.4%	-4.6%	-8.8%	3.8%	1.0%
	-2.9%	-6.5%	-4.9%	-6.0%	4.2%	1.9%
SHEL	-1.3%	-3.6%	-2.2%	-5.6%	5.4%	1.1%
APL	-3.1%	-6.1%	-7.4%	-8.8%	-7.4%	1.4%
PSO	2.3%	-3.6%	-2.0%	-5.7%	8.5%	10.2%
Avg	-0.7%	-4.5%	-3.9%	-6.7%	2.2%	4.2%

Source: PSX & AKD Research

### PSO Major Power Sector Receivables (PkRbn)



Source: PSO & AKD Research



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Neutral	> 13% to < 19% expected total return	Accumulate	> 5% to < 20% upside potential
Sell	< 13% expected total return (Rf: 13%)	Neutral	< 5% to > -5% potential
		Reduce	< -5% to > -20% downside potential
		Sell	< -20% downside potential
		Not Rated	No investment opinion or recommendation

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- Equity & Asset return based methodologies (EVA, Residual Income etc.)

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