



AKD Securities Limited

TREC Holder & Registered Broker
Pakistan Stock Exchange

Equity Research / Pakistan



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Today's Daily

■ HUBC: More than just an IPP

HUBC is Pakistan's largest multi-project power producer (1200MW RFO powered base plant + 214MW RFO powered Narowal + 84MW hydel based Laraib) and a stalwart of the IPP space in Pakistan (initiating projects under 1994 & 2002 policies). Continuing with its pedigree of developing diverse capacity additions, expansion into coal fired power through its 46% stake in China Power Hub Generation Company Ltd (CPHGCL), is now likely. Inclusion of the 2x660MW project in the priority list for CPEC projects, confirms the markets bullish expectations and allows us a firm basis to include dividend income from the project in our valuation set. We await the financial close of Thar Electric Power, to incorporate upside. Furthermore, the COD of SECMC (expected Dec'18) may also be achieved offering additional upsides. Moreover the company has also approached relevant authorities for developing a mine mouth power project of, 330MW in Thar. Having had a strong bull run (FY14-16 return of 102%), on the back heightened investor expectations of value addition post expansion plans, the stock trades near our raised DDM based TP of PkR142.7/sh (incorporating CPHGCL) offers 8% upside, with FY17/18F D/Y of 7.6/8.3% implying a NEUTRAL stance.

KSE100 - Index

Current 48,981.65
Previous 49,015.09
Chg. -0.07%

Mkt Cap. (PkRbn/US\$bn)

Current 9,699 / 92.51
Previous 9,727 / 92.77
Chg. -0.29%

Daily Turnover (mn)

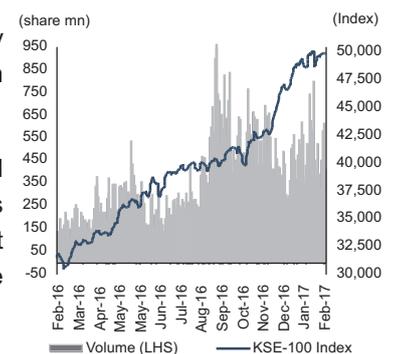
Current 379.90
Previous 343.12
Chg. 10.7%

Value Traded (PkRmn/US\$m)

Current 16,529 / 157.64
Previous 13,921 / 132.77
Chg. 18.7%

News and Views

- The GoP raised PkR59.7bn through PIBs on Feb 22'17 against banks' bids of PkR115.2bn and target of PkR50bn. Cut off yields were largely flat at 6.4066% (down 0.08bps), 6.8994% (0.04ps) and 7.9406% (down 0.08bps) for 3yr, 5yr and 10yr bonds respectively.
- The Economic Coordination Committee (ECC) of the cabinet approved a proposal, seeking exemption from 12.5% withholding tax on dividends from the US\$1.76bn Matiari-Lahore transmission line project, being built by a Chinese firm State Grid Corporation of China (SGCC) under the China-Pakistan Economic Corridor (CPEC).
- As per news reports, briefing the National Assembly Standing Committee on Finance, Secretary Finance Tariq Bajwa stated that the government is considering a subsidy package for farmers in the upcoming budget.



Ali Asghar Poonawala
ali.poonawala@akdsecurities.net
111-253-111 Ext:646

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Why HUBC is different: Going forward, earnings are expected to be driven by: 1) movement past the trough of the U-shaped tariff for the base plant, 2) improved efficiency in the base plant from continuing overhauls (boiler overhaul completed) and 3) termination of O&M contract with O&M services at the base plant (and planned coal expansion) to be managed internally, reducing consolidated O&M costs (halving of annual O&M expense). The separation of O&M services subsidiary Hub Power Services Limited as an in-house O&M provider in a technical agreement with GE and its stake in SECMC are value accretive. The absence of these companies in the consensus valuation method (DDM using income paid through tariffs post indexation), may be undervaluing the company and missing value additions from these segments of HUBC's business.

CPHGCL adds growth: 2X660MW coal fired plant with accompanying jetty adjacent to its base plant site, with an expected cost of US\$2.4bn (in an 80/20 debt to equity) through a JV with China Power International Holdings, and HUBC holding minority stake in the project (recently notified at 46%). To recall, coal based power plants have a lucrative upfront 27.2% ROE (imported coal) during the four year construction period, with a guaranteed 17% US\$ indexed IRR. China Power Hub Generation Company Ltd. (CPHGCL) is expected to add PkR30.98/sh to our TP using DDM value of dividend income from the project. Thus, the planned project, with expected COD by FY19-20 (staggered COD is planned, with each 660MW unit brought online in a span of 2-3 quarters of each other), is expected

Plant Wise DDM Buildup

Component	DDM (TP) Dec'18
HUBC Base	63.2
Narowal	23.8
Laraib	24.7
CPHGCL	31.0
Sum	142.7

Source: AKD Research, PSX Notice



to be a major contributor to payouts from FY20 (~Pkr5.73/sh in annual dividend income from CPHGCL).

Base plant is key till then: 1,200MW net generation capacity base plant (on RFO) forms the foundation of our current valuations as it makes up for ~80% of units generated by the company. These factors allow the base plant to add Pkr63.2/sh to our DDM based valuation in the form of dividend income (at 100% ownership). Having a U-Shaped tariff (unique in the Power Sector) the plant's tariff peaks towards the end of its tariff period, expiring in FY27. Additionally, the recent completion of boiler overhauls and incorporation of a wholly owned subsidiary to carry out plant O&M significantly reduces O&M costs for the consolidated entity.

Road to expansions: A number of catalysts continue to fuel investor expectations including: 1) demerger of Narowal (contributes Pkr23.8/sh to our TP currently) into a separate IPP, with potential listing to raise additional funds for sizeable CPHGCL equity drawdown, 2) Pkr depreciation and increase in US CPI provide upside to indexations built into the tariff and adjusted quarterly, and 3) additional income from the acquisition of ~6% stake for US\$20mn in Sindh Engro Coal Mining Company (SECMC) tasked with mining for coal in Thar Block II (COD expected Dec'18). Lastly, headway on additional projects, including 330MW Thar Electric (TEL) could be value accretive (26.5% ROE on local coal vs. 24.5% on imported coal for 330MW).

What comes after Narowal's demerger: Under the scheme of arrangement for asset desegregation approved in the EOGM on Feb'15, the newly formed Narowal Company Ltd will have 392.2mn shares. Post demerger, 100% ownership of Narowal Company Ltd will remain with HUBC, where we expect the company to put up a minority stake for listing through Offer For Sale. We have run a sensitivity analysis of possible funds that may be raised by putting up 10, 15, 20 & 25% of the newly formed standalone IPP (see charts for details).

Valuation & Investment Perspective: Having had a strong run (FY14-16 return of 102%), on the back heightened investor expectations of value addition post expansion plans, the stock trades at a premium to our DDM based TP of Pkr42.7/sh (incorporating base plant, Narowal, Laraib and CPHGCL). We await the financial close of TEL (Thar Electric Power yet to be approved) to incorporate additional upside. Between now and the commencement of operations in the 1320MW coal fired extension project, the COD of SECMC (expected Dec'18) may also be achieved offering additional upsides. That said, both projects will be a drain on liquidity, which the company may balance by offloading Narowal post demerger (expected

Plant Specifications

Fuel Type	RFO
Plant Type	Combined Cycle
Technical Specification	11X18.428MW + 1X16.45
Turbine Manufacturer	MAN Germany
Steam generator Manufacturer	Dresser Rand
Benchmark Efficiency	45%
Net Capacity	213.82
Power Purchase Agreement	With NTDC on Nov'2008
Fuel Supply Agreement	Bakri Trading Company for 25yrs
IRR	15%

Source: Company Reports & AKD Research

Narowal Financial Highlights

Pkr mn	FY16	FY15	FY14	FY13
NPAT	2,450	2,149	1,268	1,433
Assets	28,080	30,009	34,654	25,200
Liabilities	16,470	21,455	26,052	21,582
Depreciation	985	975	971	966
CAPEX	236	336	55	29
Overdue Rece.	4,527	6,205	4,776	843
Equity	11,610	8,554	8,602	3,617
ROE	21%	25%	15%	40%

Source: Company Reports & AKD Research

Pkr/Sh. Sensitivity -- Funds raised from possible Narowal OFSD

Strike price as % of DDM Value	% of paid up capital offered			
	10%	15%	20%	25%
50%	1.19	1.79	2.38	2.98
40%	0.95	1.43	1.91	2.38
30%	0.72	1.07	1.43	1.79
20%	0.48	0.72	0.95	1.19
10%	0.24	0.36	0.48	0.60

Source: AKD Research
DDM value Pkr70.3/sh
Total Paid up Capital of Pkr3.9bn

Narowal - Back of the Envelope Valuation

Total Market Cap (Pkr MN)	27,586.46
No. of Shares post segregation (Shmn)	392.178
Value per share (Pkr/sh)	70.34
Dividend FY17E (Pkr Mn)	3,240.02
DPS Post separation (Pkr/Sh.)	8.26
Justifies D/Y FY17 Standalone	11.7%

Source: AKD Research, PSX Notice



value and funds raised included in table). Despite this, management has recently stated its aim to implement quarterly payout regime, where our DDM based target price of PkR142.7/share incorporates a FY17/FY18F D/Y of 7.6%/8.3%.

Risks to Thesis: Regulatory impediments with pending approvals on 1,320MW coal fired power plants having the potential to delay the project in a material manner. In the backdrop of additional burden of upcoming projects and investments, liquidity crunch may ensue if circular debt resurges. Any surge in debt build up may impede FO supply, particularly at the base plant, where PSO (with whom a Fuel Supply Agreement governs payments) is exposed to a liquidity crunch and may face problems opening LC's/ facilitating shipments.



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