AKD Daily

Thursday, Mar 16, 2017

Today's Daily

- **FFC & HUBC: Friends in need**

HUBC & FFC announced in separate notices the offer and receipt of an equity divestment plan relating to Thar Energy Ltd. (TEL), a 330MW mine mouth coal fired project in Thar Block II. At a total project costs of PkR52.11bn and equity component amounting to PkR13.03bn (25% equity injection) we parse through NEPRA's upfront tariff for Thar coal (now expired) and HUBC's application to the Authority for Generation License (under determination). Emphasizing the equity investment for the project as straining already stressed balance sheets, FFC's acceptance of the proposal may signify a continuing shift to energy related diversification, while HUBC suffers from circular debt issues. We estimate the project to contribute PkR1.06/2.11bn in annual dividend income for FFC/HUBC making up PkR0.83/1.83 per share for the two companies in cash based income following COD (planned for 4QFY20). Following tariff stipulations (adjusted for lower equity share and 4% annual PkR depreciation vs. US$) the project is expected to contribute PkR5.5/12.6 per share to the TPs of FFC/HUBC.

KSE100 - Index	
Current	48,305.83
Previous	48,539.06
Chg.	-0.48%

Mkt Cap. (PkRbn/US$bn)	
Current	9,532 / 90.91
Previous	9,573 / 91.30
Chg.	-0.43%

Daily Turnover (mn)	
Current	206.11
Previous	195.13
Chg.	5.6%

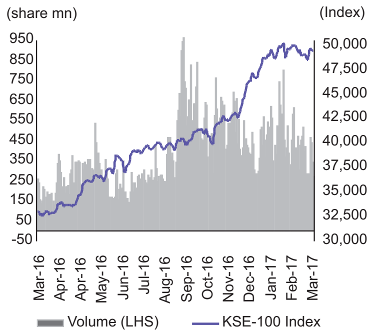
Value Traded (PkRmn/US$mn)	
Current	10,885 / 103.82
Previous	11,984 / 114.30
Chg.	-9.2%

News and Views

- The SBP issued PkR284bn worth of short-term government papers at the MTB auction held on Wednesday (Mar 15'17). This remained lower than GoP's target of PkR350bn despite adequate participation with PkR381.6bn worth bids received. Cut off yields on 3mth and 6mth papers remained stable at 5.9463% and 5.9896% respectively. Bids for 12mth MTBs were rejected.

- The World Bank has initiated the process to approve a credit of US$200mn for increasing the installed generation capacity of renewable energy and enhance its development in Pakistan. The project, which will cost US$300m, will also receive a loan of US$100m from the Green Climate Fund.

- News outlets have quoted a senior official from Finance Ministry which has proposed PSDP expenditure of PkR700bn, up 6.87%YoY from PkR655bn (ex PkR145bn for TDP settlement) allocated in FY17.



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Background and features: Incorporated as a wholly owned subsidiary in May'16, TEL was formed to construct and operate an indigenous lignite coal fired, mine mouth power plant of 330MW (300MW net) capacity situated near Thar Block-II. SECMC plans to extract 7.6mtpa of coal from Thar Block-II in its second phase with planned completion by CY19, enough to fuel 1,320MW in generation capacity. Low quality coal from Thar necessitates the use of Circulating Fluidized Bed (CFB) Boilers, with the plant expected to be operational by July'20.

Lucrative tariff awaited: Having a slightly higher ROE of 30.65% vs. 24.5/26.5% for imported/local coal projects through the 30yr tariff period, Thar coal's tariff incorporates the higher operational risk of using low quality coal (low calorific value, high ash and moisture). Although the sponsors of the project have approached NEPRA for obtaining a generation license (application submitted on Oct'16), the process is ongoing where similar projects have been granted licenses within a 4-5 month timeframe. Lastly, NEPRA has called a closed period on additional licenses being granted under the Thar Coal Upfront tariff (valid for two years and lapsed on Jan'17), which does not cover TEL as its application is already under process under the previous upfront tariff (notified Jan'15).

Project outlays: Under terms laid out in the upfront tariff for coal, TEL is expected to have a total project outlay of PkR52.11bn, funded by a 75/25 debt to equity break up (PkR15.6bn equity injection) as proposed under the application for generation license submitted to NEPRA. In terms of the proposed divestment, HUBC's contribution for a 60% equity stake amounts to PkR7.82bn.

Thar Energy Ltd: Project Snapshot

Project Assumptions	
Gross capacity (MW)	330
Auxiliary load (%)	9%
Net capacity (MW)	300
Net generation at 100% (GWh)	2,631
Construction period (mth)	40
Concession period (yrs)	30
Project Cost Assumptions	
Capex (US$mn)	408.2
Custom duties & cess (US$mn)	16.2
Financing fees & charges (US$mn)	11.1
Sinosure fee (US$mn)	33.2
Interest during const. (US$mn)	28.9
Total	497.7
Technical Assumptions	
Plant efficiency (%)	37%
Plant efficiency (%)	85%
Coal Calorific value (Kcal/kg)	2,773
Project Financing Plan	**US$mn**
Debt	373.3
Equity	124.4
Project Debt Assumptions	
Repayment tenor (yr)	10
Grace perion (mth)	40
Reference LIBOR (%)	0.45%
Reference Spread (%)	4.50%
Interest during construction (US$mn)	28.9
Project Returns	
Return of equity (%)	30.65%
Return of equity (US$mn)	38
Equity IRR	20%

Source: License Application & AKD Research

Original vs. Revised Timelines

Task	Original Timeline	Revised
Issuance of LOI by PPIB	Jul'16	Jul'16
Generation license from NEPRA	Aug'16	Oct'16
Application of upfront tariff acceptance from NEPRA	Aug'16	Oct'16
Upfront tariff determination for project by NEPRA	Aug'16	Oct'16
EPC price lock-in from EPC contractor	Aug'16	Oct'16
LOS issuance from PPIB	Sept'16	Nov'16
Execution of EPC contract	Oct'16	Dec'16
Execution of coal supply agreement	Oct'16	Dec'16
Execution of land lease agreement	Nov'16	Jan'17
Execution of PPA and IA	Nov'16	Jan'17
Financial close	Apr'17	Jun'17

Source: License Application & AKD Research

FFC to continue focusing on energy: Having successfully pioneered Pakistan's first wind power renewable energy project having a capacity of 49.5MW, FFC is continuing with its strategy to diversify into energy sector. In this regard, the company has recently notified to take up a 30% equity stake offering in Thar Energy limited (divestment coming from HUBC). In order to finance the said project, FFC will have to contribute approximately PkR3.9bn (US$37mn) which will probably need to be financed by taking additional loans considering current liquidity situation of the company and ability to continue its historic payout ratio (avg. 90%) in the future. Slated for COD in Jul'20, the earnings impact will likely be visible in FY21 where we estimate the project to contribute PkR1.06bn in annual dividend income for FFC making up PkR0.83 per share in cash based income (estimated jump of PkR5.5/sh in TP).

HUBC lessening its liquidity burden: HUBC recently disclosed the divestment of minority interest in Thar Energy Ltd. (TEL) to FFC (30%) and CMEC (10%, also EPC contractor for project). Previously HUBC held 100% ownership in the project, which has now been reduced to 60%. We believe the willingness to dilute ownership in TEL is a move to reduce project related investment burdens, in our view. Assessing its impact on HUBC, this reduces the expected dividend income from the project to PkR1.83/sh (PkR2.11bn) from PkR3.53/sh (PkR3.05bn) commencing from FY20. Moreover, the project at 60% ownership stake may add PkR12.6/sh to HUBC's TP, which currently stands at PkR142.7 (incorporating 1320MW coal extension). At last close, 10% upside is implied to our TP, where we await financial close of TEL to incorporate further upsides.

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