

PAKISTAN
Power

REP-019
MARKET
VISTA

Circular debt is a blemish on the sector

- Circular debt has grown worse over the period, rising to PkR1.18tn, and inducing a liquidity crunch in the entire IPP universe leading to reduced payouts and dampening price performance as investors re-assess expectations.
- While IPPs have historically remained low beta, defensive stocks, recent price performance due to furnace oil issue and payout uncertainty have increased the sectors' beta to 0.839 as at Sep'18 on a 1000 trading day basis vs. 0.793 previously.
- Going forward, pressure will exist as additional IPPs come online demanding higher payments under the CPP. However, HUBC's upcoming projects and the strategic partnerships it has signed is set to provide an ideal mix of growth and value to the investors. Our TP of PkR142/sh offers a capital upside of 58.5%, in addition to FY19/20F D/Y of 8.31/12.92%. **BUY!**

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Circular debt making lives difficult: Entangling companies in the IPP sector one by one, circular debt has grown worse over the period with latest news flows totaling the amount to PkR1.178tn. Of this, ~PkR583bn is parked in the Power Holding Company. While it initially affected efficient power plants like NPL and NCPL, other IPPs have not been able to save themselves either, where the list includes PKGP, SPWL and LPL. A closer look at their latest available financial statements reveal that trade debts have cumulatively grown to PkR165.44bn, however, payables have seen a less steeper rise, partly because the inefficient plants did not incur heavy fuel cost as compared to previous years. The situation led to negative cash flow from operations eventually culminating into reduced dividends for shareholders whereby the payout ratios of NPL, NCPL, PKGP, SPWL and LPL clocked-in at 65% vs. 3 yr historical average of 88% (with PKGP, LPL, SPWL skipping HY18 dividends). While we believe the resolution of circular debt is the GoP's top most priority, additional outlay on account of upcoming projects' CPP (1,320MW CPHGC, 660MW LEPL) can be burdensome for the national exchequer where GoP pays ~PkR130bn per annum under CPP to the existing IPPs, as per our calculation.

Company wise position

(PkRbn)	HUBC	YoY	KAPCO	YoY	NPL	YoY	NCPL	YoY	PKGP	YoY	SPWL	YoY	LPL	YoY	Total	YoY
Latest Receivables	98.9	15.5%	6.9	35.3%	11.5	29.2%	11.6	28.9%	16.12	13.9%	7.12	25.8%	13.3	23.7%	165.44	18.9%
Receivables as of Jun 30'17	85.6		5.1		8.9		9		14.15		5.66		10.75		139.16	
Payables	82.9	22.3%	48.8	40.6%	0.438	-16.3%	0.451	-0.2%	0.987	-29.5%	1.21	-40.4%	0.64	-30.5%	135.426	25.6%
Payables as of Jun 30'17	67.8		34.7		0.523		0.452		1.4		2.03		0.921		107.826	
Payout Ratio	77%		76%		49%		31%		82%		62%		81%			
2/3 yr historic payout ratio	96%		83%		71%		103%									Skipped HY dividend

Beta Swings: Regarded as low beta, defensive stocks with built-in macro-hedge characteristics, IPPs have historically provided cover to investors in times of market volatility, with consistent stream of dividends and a relatively stable price performance. However, GoP's indecisiveness on furnace oil outlook back in CY17 and the recent dividend cuts have led to scattered movements in their price performance. In this regard, our calculation of the sectors' beta in relation to KSE-100 reveals that on a 1000 day price performance, beta has risen to 0.839 vs 0.833 in Dec'17 and 0.793 in Dec'16. Based on this, NPL comes out to be the least volatile stock with a beta of 0.752 while HUBC leads the list at 0.913.

Investment Perspective: Although volatility in the IPP sector has risen, the beta still remains below one, signifying the overall defensive nature of scrips. Specifically, while HUBC topped the list, we believe its price performance is also attributable to the positive developments in the backdrop of upcoming projects and strategic partnerships. As per latest annual report, the company has generated CFO of PkR5.99/sh in FY18 vs PkR2.86/sh in FY17 signifying its ability to sustain in stressful times. Moreover, HUBC has invested an additional PkR9.5bn into the upcoming

Source: Company Reports & AKD Research



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projects and the management seeks to start commercial operations of the 1,320MW CPHGC by Aug'19 with its first unit scheduled to go online by Dec'19, as per news flows. While we believe the stock is an ideal mix of value and growth in the long run, short term price performance can also be triggered by updates of the ongoing projects. We have a BUY call on the scrip with a TP of PkR142/sh, while its FY19/20F D/Y stands at 8.31/12.92%.

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Neutral	> 10% to < 16% expected total return
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Accumulate	> 5% to < 20% upside potential
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