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PAKISTAN Strategy

REP-019

MARKET VISTA

RLNG is far from a silver bullet

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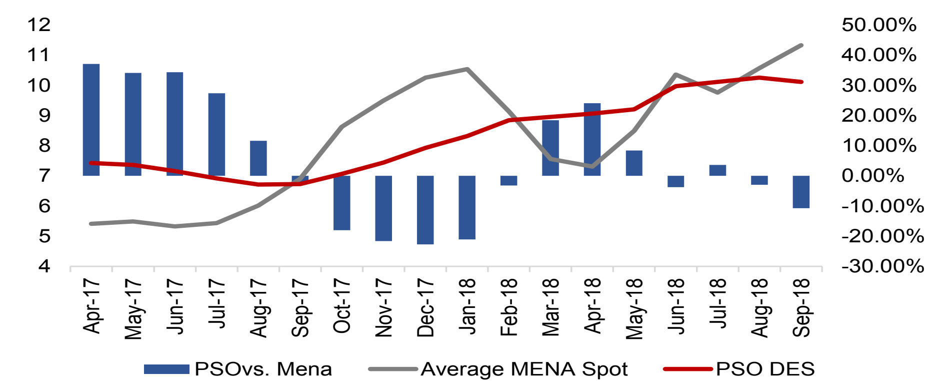
- **Considered the need of the hour, RLNG imports have surged 56%YoY for FY18 (59 cargoes 5.5mn tonnes), where the accompanying payments mark a rise of 60%YoY amounting to US$2.04bn**
- **Contrary to criticisms, pricing for imports have remained competitive, highlighted by weighted average DES price comparison to the MENA Spot LNG benchmark where only a 5% premium in monthly average rates prevails**
- **The commencement of spot tender imports through PLL have been at an average discount of 8% to PSO's slope (US$9.43/mmbtu average DES for 8MCY18), whereas retainage, T&D losses and other levies raise distribution prices by ~26.3%, indicative of infrastructure constraints**
- **Looking at the impact of the rise of RLNG on listed entities, namely PSO and ENGRO, we highlight possible end-use cases (particularly for fertilizers), citing higher costs, low pricing power and debt accretion as major detriments to overcome.**

DES prices are competitive: Looking through historic DES price of RLNG imports, we highlight the recent commencement of imports through Pakistan LNG Limited (PLL) as being instrumental in driving down weighted average LNG Prices. Since Jan'18 PLL's DES price has been 8% lower than PSO's, which is reliant on the long term supply agreement and fixes slope (13.37% of 3M Brent average), while inviting tenders for its imports, PLL has been able to secure a lower slope (~12.3% to Brent Average) for 8MCY18. Imports and Competitive pricing of DES prices fail to reach the end consumer as additional charges, levies and loss adjustments raise transmission prices by ~14.23% for transmission and a further ~12.03% for notified distribution prices (average of US$11.89/mmbtu) ex of GST (additional 17% levy currently).

PSO DES vs. MENA Spot LNG Price (US$/mmbtu) monthly average differentials



Source: Bloomberg, OGRA & AKD Research

PSO: The state owned OMC earned ~PkR200bn from the segment, where its contribution to Gross profits was PkR4.86bn (up 51.5%YoY), making up 12.3% of total gross profits for FY18. Moreover, this income stream compensated ~40% of the PkR500mn lost due to FO sales sliding. For FY19F we expect the income stream to add ~PKR876mn (PkR2.68/sh.) to the firm's bottom-line (based on current margins of 0.5% prevailing).

ENGRO: Under a revised arrangement with SSGC in Mar'17, Engro Elengy is mandated to handle 600mmcfd of LNG (100% utilization) at an average tolling fee rate of US$0.479/mmbtu. The LNG terminal handled 36 cargoes during 1HCY18 and delivered 111.1bcf re-gasified LNG to SSGC

LNG Imports Sensitivity (US$mn)

Brent US$/bbl	FY19F
60	3,449
72	4,139
80	4,599

Source: OGRA & AKD Research

LNG Imports Bill (US$mn)

	FY15	FY16	FY17	FY18
LNG Imports	135	579	1,271	2,036

Source: SBP & AKD Research

LNG Cost additions as % of DES price

(September'18)	PSO	PLL
PSO/ PLL other imports related actual costs	2.9%	1.6%
PSO / PLL margin	2.5%	2.5%
Terminal Charges	4.3%	8.8%
Retainge volume adjustment	0.8%	0.8%
T & D volume adjustment	0.2%	0.2%
LSA management fee (SSGC/ PLTL)	0.2%	0.3%
Cost of supply	4.9%	5.7%

Source: OGRA & AKD Research

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maintaining an availability rate of above 100%. In this regard, we expect a stable contribution of PkR3.92/sh and PkR3.74/sh to ENGRO's bottom-line in CY18E and CY19F from Elengy terminal.

Outlook: Apart from power production (32.5% of total natural gas consumption in FY17) where input costs of RLNG are passed on, but remain prone to accruals. PSO records PkR15.9bn in receivables under the header from SNGPL where PkR1.5bn were added to the stock during FY18. Still paltry when compared to PkR23.7bn in accretion of power sector receivables during the period. Apart from power sector demand, fertilizer feed stock remains the other major industrial use of natural gas. Here too, high RLNG costs make it infeasible for closed fertilizer plant to operate, where our calculation suggests negative primary margins of PkR580-600/bag (assuming RLNG/Normal gas mix of 72%/28%). However, in order to make these plants operational, GoP is required to provide hefty subsidy of at least ~PkR6.5-7bn to make their operation viable at 300k tons of Urea production.

Investment Perspective: Seeking the relative safety of guaranteed take or pay terminal agreement (US$0.44/mmbtu), and plans for participating in another terminal, ENGRO remains our preferred play for exposure to RLNG based income streams.

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