Day Break

Thursday, 03 December 2020

IGI Securities

COMPANY UPDATE

The Hub Power Company Limited

Power Generation & Distribution

Recommendation		**BUY**
Target Price:	Jun-21	129.0
Last Closing:	2-Dec-20	84.8
Upside (%):		52.2
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		7M

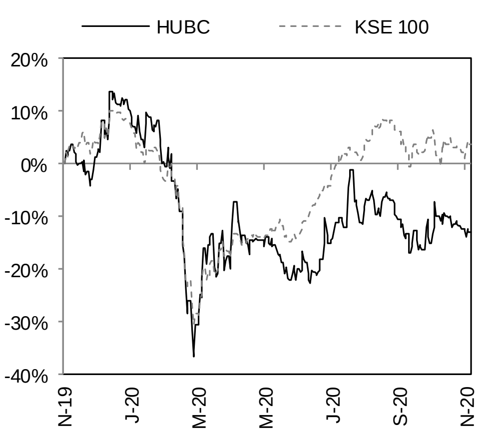
Market Data			
Bloomberg Tkr.			HUBC PA
Shares (mn)			1,297.2
Free Float Shares (mn)			972.9
Free Float Shares (%)			75.0%
Market Cap (PKRbn | USDmn)		109.9	659
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	(6.7)	1.0	(13.1)
Lo	75.4	70.3	57.4
Hi	86.2	89.8	103.2

Key Company Financials

Period End: Jun

PKRbn	**2020a**	**2021f**	**2022f**	**2023f**
Total Revenue	48.3	56.6	84.5	87.4
Net Income	25.0	32.2	41.7	45.6
EPS (PKR)	19.3	24.9	32.1	35.1
DPS (PKR)	-	8.0	10.0	7.0
Total Assets	293.5	342.9	362.3	371.8
Total Equity	78.6	97.8	131.4	172.8
Key Financial Ratios				
ROE (%)	32.5	26.0	38.7	36.6
P/E (x)	4.4	3.4	2.6	2.4
P/B (x)	3.1	2.2	1.4	1.1
DY (%)	-	9.4	11.8	8.3

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Power Generation & Distribution

HUBC: Quasi bailout in a tough backdrop – worth considering

- As per news report, Hub Power Company Limited (HUBC)'s proposal to GoP to buyout base plant for PKR 65bn was met with a counter proposal with the Government offering PKR 65bn on a conditional basis that HUBC would be utilize the funds for coal conversion of two out of four boilers on Thar coal while the remaining amount is to be utilized for installing water desalination plant for water supply to Karachi.
- Although, forgoing PKR 260bn over a period of 7 years for PKR 65bn right now may not seem much of a bargain, however, in our view, the proposal and counter proposal seems fairly reasonable from HUBCs standpoint considering the time value of cash and risk associated with FO based power plant.
- In our view, accepting PKR 65bn payment seems financially reasonable and positive in terms of cash flow considering HUBC's reliance on debt financing for coal and water desalination plant would be reduced by PKR 65bn. Furthermore, it would be positive in terms of cash flow for HUBC as cash cycle is relatively better with KEL.

HUBC's proposal to GoP and their counter proposal

As per news report, Hub Power Company Limited (HUBC)'s proposal to GoP to buyout base plant for PKR 65bn was met with a counter proposal by Government offering PKR 65bn on a conditional basis that HUBC would utilize the funds for coal conversion of two out of four boilers on Thar coal, while the remaining amount is to be utilized for installing water desalination plant for supply to Karachi. To note, HUBC has already signed MoU with K-Electric (KEL) for supply of 600MW of electricity. As a result HUBC will be foregoing the future CPP payments of base plant to the tune of PKR 260bn till 2027.

FO based plants remain low in NEPRA's merit order list

Hub plant has been operating at negligible load factor and would likely remain low on the merit order list along with other FO plants. Considering the supply-demand dynamics in Pakistan and future of FO based plant, the Company has opted for this proposal in our view.

Forgoing future CPP payments for PKR 65bn right now seems fairly reasonable

Although, forgoing PKR 260bn over a period of 7 years for PKR 65bn right now may not seem much of a bargain, however, in our view, the proposal and counter proposal seems fairly reasonable from HUBCs standpoint considering the time value of cash and risk associated with FO based power plant. Based on our working, conversion cost of two boilers to coal would be around USD 400-480mn which comes to around PKR 64-76bn thus HUBC would have to inject additional PKR 20bn (PKR 15/share) for coal conversion. In addition further cost would be added for installation of water desalination plant.

On net equity basis, our calculation suggests that remaining profits from Hub plant till 2027 would stand at PKR 121bn (after MoU adjustments and assuming no payout). This, in addition to net equity as at Sep-20 (PKR 46bn), would lead to total Net equity of PKR 166bn which discounted at 15% would have a PV of PKR 66bn, which makes PKR 65bn settlement fairly reasonable. Adjusting the equity for dividend would further bring down the PV of equity.

Clarity awaited on termination of PPA and settlement of overdue receivables

We await further clarity on whether the PPA would be terminated early and potential settlement of Hub plant's overdue receivables. HUBC is yet to receive its overdue payments under the recently signed MoUs with the GoP (to be cleared in 3 installments over next 3 years). HUB's net payable position stands at PKR 5.7bn for its base plant based on PKR 81bn trade debt, PKR 57bn trade payables and PKR 30bn short term borrowing as at Sep-20. Thus even after receiving the overdue receivable and clearing ST borrowing and trade payable, HUBC would still have to meet the entire capital requirement for coal conversion and installation of water desalination through debt (in the event the GoP does not fall through on the PKR 65bn liquidity to HUBC).

Outlook

In our view, accepting PKR 65bn payment seems financially reasonable and positive in terms of cash flow considering HUBC's reliance on debt financing for coal and water desalination plant would be reduced by PKR 65bn. Furthermore, it would be positive in terms of cash flow for HUBC as cash cycle is relatively better with KEL. It would also reduce the risk of exposure to circular debt along with delays in CPP payments and risks associated with future operations of FO based plants in Pakistan.

Recommendation

As a result, we still maintain our BUY stance on the scrip with target price of PKR 129/share offering 52% upside from last close. The Company is currently trading at FY21 P/E of 3.4x and offers a DY of 9.4%.

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Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
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Time Horizon: Dec – 2020
Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
(Discounted Cash Flow)

Risk: Investment in securities are subject to economic risk, market risk, interest rate risks, currency risks, and credit risks, political and geopolitical risks. The performance of company (ies) covered herein might unfavorably be affected by multiple factors including, business, economic, and political conditions. Hence, there is no assurance or guarantee that estimates, recommendation, opinion, etc. given about the security (ies)/company (ies) in the report will be achieved.

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