Day Break

Thursday, 17 May 2018

COMPANY UPDATE

The Hub Power Company Limited

Power Generation & Distribution

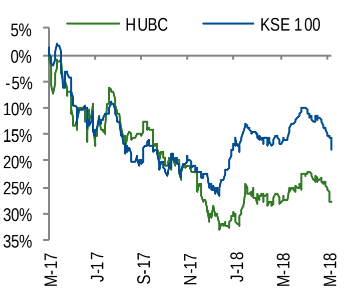
Recommendation			**BUY**
Target Price:			133.3
Last Closing:	16-May-18		96.5
Upside:			38.1
Valuation Methodology:			Dividend Discount Model (DDM)
Time Horizon:			Dec-18
Market Data			
Bloomberg Tkr.			HUBC PA
Shares (mn)			1,157.2
Free Float Shares (mn)			694.3
Free Float Shares (%)			60.0%
Market Cap (PKRbn | USDmn)		111.7	965.7
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	(2.1)	(7.6)	(27.9)
Lo	95.9	89.9	89.9
Hi	104.9	104.9	135.1

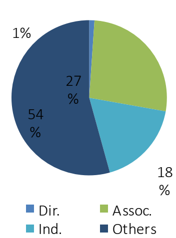
Key Company Financials

Period End: Jun

PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	101.2	100.4	92.2	88.3
Net Income	10.7	11.1	11.8	16.4
EPS (PKR)	9.2	9.6	10.2	14.2
DPS (PKR)	7.5	6.6	7.5	12.0
Total Assets	159.6	171.1	153.2	123.5
Total Equity	32.6	33.1	34.0	34.6
Key Financial Ratios				
ROE (%)	32.8	33.5	34.7	47.3
P/E (x)	10.5	10.1	9.5	6.8
P/B (x)	1.6	3.4	3.4	3.3
DY (%)	7.8	6.8	7.8	12.4

Relative Price Performance





About the Company

The Company was incorporated in Pakistan on August 01, 1991 as a public limited company. Its GDR are listed on the Luxembourg Stock Exchange. The principal activities of the Company are to develop, own, operate and maintain power stations.

Source: Bloomberg, PSX & IGI Research

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Power Generation & Distribution

HUBC: Alpha from new ventures to counter short term headwinds; 'BUY' Intact

- The Hub Power Company Limited's (HUBC) reported 3QFY18 consolidated earnings of PKR 2.98bn (EPS PKR 2.58) up by +16%YoY, resultantly taking 9MFY18 profitability to PKR 8.28bn (EPS PKR 7.15), up by +9%YoY.
- We attribute growth in 3QFY18 earnings to lower repairs and maintenance both at the Narowal plant (11 engines) and Hub plant which consequently led to lower stores and spares cost. Further growth in earnings emanated from 4.5% PKR depreciation in Mar-18.
- As per management guidance this is to be financed c.80-85% by debt and remaining through internal cash flows. Although this may strain dividend payout (~69-80% FY18-20F) in the medium-term, upward timeline revision in cash flows from CPHGCL (COD: Aug'19) will likely dilute the impact in the long run as CPHGC is likely to commence operations by Aug-19, however from FY20F onwards payout is expected to normalize along with commencement of production from CPHGC taking DPS to PKR 12/share with D/Y of 12.4%
- We maintain our 'BUY' call on the company with a target price of PKR 133/share, offering a substantial +38% upside from its last closing. The company is currently trading at a FY18/19F P/E of 10.1x/9.5x.

Earnings lifted by +9%YoY to PKR 7.15/share in 9MFY18, DPS PKR 4.6

The Hub Power Company Limited's (HUBC) reported 3QFY18 consolidated earnings of PKR 2.98bn (EPS PKR 2.58) up by +16%YoY, resultantly taking 9MFY18 profitability to PKR 8.28bn (EPS PKR 7.15), up by +9%YoY. Results were accompanied with cash dividend of PKR 1.6/share, taking 9MFY18 cash payout to PKR 4.6/share (payout ratio: 64%- lowest ever). Going forward, strain on dividend payout may continue as HUBC looks towards internal financing for equity stake in its associated undertakings (namely: CPHGCL and TEL).

We attribute growth in 3QFY18 earnings to lower repairs and maintenance both at the Narowal plant (11 engines) and Hub plant which consequently led to lower stores and spares cost. Further growth in earnings emanated from 4.5% PKR depreciation in Mar-18. However, drag from associates via weak profitability (Laraib Plant PAT down by 26%YoY), owing to lower generation and higher finance cost, kept earnings growth in check. Finance cost increased due to heavy reliance on short term borrowing amid rising circular debt as receivables piled up 26% or PKR 6.3bn since Jun-17. Both Hub and Laraib plants operated at low load factor of 27% and 25% during 3QFY18 vs. 61% and 44% respectively in the same period last year. Weak hydrology at Laraib's plant coupled with lower demand from WAPDA for HUBC's base plant, dampened over all dispatch levels.

Exhibit:

Financial Highlights (Consolidated)

PKR mn	3QFY18	3QFY17	YoY	9MFY18	9MFY17	YoY
Turnover	19,495	25,912	-25%	73,786	74,140	0%
Operating Costs	14,871	21,648	-31%	60,396	61,709	-2%
Gross Profit	4,624	4,264	8%	13,390	12,431	8%
Admin expenses	325	340	-4%	1,113	980	14%
Financing Cost	1,091	1,021	7%	3,247	3,083	5%
PBT	3,149	2,821	12%	8,828	8,301	6%
PAT	3,081	2,694	14%	8,642	8,064	7%
PAT - Attributable to HUBC	2,981	2,559	16%	8,279	7,628	9%
EPS (PKR)	2.58	2.21		7.15	6.59	
DPS (PKR)	1.60	2.00		4.60	5.00	

Source: Company Financials & IGI Research *No of Shares: 1,157.15 mn*

Exhibit:

Operating Segment Profitability (PKR/share)	3QFY18	3QFY17	9MFY18	9MFY17
Hub Plant	1.72	2.38	5.02	5.55
Narowal Plant	0.76	0.62	1.73	1.16
Laraib	0.26	0.35	0.93	1.13
HPSL	0.10	0.01	0.32	0.08
Elimination/Unallocated	0.27	1.15	0.86	1.33
HUBC Earnings	**2.58**	**2.21**	**7.15**	**6.59**

Source: IGI Research, Company Financials

Generation remained subdued during 3QFY18

Hub and Laraib plant operated at low load factor of 27% and 25% during 3QFY18 as compared to 61% and 44% respectively in the same period last year. Low load factor from Laraib was due to low hydrology while Hub plant's generation remained low due to lower demand from WAPDA. Generation from Narowal plant dropped to 66% during 3QFY18 compared to 77% in the corresponding period last year.

Exhibit:

Load factor remained subdued during 3QFY18

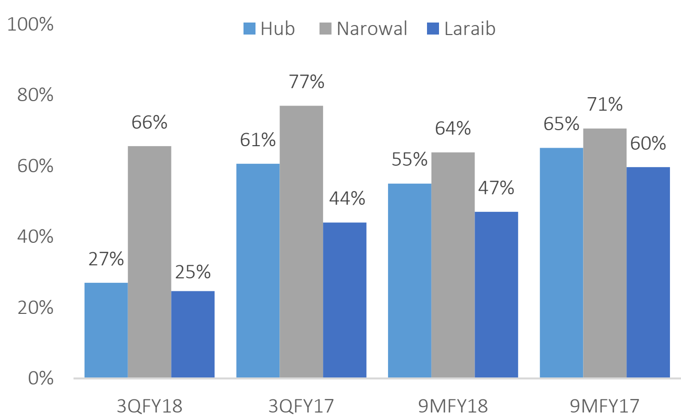
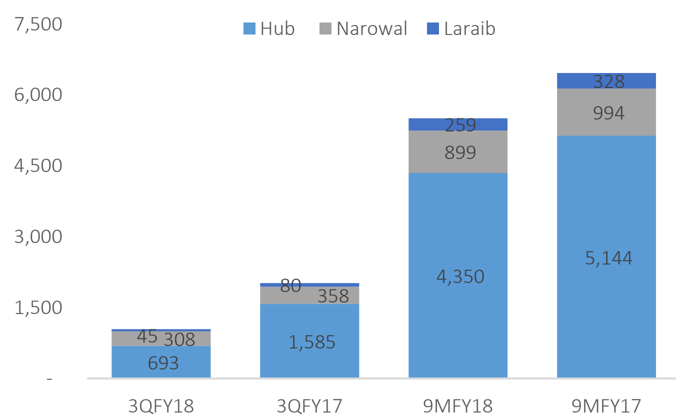


Exhibit:

Generation from all 3 plants during 3QFY18 and 9MFY18 - Gwh



Source: IGI Research, NEPRA, Company Financial

Equity portion to be financed through a mix of debt and internal cash flows for upcoming projects…

HUB Power Holding Limited (HPHL) requires financing for its 46% equity stake in 1,320MW coal fired project; Chin Power Hub Generation Company Limited (CPHGCL). To recall, HPHL project cost was revised down to USD 2bn (prev. US 2.5bn), where USD 500mn now accounts for equity portion. Post financial close, both HUBC and CPIH will allocate 1.5% equity portion each to the Govt. of Baluchistan, while bearing all costs to the bottom-line. Therefore, we incorporate 46% (previously: 47.5%) equity injection by HPHL which translates to about USD 238mn/PKR 21bn. As per financial report for 3QFY18, the Company has also initiated the process for increasing its shareholding to 47.5% after exercise of its call option as per Share Purchase Agreement (SPA) which is expected to be completed by

1QFY19. As per management guidance this is to be financed c.80-85% by debt and remaining through internal cash flows. This is further illustrated in FY17 financials, wherein HUBC has entered into PKR 21bn loan for financing of associated undertakings (CPHGC, TEL and SECMC) and during 3QFY18 has further borrowed PKR 5.5bn for specifically for financing equity stake in CPHGC.

…however in the medium-term dividend payout may remain depressed

Although this may strain dividend payout (~69-80% FY18-20F) in the medium-term, upward timeline revision in cash flows from CPHGCL (COD: Aug'19) will likely dilute the impact in the long run as CPHGC is likely to commence operations by Aug-19. However, as SECMC and TEL will commence operation by Jun-19 and Dec-20, respectively we believe HUBC's dividend payout to remain restricted till FY20. Total financing requirement through internal cash flows for CPHGC, TEL and SECMC comes at PKR 7.7bn in our view considering 80%/20% debt/equity for the 25% equity portion in the aforementioned investments. As a result, we estimate HUBC to curtail dividend of PKR 2.25-2.75/share in FY19 which is in addition to estimated PKR 1.25/share and PKR 2.75/share dividend curtailment in FY17 and FY18, respectively. Based on this, dividend yield for FY18/19F is expected to remain at 6.8/7.8%, however, from FY20F onwards payout is expected to normalize along with commencement of production from CPHGC taking DPS to PKR 12/share with D/Y of 12.4%.

Exhibit:

Project cost and financing

		CPHGC	TEL	SECMC	Total
Cost (USDmn)		2,000	500	845	3,345
Stake		48%	60%	8%	
HUBC's portion (USDmn)		950	300	68	1,318
Debt (75%)		713	225	51	988
Equity (25%)		238	75	17	329
Of which: Debt	80%	190	60	14	264
Of which: Equity	20%	48	15	3	66
Total Equity Requirement (PKRmn)	117	5,558	1,755	396	7,709
Total Equity Requirement (PKR / Share)		4.80	1.52	0.34	6.66

Source: IGI Research, Company Financials

TEL & SECMC projects on track

Project timelines of HUBC's other associated undertakings are on track. Thar Energy Limited (60% owned Associate) is expected to achieve commercial operations tentatively by Dec'20. Implementation Agreement (IA) has been initiated while Water-usage Agreement is under execution. Coal Supply Agreement (CSA) and Power Purchase Agreement (PPA) have been signed while financial close has been extended by six months to 9th Sep-18. To recall, FFC entered TEL as 30% equity strategic partner in 3QFY17. As per management guidance, SECMC project (8% equity ownership) is 10% ahead of schedule and stands at 50% completion with production commencement expected by Jun'19.

Exhibit:

Time line of Projects

Project	Financial close	Commercial Operation
CPHGC	Jun-17	Aug-19
TEL*	Sep-18	Dec-20
SECMC	Apr-16	Jun-19

Source: IGI Research, Company Financials
** PPA, CSA and IA have been signed*

Increased working capital financing may sting despite injection of funds in to power sector

Fears of earnings volatility on foreign currency loans of associated undertakings seem overblown in our view. Based on USD 2bn project financing for CPHGC, 75% debt portion translates to USD 1.5bn. With no major cash flow impact given the nature of USD denominated loans (pass through item), and expected curtailment of dividend to finance equity stake, we deem fears of earnings attrition as unwarranted. However, increased reliance on short term borrowing to manage working capital requirements (Short-term borrowings up +26% since Jun-17) may keep finance cost elevated in the medium-term. This is despite injections of funds in to power sector in 2HFY18 which has led to trade payables falling by 10%QoQ to PKR 79bn while trade debts have only fallen by 3%QoQ to PKR 101bn due to significant rise in circular debt. As a result the Company borrowed additional 2.9bn during 3QFY18.

Recommendation

As reliance on debt financing for 46% equity stake in CPHGCL contracts to c.80-85% and rising circular debt may keep finance cost inflated, this may dampen dividend payout in the medium-term, however we anticipate early COD of associated undertakings may dilute impact in the long run. We maintain our 'BUY' call on the company with a target price of PKR 133/share, offering a substantial +38% upside from its last closing. The company is currently trading at a FY18/19F P/E of 10.1x/9.5x. Although existing dividend yield lacks vigor, this does not detract from swift dividend yield progression to c. 15% by CY21.

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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 – 2018

Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
DDM (Dividend Discount Model)

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