Day Break

Monday, 17 August 2020

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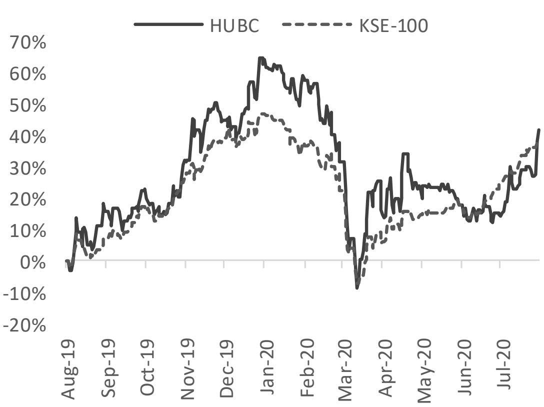
Sector Update

IPP MOU signed with GoP

Relative Performance to KSE 100



Source: Bloomberg, PSX & IGI Research

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Power Generation & Distribution

Two separate MOU's signed for plant under 1994 and 2002 Power Policy

- ✓ After much deliberation and discussion, IPP and the GoP reached an agreement (on 13-Aug-2020) to reduce power tariffs and accumulation of circular debt. Two separate MoUs have been finalized and are subject to final approval from NEPRA, the Federal Cabinet and IPP boards.
- ✓ The common points under both MOUs are reduction in ROEs and fixed capacity payments, establishment of a Competitive Trading Agreement and importantly payment of overdue receivables to the IPPs within an agreed period of time through a mechanism to be devised by power purchaser and GoP.

IPPs and GoP signed two different MOU's for plants falling under 1994 and 2002 Power Policy

After much deliberation and discussion, IPP and the GoP reached an agreement (on 13-Aug-2020) to reduce power tariffs and accumulation of circular debt. Two separate MoUs have been finalized and are subject to final approval from NEPRA, the Federal Cabinet and IPP boards. The two settlement pacts signed include agreement with plants falling under 2002 and 1994 Power Policy. Both these MOU's are valid for a period of six months from the date of signing of the contract, subjected to approval of NEPRA, Federal Cabinet and IPP's Board of Directors. Once approved, a detailed agreement would be made for the terms mentioned in the MOU which would be signed by all parties and after which the current MOU would stand terminated. Another MOU has also been signed with Wind Power Projects (WPP).

The common points under both MOUs are reduction in ROEs, the establishment of Competitive Trading Agreement and a payment of overdue receivables to the IPPs within an agreed period of time through a mechanism to be devised by power purchaser and GoP.

MOU signed with plants under 2002 Power Policy

The MOU signed between the Negotiation Committee and the IPPs falling under 2002 Power Policy, include 6 key points namely a) sharing of fuel efficiency gains with power purchaser, b) sharing of O&M gains with power purchaser, c) reduction in rate charged on Delayed Payments for the first 60 days after the due date, d) USD/PKR indexation for the purpose of ROE being capped at USD 148, e) all projects to be converted to "take and pay basis" from current "take or pay" basis after successful implementation of competitive trading agreement and, e) establishment and implementation of Competitive Trading Agreement. The following are the extracts from the MOU:

- For oil fired projects, any future savings in fuel shall be shared on a sliding scale starting from 70:30 in favor of the power purchaser for the first 0.5% efficiency improvement above currently NEPRA determined

Exhibit: List of power plants under Power Policy 1994 and 2002		
Plant under Power Policy 1994	**Ticker**	**Capacity (MW)**
Lalpir Limited	LPL	362
Pak Gen. (Pvt) Limited	PKGP	365
Altern Energy Limited	ALTN	31
Fauji Kabirwala Power Company		157
Gul Ahmed Energy Ltd. (GAEL)		136
Habibullah Coastal Power (Pvt) Co.		140
Japan Power Generation (Pvt) Limited		120
Kohinoor Energy Limited	KOHE	131
Liberty Power Project		235
Rousch (Pakistan) Power Limited		450
Saba Power Company Limited		134
Southern Electric Power Company Limited		117
Tapal Energy Limited		126
Uch Power Limited		586
Davis Energen Power Project		10.5
Kot Addu Power Company Limited	KAPCO	1638
Plant under Power Policy 2002		
Attock Gen Limited		165
Atlas Power Limited		225
Engro Energy Limited	EPQL	227
Saif Power Limited	SPWL	229
Halmore Power Generation Company Limited		225
Hub Power Project - Narowal	HUBC	220
Liberty Power Tech		200
Nishat Power Limited	NPL	200
Nishat Chunian Limited	NCPL	200
Orient Power Company Limited		229
Foundation Power Company (Daharki) Limited		185
Sapphire Electric Company Limited		225
Uch-II Power Project		404
Patrind Hydropower Project		147
Gulpur Hydropower Project		102

Source: PPIB

- Benchmark efficiency, followed by 60:40 for next 0.5%, followed by 50:50% for next 0.5%, and finally 40:60 for any efficiency above that.
- Power purchaser shall not share in any efficiency losses
- For oil fired projects, any future savings in O&M shall be shared 50:50 after accounting for any reserves created, or to be created, for major overhauling, to be reviewed by power purchaser or NEPRA as mutually agreed.
- For all future invoices, Delayed Payment Rate ("DPR") under the PPA shall be reduced to KIBOR + 2% for the first 60 days after the due date, and thereafter at KIBOR + 4.5% as per the PPA
- In future, for foreign equity investment presently registered with SBP, the Return on Equity ("RoE") including Return on Equity During Construction ("RoEDC") shall be 12% per annum, and for local investors, the RoE including RoEDC shall be changed to 17% per annum in PKR on NEPRA approved equity at CoD calculated at USD/PKR exchange rate of PKR 148/USD, with no future USD indexation
- The Government of Pakistan shall actively support the creation of competitive power markets. All projects shall convert their contracts to Take and Pay basis, without exclusivity, when Competitive Trading Arrangement is implemented and becomes fully operational, as per the terms defined in the license of each IPP. In the interim period, CPPA (G) shall work towards providing access to the bilateral market at the earliest.

MOU signed with plants under 1994 Power Policy

The MOU signed between the Negotiation Committee and the IPPs falling under 2002 Power Policy, include 4 key points namely a) CPP payment and variable O&M to be reduced by 11%, b) USD exchange rate and US inflation indexation shall be capped and discontinued on 50% of the reduced CPP component at NBP notified TT selling rate as on 12th-Aug-2020 which is 168.6 (Link), c) existing USD exchange rate and US inflation indexation to continue for the remaining 50% of the reduced CPP component and, d) establishment and implementation of Competitive Trading Agreement. The following are the extracts from the MOU:

- the MoU has, in the larger national interest, voluntarily agreed to provide concessions
- the existing capacity payments and variable O&M shall be reduced by 11%
- USD exchange rate and US CPI indexations shall be discontinued on 50% of the reduced capacity payment, which shall be fixed at National Bank of Pakistan's TT/OD selling PKR/USD exchange rate prevailing as on August 12, 2020 without any local or international currency indexation or inflation adjustment for the future
- USD exchange rate and US CPI indexations on reduced variable O&M and 50% of the reduced capacity payment shall continue as per existing arrangement
- The parties shall look into the possibility of termination of plants considering their' commercial and technical viability

Hub plant to negotiate on a separate agreement

According to the notice issued by HUBC through PSX, HUBC's 1200MW base plant does not operates under any policy, therefore amendments in 1994 policy will not apply to the Hub base plant. Another separate agreement is being negotiated with the Committee. We expect HUBC's unique U-shaped PCE (Project Company Equity) to limit the overall downside risk to any reduction in CPP (capacity payments) and capped indexation. We await further details on separately negotiated agreement for Hub plant. However, plants falling under 1994 policy such as LPL, PKGP and KOHE will likely face ROE contraction whereas receipt of overdue payments will be positive for cash flows.

ROE contraction to have minimal impact on Narowal

Operating under Power Policy 2002, Narowal (225MW), is likely to witness a far greater impact on its earnings vs. the base plant. While the capping of indexation at PKR148 to the Dollar, is less severe vs. 1994 amendments (USD/ PKR/168), the reduction in ROE. Moreover, in the event of conversion to Take and Pay contract (from Take or Pay previously), Narowal's earnings should drop even further. Under Take and Pay structure, capacity payments will be paid to IPPs on actual generation (vs. net rated capacity previously). We expect a 1% on average decline in earnings for Narowal from FY20 onwards with a 3% reduction in Narowal's TP.

Exhibit: Impact of changes on Narowal Plant

Based on changes in Power Policy 2002		EPS (PKR)				
PKR/share		FY21	FY22	FY23	FY24	TP
Key Macros						
	USD/PKR	148	148	148	148	
Narowal	Reduced ROE	(0.33)	(0.42)	(0.50)	(0.57)	(4.00)
	Total Impact	**(0.33)**	**(0.42)**	**(0.50)**	**(0.57)**	**(4.00)**
% of annual earnings		-1%	-1%	-1%	-1%	-3%

Take and pay conversion

As per our understanding, the take and pay agreement would be effective once Competitive Trading Arrangement becomes operational. Thus we have not incorporated Take and Pay contract into our assumptions for Narowal as we await further clarity on this front once detailed agreement is signed. Further elaboration on mechanism of overdue payments to IPPs and take and pay conversion would provide clarity on this matter. However, excluding overdue payments and assuming not reduction in short term borrowings and fixed costs, we expect Narowal's earnings to take a hit of PKR 1.8-2.0/share on conversion to take and pay basis assuming 4-5 months generation per annum.

KAPCO to benefit most from receipt of overdue payments

On account of net receivable position of FO based power plants, KAPCO is likely to benefit the most as it stands at net receivable of PKR 47bn whereas its PPA is expiring in 2021. NCPL and NPL are also key beneficiaries of receipt of overdue payments as their net receivable stand at PKR 7bn and PKR 13bn respectively. However, for HUBCO net position stands negative on account of higher short term borrowings.

Exhibit: Net Receivables position as at Mar-20				
PKR bn	HUBC	KAPCO	NCPL	NPL
Receivables	95.49	125.40	20.14	19.04
Payables	76.64	28.65	0.54	0.41
ST Borrowing	38.39	50.15	12.31	6.05
Net	(19.54)	46.59	7.30	12.58
No of shares	1,297	880	367	354
Net position (PKR/share)	**(15.07)**	**52.93**	**19.86**	**35.53**

Negotiation underway to review PPA's of power plants falling under CPEC

Pakistan has also received positive indications from Chinese authorities regarding negotiation of PPAs of IPPs falling under CPEC in the wake of rising circular debt. Although this is in the preliminary stages, details regarding negotiations are not available. There is likely possibility of debt restructuring of plants by increasing their tenure which would have no impact profitability wise but would enable in bringing down power tariff. However, a similar cut in CPP payments or capped indexation would have negative barring on earnings. Plants under CPEC include HUBC (Thar Energy, Thal Nova, CPHGC), Sahiwal, Engro Coal, Coal fired power plant, Sahiwal Coal, etc. Thus, any revision in coal projects under CPEC would be negative for HUBC.

Cut in ROE negative for all, while clarity awaited on circular debt and take and pay arrangement

While we await clarity on take and pay basis arrangement and mechanism for clearing overdue receivables of IPPs, we highlight that reduced ROE is likely to have negative barring for all 1994 and 2002 plants. However, upon receipt of overdue amounts we expect KAPCO, NCPL, NPL, LPL and PKGP to benefit the most on account of their net receivable position. While reduced ROE to have minimal impact on HUBC's earnings, we await details regarding separately negotiated agreement for Hub plant, however, we expect a similar arrangement to amendments in1994 policy. With possible debt restructuring of coal project, we foresee improved cash position for HUBC with receipt of overdue payments.

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