Nishat Power Limited

PKR32.2 - BUY

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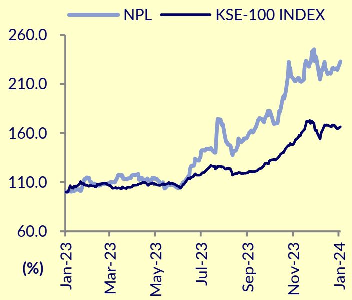
Pakistan

Power Generation & Distribution

Reuters	**NISH.PSX**
Bloomberg	**NPL PA**
Priced on 22 January 2024	
KSE100 @ 63,939,4	
12M hi/lo	PKR33.1/13.8
Dec-24 price target	PKR43.1
±% potential	+33.9%
Shares in issue	354.1m
Free float	159.3%
Mkt. cap	USD40.7m
3M ADV	USD0.1m

NPL vs KSE100 performance



Source: PSX, Bloomberg

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Dividend yield shines: A solid income play

Amid structural reforms, sustainable payouts on the horizon

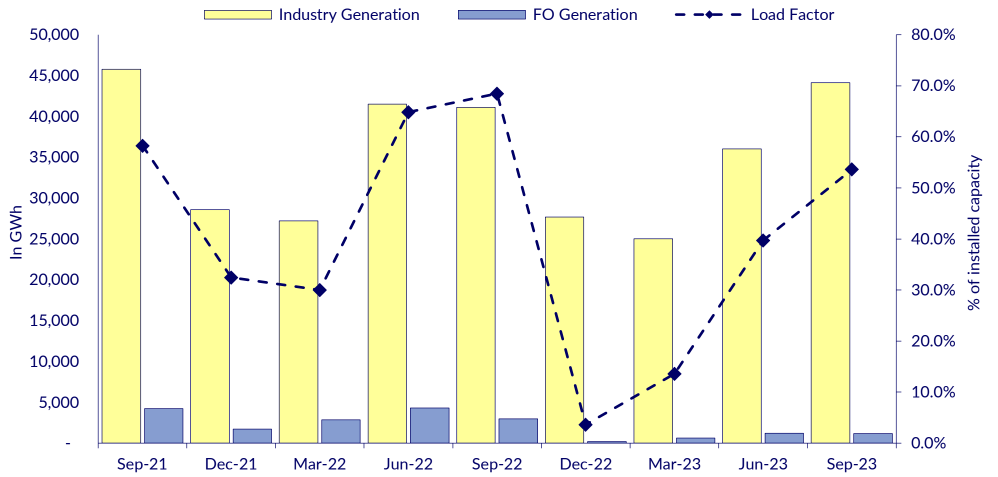
We initiate our coverage on NPL with a BUY call and target price of PKR 43.10/sh. Our proposed investment thesis is focused on structural reforms being undertaken by the State to curb circular debt in the power sector. The government has taken prudent steps towards easing receivable accumulation through subsidies and timely pass through of quarterly adjustments to end consumers. This has provided much needed room to the company to manage its working capital effectively via internal cash generation. Settlement of overdue receivables will alleviate liquidity concerns, allowing for higher distributions to investors.

Increased dividend payout on back of fiscal support and reforms: Although buildup of power sector circular debt is expected to continue, however, with the State committed to clearing its dues and with IMF mandated reforms being undertaken to increase cash collection from end consumers, we expect NPL's cash generation to improve over the long-run. Note that PKR310 billion has been earmarked for IPPs in the national budget for FY24 (3.3% of target tax receipts). This would help toward decelerating the accumulation of circular debt, giving NPL the flexibility to increase its distribution to investors. We anticipate a dividend yield of 18.7% in FY24.

Margins remain steady in face of declining load factor: In 5MFY24, NPL generated 231GWh of electricity, a 25% decline from the corresponding period last year. This decline can be attributed to seasonal effects and subdued demand and NPL's lower rank in the NTDC merit list. Furthermore, RFO based generation continues to shrink as the generation mix shifts towards more cost-effective sources i.e. renewables and coal. NPL has held its ground in terms of profitability by the virtue of its power purchase agreement (take or pay basis) which guarantees it income that includes the 17% ROE component even if its capacity is not utilized. In FY24, we estimate it to receive Rs 4.06bn of capacity payments (PKR 11.48/sh).

The plant's average utilization in FY23 was 31.4%. The capacity utilization of the plant has been relatively higher compared to that of its peers in an environment where RFO based generation is on decline. This is owing to its reciprocating engine technology that offers flexible dispatch with minimum maintenance penalties. Hence in times of peak demand from the power purchaser, it can address shortfalls

NPL Load Factor vs Industry Generation



Source: NEPRA, Alfalah CLSA Research

with ease. Moreover, after the expiry of its contract with Wartsila, operation & maintenance related activities have been moved inhouse allowing it to reap higher OEM savings. This however has been impacted by OEM savings being shared on 50:50 basis with the power purchaser. Below is the EPS impact of OEM savings expected at different utilization levels.

Figure 1

Scenario Analysis			
Capacity Utilization	0%	35%	60%
EPS Impact/sh	0.56	1.37	1.94

Source: Company Accounts, Alfalah CLSA Research

Lower oil prices to be a boon: The plant is the third plant commissioned under the 2002 policy. Demand destruction and build-up of U.S inventories has been putting a downward pressure on global crude oil prices. If the oil prices were to fall below the USD60/bbl benchmark, furnace oil offtake by the power sector would increase as it would rank higher in the dispatch merit order. This has the potential of increasing NPL's capacity utilization resulting in increased earnings, should it increase its fuel efficiency above the 45% benchmark.

Shift to market model: What to expect? Going forward, the power sector is expected to shift from a single buyer model to a wholesale market model where multiple buyers and sellers can engage in bilateral contracts. NPL has agreed once CTBCM model is implemented, its power purchase agreement basis will be amended from "take or pay" to "take and pay" which would render capacity payments redundant as revenue will be incumbent on the offtakes agreed. This can go in different directions for NPL i) it can negotiate to lock in a portion of its capacity payment structure retaining some elements of the "take or pay" provision. ii) acquire license to sell to bulk power purchasers or negotiate an industrial wheeling arrangement

Penal income from overdue receivables: NPL's net receivable position as of 1QFY24 is PKR17.6 Bn (PKR 49.70/sh). With interest rates at its highest, NPL has been able to rake in higher delayed payment markup on its receivables, this has not only mitigated the finance costs emanating from its short-term borrowing line but also contributed positively towards bottom-line growth. However, we anticipate interest rate cuts from Mar'24 would impact the income received (FY24E: PKR5.55/sh vs FY23: Rs 6.2/sh)

Recommendation: NPL is currently undervalued and trading at a forward P/E of 2.23x making it an intriguing opportunity for investors. It is characterized by substantial dividend, with consistent dividend growth throughout its life cycle, making it an excellent opportunity for income focused investors. We highlight a BUY call on the scrip with Dec-24 target price of PKR43.10/sh offering a 34% upside from the previous close. Together with its dividend yield, annual return is 53%.

Figure 2

Financials Snapshot					
Year till 30 Jun	FY22	FY23	FY24E	FY25E	FY26E
EPS	9.4	11.6	13.5	12.4	11.4
P/E	3.43	2.78	2.38	2.59	2.81
DPS (PKR/sh)	4.5	5.0	6.0	6.0	6.0
Div. Yield	14.0%	15.5%	18.7%	18.7%	18.7%
P/BV	0.41	0.38	0.35	0.33	0.31
ROA	10.4%	12.6%	14.8%	12.7%	11.0%
ROE	12.3%	14.1%	15.3%	13.1%	11.3%

Source: Company Accounts, Alfalah CLSA Research

Key methodology and triggers: NPL's Dec-24 Target price of PKR43.10/sh is based on the Dividend Discount Model.

Upside Risk

- Strong operating performance in line with NEPRA's stated benchmarks, increasing efficiency gains
- Lower exposure to circular debt due to sovereign cash injections

Downside Risk

- Unfavorable terms and conditions under the competitive trading agreement
- Acceleration of circular debt accumulation
- Increasing shift towards renewables and alternative sources of power of generation will result in the plant further sliding down the merit order
- Volatility in international crude prices, hindering capacity utilization

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