Alfalah CLSA

The Hub Power Co. Ltd.

PKR166.69 - BUY

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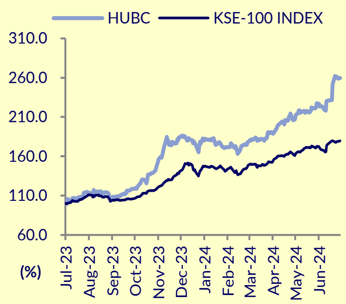
Pakistan
Power Generation & Distribution

Reuters	HPWR.PSX
Bloomberg	HUBC PA
Priced on 03 July 2024	
KSE100 @ 80,233.7	
12M hi/lo	PKR166.7/63.8
Jun-25 price target	PKR181.0
±% potential	+8.6%
Shares in issue	1,297.2m
Free float	75.0%
Mkt. cap	USD776.7m
3M ADV	USD2.4m

HUBC vs KSE100 performance



Source: PSX, Bloomberg

A Compelling Income Proposition

Amid structural reforms, sustainable payouts on the horizon

We initiate our coverage on HUBCO with a BUY call and Jun-25 target price of PKR 181/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 to stem the rise of circular debt through timely annual tariff rebasing, disbursement of allocated subsidies, and timely pass through of quarterly adjustments to end consumers. The State is now looking to undertake a new medium-term IMF programme which will require it to implement further structural reforms to stem the bleeding in the power sector starting with the privatisation of loss-making DISCOs. The reforms are expected to provide much needed room for the company to manage its working capital effectively. We believe that HUBC has long-term growth potential with regular dividend payouts in the foray (FY24E/FY25E D/Y 12.2%/13.5%).

CPEC based power projects to drive profits

HUBC has completed all of its expansion projects including its diversification into E&P operations via PIOGL. However, TEL and TNTPL are awaiting tariff true up which is a precondition for dividend issuance. We expect tariff readjustment in the mid of FY25 with the dividend payments starting by the end of FY25. CPHGC has also begun payouts in Dec'23, with proceeds being likely used for debt repayment by HPHL. After debt repayment ends, we expect a regular stream of dividends from Jun'25 onwards.

Resolution of Circular Debt to Boost Investor Confidence

Presently, the country's annual capacity payments are approx. PKR 1.9trn. In FY25, capacity payments are expected to swell to PKR 2.278trn with the addition of 1,002 MW in the same year.

The government had raised the base tariff by PKR 7.9/kwh in FY23 to narrow the gap between revenue required and collected by DISCOs. For FY25 the State has announced a PKR 5.7/kwh increase in the base tariff to contain growing capacity charges. Timely rebasing and quarterly adjustments will ensure that the circular debt accumulation rate does not accelerate, easing HUBC's counterparty risk. The move would brace expected dividend yield and payout, thereby, uplifting investor confidence in the stock's returns

Attractive Returns

HUBC's plants rank higher on the NTDC merit order which makes them more likely to receive payment from the government. This would improve HUBC's liquidity and ensure continued operations. Moreover, due to Chinese interest, CPEC power projects enjoy greater priority over non CPEC IPP projects. Currently, the company is trading at a forward P/E of 3.25x. We project earnings to increase at a 3-year CAGR of 13%

Financial Snapshot (Consolidated)

Key Metrics	FY22A	FY23A	FY24E	FY25E	FY26E
EPS	21.9	44.4	51.3	56.4	63.2
DPS	6.5	30.0	20.3	22.6	29.9
D/Y	3.9%	18.0%	12.2%	13.5%	18.0%
P/B	1.54	1.24	0.93	0.72	0.59
ROA	9.6%	16.0%	15.9%	15.9%	15.9%
ROE	26.4%	44.8%	40.2%	33.8%	30.1%

Source: Company Account, Alfalah CLSA Research

Broad based structural reforms to rein in circular debt

For decades, Pakistan's power sector has been plagued with a myriad of issues stemming from myopic energy policies and structural inefficiencies. Muted energy demand, underutilization of "take or pay" power capacity, excessive transmission and distribution losses, poor recoveries, and declining per capita electricity consumption all served to exacerbate the crisis and escalated circular debt accumulation until FY23. The circular debt stock as of Jan'24 has reached PKR2.63trn, out of which PKR1.76trn is payable to IPPs.

Figure 1

Key Circular Debt Statistics

	FY20	FY21	FY22	FY23	Jan'24
Circular Debt (PKR bn)	2,150	2,280	2,252	2,310	2,636
Payables to IPPs (PKR Bn)	1,038	1,245	1,351	1,434	1,760
Payables to GENCO	153	105	101	111	111
Amount Parked in PHL	1,007	930	800	765	765

Source: State of Industry Report, Ministry of Energy (Power), Alfalah CLSA Research

However, the State has already taken decisive steps to stem the bleed as any future programmes with the IMF are incumbent on concrete structural reforms being undertaken to keep circular debt accumulation in check. Below are the significant actions being taken by the government to arrest the pace of circular debt build up.

- **Timely Base Tariff Adjustment:** Under the Circular Debt Management Plan 2023, the state had notified annual basing in late Jul'23 as well as quarterly adjustments and monthly fuel adjustments increases later on. The base tariff was increased by PKR7.9/kwh for FY23-24. Whereas the average quarterly adjustment as of FY24 was PKR3.08/kwh.

- For FY25, another base tariff hike of up to ~PKR 5.72/kwh has been announced by the government, effective 1st Jul 2024. Considering the subdued demand over the year, we are expecting the country's annual capacity charge to surge on a per unit basis from current levels. Moreover, the government has committed to the IMF to maintain the circular debt level at FY23 levels which has already reached PKR2.7trn, this accumulation is expected to be contained using a mix of budgeted subsidies and tariff hikes before the end of FY24.

- **Crackdown on power theft:** According to NEPRA report, inefficient transformers and massive theft remain key components for T&D losses. Starting from Sept'23, the State launched a nationwide crackdown on electricity theft to curb line losses that have reached highs of 17%. Total recoveries as of date is PKR5.0bn. However, it is pertinent to note that structural inefficiencies continue to persist due to non-recoveries from AJ&K and Baluchistan.

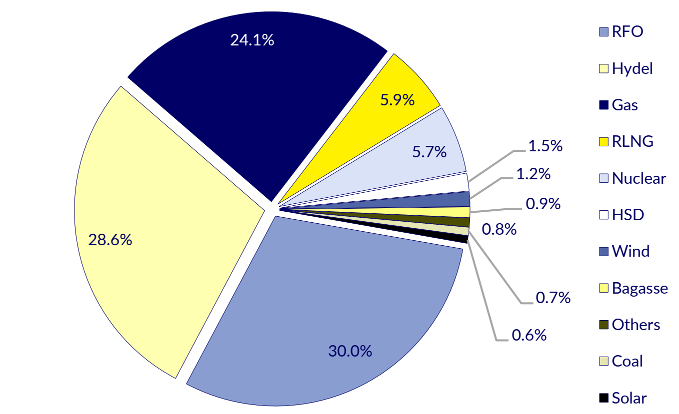
- **Rolling back of subsidies:** As stipulated by IMF, on Mar'23, the government ended power subsidies to zero-rated industries and the agricultural sector yielding savings of PKR60bn.

- **Privatisation of Power Distribution Companies:** According to the SOE consolidated report for FY22, DISCOS contributed PKR376bn in losses. The government has been, rightfully so, considering privatising loss-making power distribution companies (DISCOs) to curb financial losses and enhance operational efficiencies. In Feb'24, the CCOP approved a long-term concession model for two DISCOs namely GEPCO and HESCO where the entities will be given to the private sector on a 20 – 25 years contract lease arrangement. Currently, 10 DISCOS have been listed for the ongoing privatisation programme. IESC, GEPCO, and FESCO will be offered for complete privatisation in Phase I whereas LESCO, MEPCO, and HAZECO shall be offered for complete privatisation in Phase II.

- **Gradual shift away in the overall energy mix:** The government has committed itself to shift away from costlier sources of power mainly RFO in favour of Coal and Renewables. Pakistan's reliance on RFO and Gas has been gradually decreasing. During the period Jul-May 2024, power generation from RFO and Gas has cumulatively fallen by 480bps compared to the corresponding period last year. Whereas an uptick of 500bps has been seen in power generation from hydel and RLNG sources. In FY17, FO and coal comprised 30% and 1% of the total power generation respectively and currently, they account for 8.4% and 15.5% of the total power generation in FY24. Recently, the GoP has announced its intention of converting three imported coal power plants to Thar coal namely i.e. Port Qasim, Sahiwal, and Jamshoro (which is currently on the cards).

Figure 2

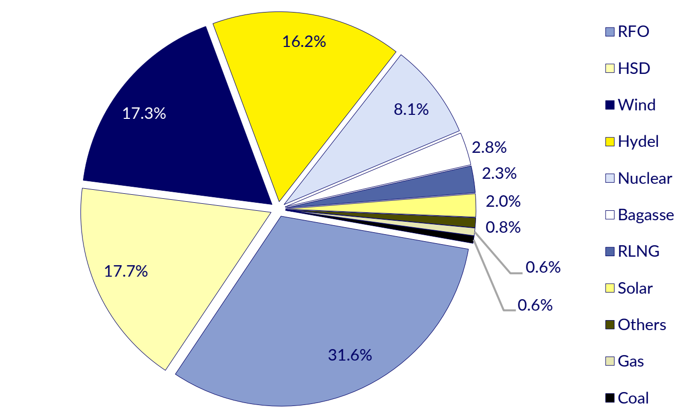
Fuel Mix FY17



Source: NEPRA, Alfalah CLSA Research

Figure 3

Fuel Mix 9MFY24



Source: NEPRA, Alfalah CLSA Research

Soaring receivables for CPEC power projects

It is also pertinent to note that in Dec'22, the Pakistan Energy Revolving Account was set as a means to cater to payment to CPEC power plant projects which allocates PKR48bn annually towards payment of payables with a monthly withdrawal limit of PKR 4bn. However., this has been in direct conflict with the tenets of the 2015 Power Policy which mandates allocation of sufficient funds to shield Chinese investors from the impact of circular debt. In Feb'24 alone the circular debt stemming from CPEC project soared to PKR487bn. At present, the State has confirmed that there will be no increase in the budgeted allocation to CPEC power projects. However fresh loans worth USD600mn to the State are conditioned on settlement of these dues. In the Finance Bill 2024, PKR 48 bn allocation towards the Energy Revolving Account has been reiterated.

There are also discussions underway to extend the debt repayment tenor of CPEC related power projects by 5 years which will reduce the tariff component by PKR0.18/kwh.

Budgeted subsidies increased

In efforts to contain the accumulation of circular debt, a hefty amount of PKR 1.19 tr has been earmarked as a subsidy for the power sector for the year FY25. This is a 104% increase from the subsidy utilized in FY24 i.e. PKR 584bn.

Figure 4

Subsidy to Power Sector

	Budget FY24	Revised FY24	Budget FY25	FY25 v/s FY24
Total Subsidy: WAPDA/KESC/PEPCO	**894**	**584**	**1,190**	104%
Subsidies for Tariff Differential to Agri Tube Wells in Baluchistan (PEPCO)	9.5	9.5	9.5	0%
Subsidies for Inter-DISCO Tariff Differential	150	150	276	84%
Subsidies for Ex-FATA	25	39	65	67%
Subsidies for Tariff Differential to AJK	25	25	108	332%
Pakistan Energy Revolving Fund (PERA)	48	0	48	
Provision for Power Subsidy	14	0	0	0%
Subsidies to KESC for Tariff Differential	171	228	174	-24%
KESC Subsidy Industrial Support Package	7	7	0	-100%
Subsidies for Tariff Differential to Agri Tube Wells in Baluchistan (KESC)	0.5	0.5	0.5	0%
GPPS – Equity	262	0	215	
Tariff Differential to AJK	55	55	0	-100%
TDS KE Arrears	127	70	88	26%
FATA Subsidy Arrears	-	0	86	
Additional Subsidy	-	-	120	

Source: State of Industry Report, Ministry of Energy, Alfalah CLSA Research

The Hub Power Company – Conglomerate

As of June 30 2023, Pakistan's total installed capacity is 45,885 MW out of which HUBCO's share is 7.7%. It is one of the largest IPPs in the country with a gross capacity of 3,581 MW.

The company is a group of diverse power generation projects ranging from RFO to Local Coal. Among its different power projects, three are listed under CPEC, offering guaranteed higher ROE compared with other projects. Moreover, the ROE component is pegged to the U.S. dollar hedging it from PKR devaluation and enabling it to lock in healthy income flow. The company has a history of stable dividends amid increasing circular debt.

Figure 5

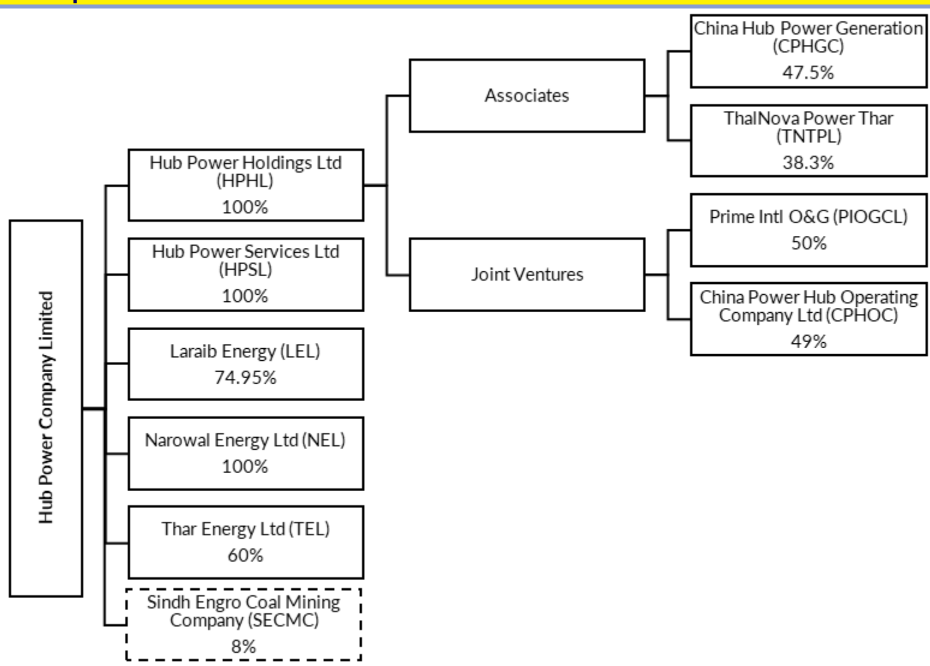
HUBCO's Power Projects

Project Name		HUBC	NEL	LEL	CPHGC	TEL	TNPTL
Gross Capacity	*in MW*	1,292	225	84	1,320	330	330
Technology	*Type*	Regenerative Steam Boilers	Reciprocating Engines	BULB Turbines	Super Critical Pulverized Coal	Sub Critical CFB	Sub Critical CFB
Fuel Source		RFO	RFO	Hydel	Imported Coal	Thar Coal	Thar Coal
Holding	%	**100%**	**100%**	**75%**	**46%**	**60%**	**38%**
Benchmark Efficiency	%	39%	45%	90%	39%	37%	37%
COD		3/31/1997	6/9/2010	3/23/2013	10/1/2022	2/17/2023	3/31/1997
PPA Term	*Years*	30	25	25	30	30	30
Time left for PPA Expiry	*Years*	2.84	11.04	13.83	25.24	28.36	28.75
Project Cost	*USD Mn*	1,600	270	220	1,995	525	525

Source: PPIB, Company Corporate Briefing, Alfalah CLSA Research

Figure 6

HUBC Group Structure



Source: Company Accounts, Alfalah CLSA Research

Hub Base Plant – Conversion to Coal Based Generation on the Cards

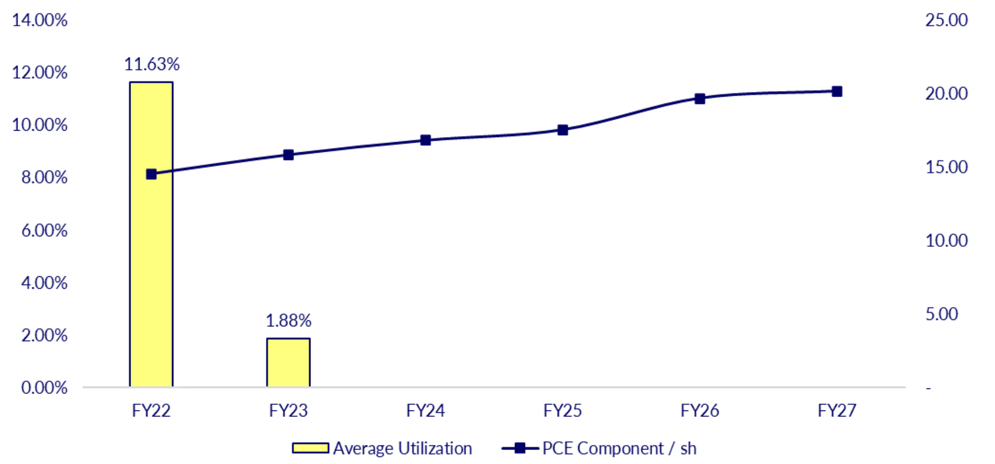
HUBC's RFO based power plant has been operational since 1997 and currently has a remaining term of 3 years. The load factor of the plant has been declining since FY19 and has fallen to 0% in recent quarters due to power evacuation issues from South to North and there have been significant capacity additions with lower variable costs. The proposal to terminate its PPA earlier is still up in the air and no conclusive result has been reached so far.

HUBC has signed a MOU with KE to enter into a new PPA which would entail the conversion of two of its turbines to Thar coal. This would require significant capex and feasibility studies to ensure an attractive ROE is achieved. For now, we have assumed that the base plant will no longer be operational after the PPA ends.

It is pertinent to note that the plant enjoys a U-shaped ROE curve (also called Project Company Equity) meaning that it escalates biannually. The ROE component began a fairly steep ascent in FY20 and continues to grow to date and this is despite the component being indexed at PKR168/USD in FY22. We estimate that the PCE component alone will increase by PKR 0.98/sh adding to HUBC's bottom-line in FY24 and it will peak increasing by PKR 4.33/sh at the end of the PPA term. This shows an organic growth in earnings despite removal of USD indexation in FY22.

Figure 7

PCE Component Graph



Source: NEPRA, Company Accounts, Alfalah CLSA Research

Narowal Plant – Still relevant even after decline in RFO based power generation

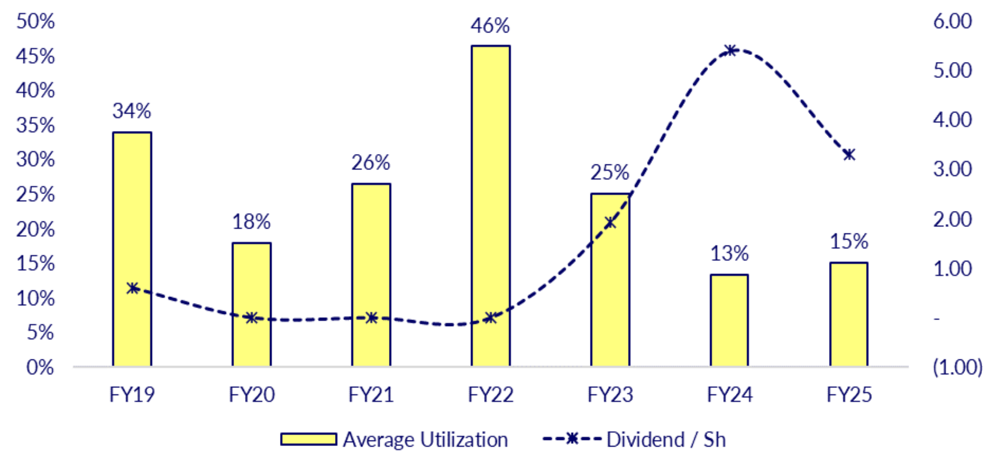
Similar to other RFO plants, the load factor for the Narowal plant has been declining since FY19 and rising during peak seasons. The declining demand for power has also contributed to its declining load factor. Keeping that in mind, we have projected 25% utilization on average for the remaining of its PPA term considering it is ranked relatively higher on NTDC's merit order list (38/74 as of May'24). The plant also enjoys O&M savings (FY23: PKR 0.83/sh) on account of it being maintained inhouse by Hub Power Service Limited.

Periodic circular debt settlement has enabled it to pay out dividends biannually. In Jun'23, NEL received PKR2.5bn giving it a much-needed liquidity boost. NEL's low rate of trade debt accumulation will give it ample room to pay out timely dividends. We expect that NEL will pay PKR3.29/sh to its parent in FY25.

Moreover, the project is estimated to add PKR14.1/sh to HUBC's total valuation.

Figure 8

NEL Dividend Vs Average Utilization Factor



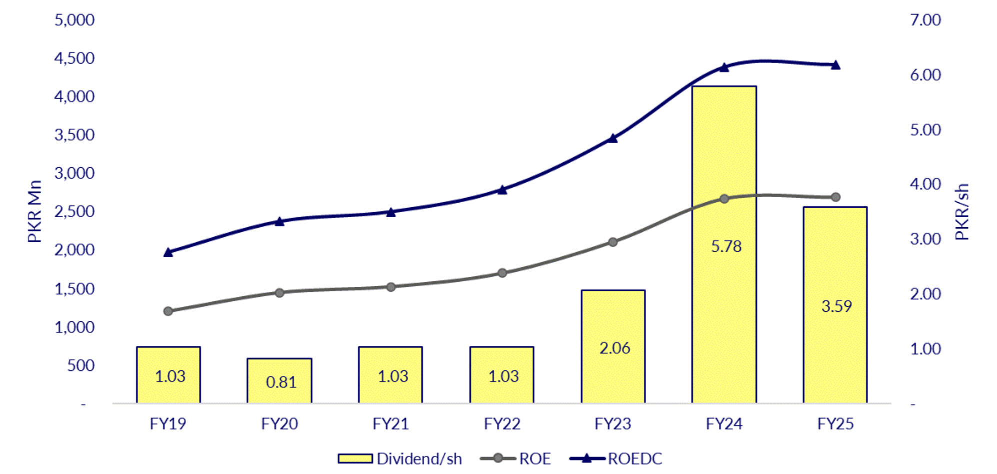
Source: NEPRA, Company Accounts, Alfalah CLSA Research

Laraib Energy – Steady dividend payout to continue

LEL is HUBC's hydel based IPP and had an average load factor of 47% in FY23. It has maintained its dividend payout over the years since it has negligible fuel expenses. Moreover, its ROE & ROEDC component remains indexed to the USD. As of Feb'24, its overdue receivables stand at PKR7.7b bn. Our calculations suggest it contributes PKR 23.2/sh to HUBC's total valuation.

Figure 9

LEL Dividend Vs ROE & ROEDC Component



Source: Company Accounts, Alfalah CLSA Research

China Power Hub Generation – Dividends set to increase; tariff readjustment remains a concern

CPHGC is HUBC's first coal-based power plant that commenced operations in Sep'19 adding 1,292MW capacity to the aggregate. The project offers an attractive ROE of 27.2% (USD and inflation hedged; PKR3.4528/kwh as of Mar'24)

Transmission constraint pressing down on utilization levels: The plant is based exclusively on imported coal however due to import restrictions placed in FY23, a mix of local coal and imported coal was used to power the plant. The plant's utilization levels have fallen since Sep'22 from an average of 70% in FY23 to just utilization level of 14% in 9MFY24 on account of power evacuation constraints. But one silver lining is that the plant is ranked relatively higher on NTDC's merit list (15/74 as of 1st May 2024) with a fuel cost of PKR13.18/kwh. We expect that the plant's utilization levels should improve by FY25.

Positive dividend outlook: CPHGC achieved Project Completion status in Feb'23, enabling it to commence dividend payments and disburse its first dividend payment of PKR9.2bn to HUBC in Dec'23. Moreover, HUBC also stands relieved of maintaining USD150mn standby letter of credit for CPHGC thereby improving its cash position. We expect, that as circular debt accumulation decelerates CPHGC would be in a better position to make increased dividend payments. However, dividends are being utilized by HPHL for debt repayment. As per our estimates, dividend payments to HUBC for FY25 is PKR9.03/sh.

Tariff true-up remains a wildcard: In Jun'22, NEPRA announced its decision for CPHGC's tariff readjustment. With reference to the ROE component, the project cost was revised downwards (↓13.2%) from USD 1.53bn to USD 1.33bn and consequently the reference ROE component to PKR1.0034/kwh (↓ 31%). CPHGC contested this and obtained a stay order against the decision. Currently, the matter is under the appellate tribunal for review.

Note that the revenue and earnings projection for CPHGC is based on the upfront tariff as of now. Any change in the ROE component post project cost revision would significantly impact the earnings. Precedent was established in the case of Port Qasim Electric Power Company (PQECL) where true-up resulted in a 31% reduction in the ROE component. Below is a sensitivity table showing the impact of ROE revision on EPS.

Figure 10

Sensitivity of ROE Component Revision of CPHGC on HUBC

	ROE Component (% Change)							
	25%	20%	15%	10%	-10%	-15%	-20%	-25%
FY25	3.22	2.58	1.93	1.29	(1.29)	(1.93)	(2.57)	(3.22)
FY26	3.71	2.97	2.23	1.48	(1.49)	(2.23)	(2.97)	(3.71)
Valuation	11.67	8.52	10.70	7.16	(9.59)	(13.31)	(14.20)	(17.63)

Source: Company Accounts, Alfalah CLSA Research

As a base case, our DCF valuation does not account for ROE reduction, CPHGC is estimated to contribute PKR64/sh via 46% HUBC's ownership.

Chinese investors to rebuff any PPA negotiations attempts: Pakistan has entered into negotiations with the IMF regarding a new and longer-term loan programme. The IMF has long called for reforms in the power sector, which includes revisiting

PPA agreements. CPEC related projects are more or less insulated from this due to vested Chinese debt and equity interests.

In July'23, CPHGC received PKR9.21 bn to reduce its burgeoning receivables. The company's overdue balance stands at PKR93 bn as of Feb'24.

Thar Energy Limited – Local Coal to Power Profits

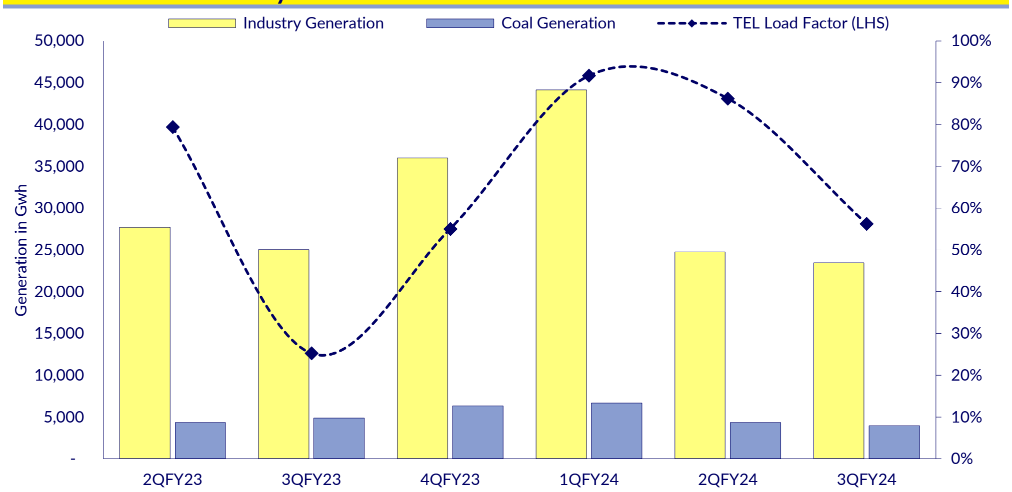
TEL is a 330MW mine mouth coal-fired power plant that commenced operations in Oct'22. Currently, both TEL and TNTPL are the highest-ranking power projects on the NTDC's merit list with a variable cost of PKR4.27620/kwh and PKR4.2750/kwh respectively as of Jul'24. This ensures regular offtakes even in the face of muted demand.

Significant debt savings adding to bottom-line: The project offers an attractive ROE of 30.65% with USD indexation and uses indigenous Thar coal as fuel. Moreover, it also incurs significant debt savings as capacity payments are benchmarked to 100% foreign financing whereas in actuality 33% of its debt profile comprises of KIBOR-linked local loans and 66% LIBOR-linked foreign loans. We estimate that the debt savings have a positive impact of PKR1.8/sh on HUBC's valuation. As a base case, our DCF valuation has been adjusted to remove the impact of debt savings in future earnings.

Tariff True Up to Rationalize Savings, Dividend Payment to Commence: Considering that the average time for a tariff true up is three years, we estimate that the tariff true up for TEL will occur towards the end of FY25, whereafter dividend payments should begin. Additionally, we have also factored in the rationalization of debt savings in our earnings calculation. We are expecting dividend of PKR 5.45/sh to be paid to HUBC in FY26.

Figure 11

TEL Load Factor vs Industry Generation



Source: NEPRA, Alfalah CLSA Research

Pending Liquidated Damages: Note that the RCOD for TEL was revised from Mar'21 to Nov'21 due to COVID-19 subject to the condition that TEL will ensure payment of charges from the COD of HVDC line amounting to USD 15mn (USD1.9mn/mth). TEL has challenged this and sought clarification regarding the COD of the HVDC line. Moreover, TEL achieved COD in Oct'22 (a delay of 10 months) which deems it liable to pay liquidated damages of USD0.75mn/mnth.

Consequently, CPPA-G has invoiced TEL USD7.7mn as of Jun-23 and the payable has been recorded by TEL accordingly.

ROE Reduction a possibility in COD Tariff: As per TEL's upfront tariff, the capital cost of USD408mn will be indexed to U.S PPI Machinery and Steel prevailing during the validity period. The validity period is between Jun'14 and Oct'16 (the time the upfront tariff was accepted). Calculations with the relevant indexation point to a 10% reduction in capital cost which would warrant a downward revision in the ROE component. Moreover, we expect further threats of adjustments such as upward revision in the reference exchange rate and KIBOR/LIBOR rates which would negatively impact returns.

ThalNova Power Thar Ltd – Promising outlook but risks remain

Similar to Thar Energy Limited, TNPTL is a 330MW mine-mouth coal-fired power project that commenced operations in Feb'23. Like TEL, TNPTL is prioritized in the NTDC merit list and has a high utilization factor

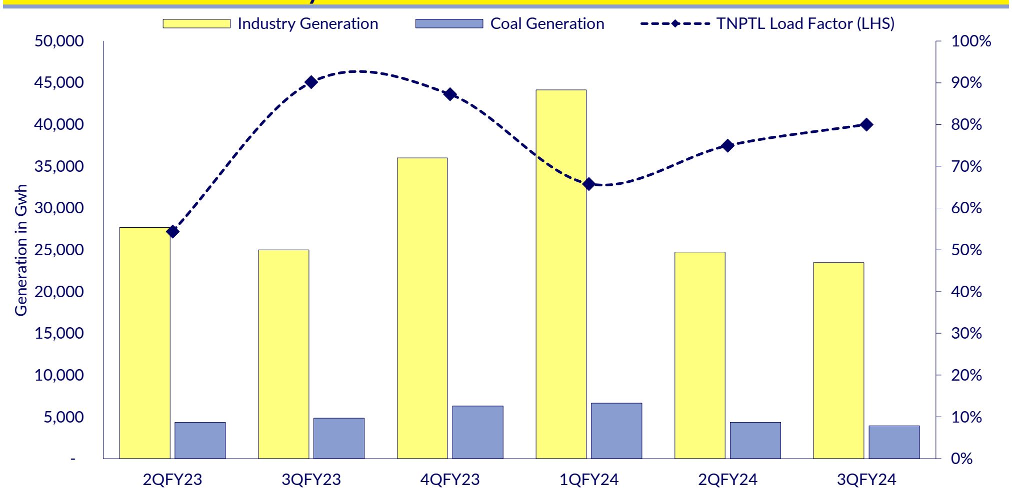
Incurring fuel losses compared to TEL: During periods of high utilization, TEL achieves fuel efficiency gains. However, TNPTL has consistently shown lower fuel efficiency levels from its inception with the average efficiency in 9MFY24 being 36.89% (Benchmark: 37%) against an average utilization level of 76%.

Significant debt savings: TNPTL also enjoys debt savings as capacity payments are benchmarked at 100% foreign financing whereas its actual debt is 33%:67% local: foreign. We estimate that the debt savings contribute PKR 2.67/sh towards HUBC's valuation. As a base case, our DCF valuation has been adjusted to remove the impact of debt savings in future earnings.

Dividend payment to commence upon Tariff True up: Just as TEL, we expect the tariff true up for TNPTL to occur towards the end of FY25 after which it will commence paying dividends to HUBCO. We estimate a dividend payment of PKR3.78/sh for FY26 to HUBC.

Figure 12

TNTPL Load Factor vs Industry Generation



Source: NEPRA, Alfalah CLSA Research

Rationalization of costs and revenue during Tariff True Up: TNPTL has the exact same capital cost as TEL i.e. USD408 Mn. Based on the indexation mechanism, it is expected that upon tariff true up the capital cost would be reduced by 10% which in turn will result in the ROE component being revised downwards. We also expect adjustments to other components such as the debt-equity ratio, interest spread, and fuel along with rationalization of debt savings.

We have not factored in potential ROE reduction in our calculations, but the sensitivity table below shows the impact on earnings.

Figure 13

Sensitivity of ROE Component Revision of TEL & TNTPL on HUBC

	ROE Component (% Change)							
	25%	**20%**	**15%**	**10%**	**-10%**	**-15%**	**-20%**	**-25%**
EPS FY26 - TEL	2.11	1.69	1.27	0.84	(0.84)	(1.27)	(1.69)	(2.11)
EPS FY26 - TNPTL	2.10	1.68	1.26	0.84	(0.84)	(1.26)	(1.68)	(2.10)

Source: Company Accounts, Alfalah CLSA Research

Lower Liquidated Damages Payable: It is pertinent to note that the RCOD for TNPTL was revised from Mar'21 to Jun'22 due to COVID subject to the condition that TNPTL will ensure payment of HVDC charges from the COD of HVDC line of USD 72mn (upto USD1.9mn/mth). Much like TEL, TNPTL has also challenged this and sought clarification regarding the COD of HVDC line. Moreover, the project achieved COD in Feb-23 (a delay of 237 days) which deems it liable to pay liquidated damages of USD0.75mn/mth. However, the company has sought extension of its RCOD by 237 days which would in turn absolve it of the penalty. The company has not allocated any provision for this liability.

Sindh Engro Coal Mining Company– The Gift that keeps on giving

HUBC had acquired an 8% stake in SECMC injecting USD15.5mn (@ Share price – PKR14.08). The mine had achieved COD for Phase I in Jul'19 and Phase II in Oct'22 increasing the mine capacity from 3.8mtpa to 7.6mtpa. Currently, SECMC is working on Phase III of the project which will increase the mining capacity to 11.2mpta and lower Thar coal price which is currently hovering around USD45/ton to USD32/ton. We estimate that Phase III would be operational by late FY25.

Assuming an 80% payout ratio, the dividend payments to HUBC are estimated to be PKR 0.42/sh in FY25 and PKR 0.74/sh in FY26 (this includes the intra-corporate dividend taxation)

Moreover, the company is in the process of purchasing a stake from HBL as part of its strategic investments and expansion process. This will increase HUBC's stake from 8.00% to 17.50% making it the second largest shareholder in SECMC after the Government of Sindh. We have not incorporated the increase in stake in our valuations as the timeline of the share purchase agreement is ambiguous. However, increasing the stake in FY25 would increase dividend payments to PKR0.91/sh in FY25.

Prime International Oil & Gas Company – Venturing into Oil & Gas Exploration

HUBC entered into the E&P space by acquiring a 50% stake in ENI Pakistan (Now Prime International) through its subsidiary HPHL. Presently, ENI has major working interests in Bhit/Badhra (40%), Kadanwari (18.42%) and shared permits in Latif (33.3%), Zamzama (18%), and Sawan (24%). Recently, the company won the bid for S.W Miano III and the project is in the planning stage with clearance expected from the DGPC. Following this, an exploration license will be awarded.

As of CY23, the company holds 123.4 bcf of gas reserves with an average reserve life of 2.3 years.

Below are the latest production statistics for the fields under HUBC

Figure 14

HUBC - Exploring upstream oil & gas sector

Major blocks	Working interests	Oil production (bopd)	Gas production (avg./day mmscfd)
Latif	33%	5.32	2.8
Miano	15%	1.7	2.2
Zamzama	18%	5.9	1.1
Kadanwari	18%	1.2	3.5
Bhit	40%	25.6	16.8
Badhra	40%	14.6	9.1
Sawan	24%	-	7.9
Tajjal	24%	-	-
Rehmat	30%	-	-
Saqib	30%	0.3	0.4
Mitha	30%	-	-

Source: PPIS, Alfalah CLSA Research
*Production numbers as of 3MCY24

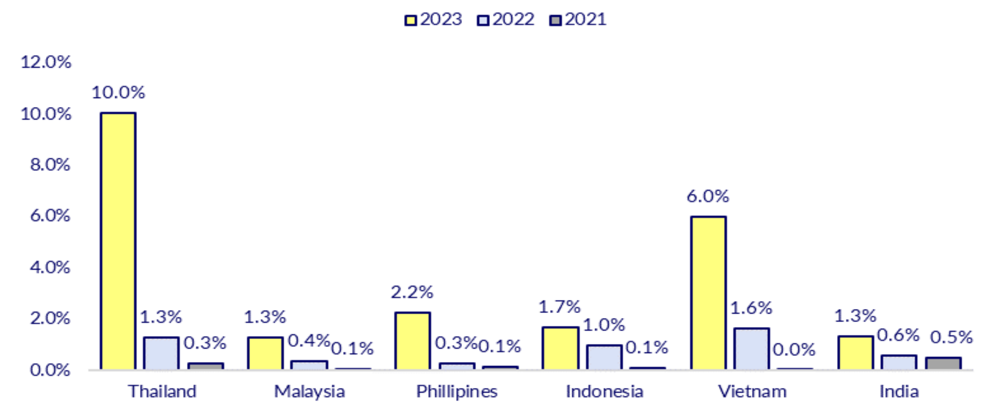
BYD – Introduction of EVs

In Mar'24, it was announced that leading EV manufacturer BYD (Build Your Dreams) is entering the Pakistani market through a local partnership with HPHL, wholly owned subsidiary of HUBC.

Currently BYD is making a beeline for the ASEAN market, having a strong presence in countries such as Thailand, Malaysia and Singapore and is planning to make its debut in the Philippines, South Korea and Vietnam.

Figure 15

EV Adoption Rate (as % of Total Passenger Car Sales)



Source: IEA, Alfalah CLSA Research

Although the share of electric vehicles is still modest in these countries, there are clear indicators for the emergence of this market. BYD's Ocean and Dynasty models are the globally best-selling models currently with BYD Atto 3 SUV leading in the South East Asia market. BYD offers both PHEV and BEV vehicles

Figure 16

Popular BYD Models

	Type	Model	Price in USD	Estimated PKR Price in '000	Battery Capacity in kwh	Comparable Models
BEV	**SUV**	**Atto 3**	19,283	8,768	60.48	Cross 1.8 HEV, Haval H6, Jolion, Santa Fe, Oshan -X7, Tiggo Pro 8
BEV	**Hatchback**	**Dolphin**	13,749	5,334	44.9	Swift, Honda City, Toyota Yaris
BEV	**Sedan**	**Seal**	24,771	11,263	82.56	Corolla Cross Mid-Grade, Deepal S07
BEV	**Hatchback**	**Seagull**	9,506	3,688	38.88	Cultus, Wagon R,
PHEV	**SUV**	**Song Plus DM-i**	27,526	12,658	18.3	Honda CR-V, Omada E5, MG HS Essence
PHEV	**Sedan**	**Han DM-i 4WD**	30,282	12,379	15.2	Honda Accord, Deepal S07

Source: Company Website, Alalah CLSA Research

Pakistan's low EV penetration presents an excellent opportunity for BYD and the potential returns to HUBC can be substantial if EVs are widely adopted by consumers in Pakistan. We present two scenarios to give further insight.

Considering the EV adoption trend in the past three years of comparable countries, we have assumed that the EV adoption rate of Pakistan will grow to 1% initially and hit 3% in the next five years. Our revenue estimate for BEVs (Battery Electric Vehicles) is based on a 75:25 sales mix of the BYD Atto 3 and BYD Dolphin which are the most likely models to be launched in Pakistan.

Moreover, the share of locally assembled hybrid vehicles in the Pakistani market is 12.82% and dominated by Corolla Cross, Haval and Hyundai's Santa Fe. If BYD were to introduce PHEV models such as the Song SUV or Han (Sedan), it could displace the current hybrid front runners. Revenue estimate from PHEV sales is based on the pricing of BYD Song adjusted for local taxes and custom duties.

Whereas in case of EVs, BYD would be the market leader in locally assembled electric vehicles since currently BEVs are being sold as CBU units by select companies such as MG.

Contribution margin has been assumed at ~ 25% with Net Profit Margin ~ 10% with HUBC's share in the JV arrangement at 50%

- **Scenario 1:** Passenger car market increases to hit the average of the past five years i.e. 159,659 units.
- **Scenario 2:** Passenger car market expands to 2018 peak levels in line with higher economic growth i.e. 258,792 units.

Figure 17

Scenario Analysis

	Units	Scenario 1	Scenario 2
Industry Estimate	No. of cars	159,656	258,792
HEV Market Share%	%	12.82%	12.82%
HEV Market Share% after BEV introduction	%	9.82%	9.82%
BYD's Share in Pakistan's HEV Market	%	50.00%	50.00%
PHEV & HEV Sale Estimate	No. of cars	7,841	12,710
Revenue	PKR Mn	99,249	160,876
PBT	PKR Mn	9,925	16,088
PAT	PKR Mn	6,054	9,813
% Share of HUBC	PKR Mn	3,027	4,907
EV Adoption Rate	%	3.00%	3.00%
EV Cars Sale Estimate	No. of cars	4,790	7,764
Revenue	PKR Mn	37,882	61,405
PBT	PKR Mn	3,788	6,141
PAT	PKR Mn	2,311	3,746
% Share of HUBC	PKR Mn	1,155	1,873
EPS Impact on HUBC	PKR/sh	3.22	5.23
Valuation per share (Incremental)	PKR/sh	15.4	24.9

Source: Company Website, Alfalah CLSA Research

In both scenarios, the JV agreement adds considerable value to HUBC's valuation and is set to increase its earnings. Another interesting fact is BYD's Seagull which is a direct rival to Suzuki's Cultus and Alto and is more competitively priced. If BYD were to introduce this model to the Pakistani market, it has the potential to bite into the local auto assemblers' market share. However, the likelihood of this model being debuted is low in the initial phase as high-end models are relatively price inelastic and are more likely to be absorbed by the market than lower end models.

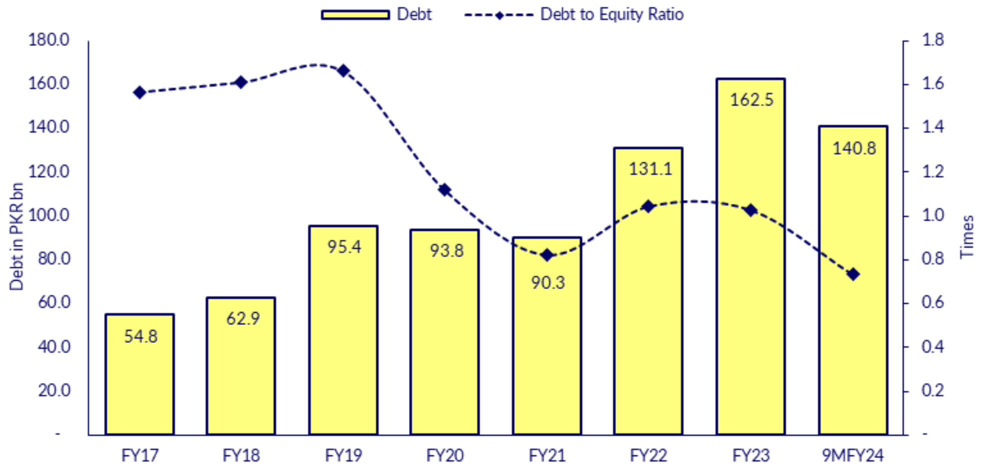
Better dividend scorecard anticipated – Cash position improving

The addition of coal-fired power plants under the CPEC umbrella is a boon for HUBC as the profits from these plants remained indexed to the USD-PKR rate, unlike its older plants. Our DPS estimates for FY24/FY25 are PKR20.2/22.5 respectively.

HUBC has maintained its track record of stable dividend payouts through efficient working capital management. As per Mar'24, the company's total trade debt is at PKR 104 bn on a consolidated basis. As of Feb,'24, overdue receivables of the base plant amount to PKR 55 bn, while NEL, LEL, and CPHGC stand at PKR 8.5bn/7.7bn/93 bn respectively.

Figure 18

HUBC Debt Position



Source: Company Accounts, Alfalah CLSA Research

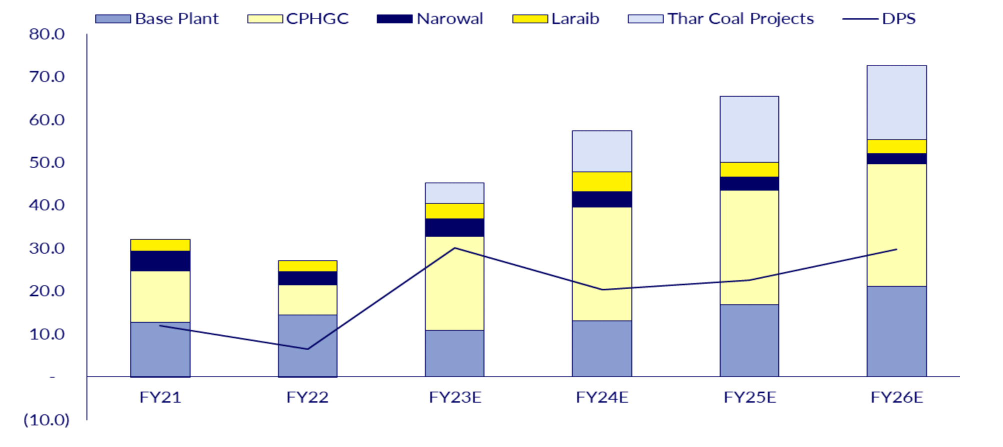
Recommendation

We reiterate our BUY call on the scrip, an upside of 8.8% and a dividend yield of 12.2% bringing the total return to 21%. Structural reforms mandated by the IMF are being implemented in letter and spirit. Circular debt levels have been contained barring the slippage in Oct'23 due to under-recoveries. Circular debt accumulation is expected to slow down, unlocking value for HUBCO as free cash flow would be available for distribution and strategic investments. The stock still appears to be considerably undervalued today trading at a forward P/E of 3.25x. As such, it is not too late to begin taking a position and profiting from the company's forward growth.

We expect HUBC's EPS at PKR 51.2/56.4 in FY24/FY25. Consistent growth along with a reasonably high dividend yield justifies our BUY stance on the scrip.

Figure 19

Earnings contribution from subsidiaries (PKR/sh)



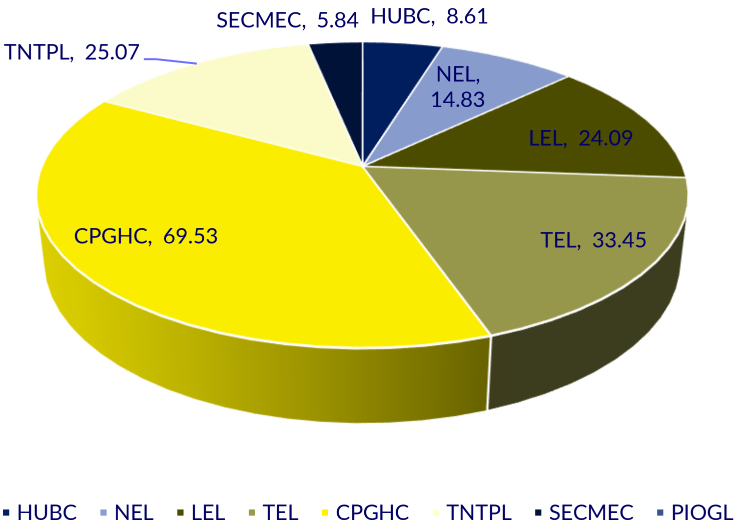
Source: Company Accounts, Alfalah CLSA Research

Key Valuation Methodology

HUBC's Target Price is based on the Sum of Parts Methodology wherein individual projects have been valued using the Dividend Discount Model.

Figure 20

Sum of Parts Valuation



Source: Company Accounts, Alfalah CLSA Research

Investment Risk

Upside Risk

- Further PKR/USD depreciation
- Resolution of circular debt pertaining to CPHGC through increased budgetary allocation
- Tax exemption on inter-corporate dividends

Downside Risk

- Tariff renegotiation with CPEC-based plants
- Delay in implementation of annual rebasing of tariff, QTA and FCAs
- Increase in WHT rate on inter-corporate dividends
- PKR- USD appreciation
- Reduction of ROE component or removal of USD indexation for CPEC power plants

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