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Insight Securities

Pakistan Economy

Gas tariff hike: Respite for some; trouble for others

ECC has finally approved the much anticipated increase in gas tariff, effective from Nov'23. Tariff for residential sector has increased by ~29%-173%, while non-resident sector witnessed an increase of ~5%-193%. This tariff hike was long overdue as gas circular debt was growing at a rapid pace and is estimated at ~PKR2.9tr. Rationalization of energy tariffs is key demand of IMF as mentioned in staff report. Gov't has also increased the fixed monthly charge for protected consumers from PKR10 to PKR400 and for non-protected consumers, it has been increased from PKR460 to PKR1,000-2,000. The increase in gas tariff will slow down the pace of accumulation of gas circular debt, thus improving the liquidity position of gas utility companies (SSGC & SNGP) and will unlock the valuation of cash strapped exploration companies (PPL & OGDC).

Second round impact to keep CPI elevated

As we anticipate the official notification from OGRA, news reports indicate a gas tariff increase ranging from ~29%-173% across various consumer categories. This adjustment is expected to have a marginal impact of ~65bps on Nov'23 inflation print, given that gas prices hold a relatively modest share of 1.08% within the CPI basket. However, the second round impact of the said hike will be reflected in prices of food and other items, which tend to be more persistent and sticky.

Cashflows to improve for energy chain

The increase in gas prices is expected to have a cascading effect on energy chain, primarily benefiting E&Ps. Their future cash flows are set to improve significantly as a result of these price hikes, which will boost their future cash flows, improving their financial health which will help them in undertaking new exploration projects.

Similarly, Sui companies will also witness improvement in cash collection which will alleviate the ongoing issue of gas circular debt by reducing its future accumulation. Additionally, Pakistan State Oil (PSO) is also expected to benefit from this situation. With improved cash collection resulting from the higher gas prices, PSO should see a reduction in the accumulation of receivables. This is a positive development for the company, addressing its financial constraints.

Fertilizer sector

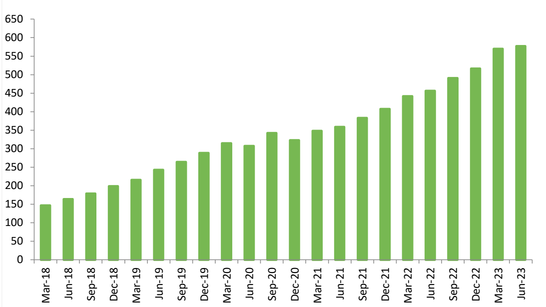
The ECC has finally approved the much-anticipated gas price hike for the fertilizer industry. To highlight, previous adjustment in gas tariffs caused confusion within the sector as only SSGC and SNGPL network gas prices were increased, while the MARI network plants continued to receive gas at previously prescribed rates. This situation resulted in a notable discrepancy in urea prices, which currently stands at PKR3,410 for EFERT, PKR3,210 for FFC, PKR3,595 for FFBL, and PKR3,210 for FATIMA/SARSABZ, respectively.

Nov'23: Proposed increase in gas tariff (PKR/mmbtu)

	Exsisiting rate	Proposed rate	%▲
Non-Protected			
Up to 1 hm3/month	400	1,000	150%
Up to 1.5 hm3/month	600	1,200	100%
Up to 2 hm3/month	800	1,600	100%
Up to 3 hm3/month	1,100	3,000	173%
Up to 4 hm3/month	2,000	3,500	75%
Above 4 hm3/month	3,100	4,000	29%
Bulk	1,600	2,000	25%
Special Commercial (Roti Tandoor)	697	697	0%
Commercial	1,650	3,900	136%
Power			
KE, SNPC, EPQL	1,050	1,050	0%
Liberty	2,406	3,890	62%
Fertilizer			
Feed (Engro)	200	200	0%
Feed (FFBQL)	510	580	14%
Fuel	1,500	1,580	5%
Cement	1,500	4,400	193%
Export Industries			
Process	1,100	2,050	86%
Captive	1,100	2,050	86%
Non Export Industries			
Process	1,200	2,600	117%
Captive	1,200	2,600	117%
CNG	1,805	4,400	144%

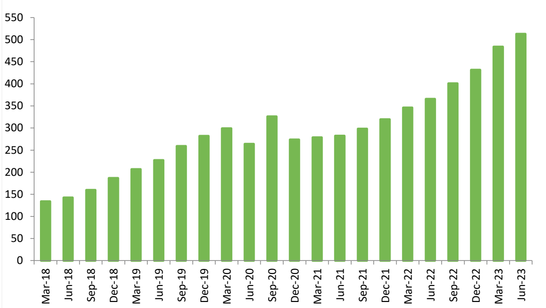
Source: News, Insight research

OGDC Trade Debts (PKRbn)



Source: Company Accounts, Insight Research

PPL Trade Debts (PKRbn)



Source: Company Accounts, Insight Research

Per bag increase in cost of production of urea

Company	PKR/bag
FFC	529
EFERT	164
FFBL	86
FATIMA	414

Source: Insight Research

Insight Research[AC]

research@insightsec.com.pk

+92-21-32462541 Ext 114

If the proposed gas price hike is extended to all networks, including SSGC, SNGPL and MARI, the implications will differ. For plants relying on SSGC and SNGPL, feed and fuel costs are expected to increase from PKR510/mmbtu and PKR1500/mmbtu to PKR580/mmbtu and PKR1,580/mmbtu, respectively. Meanwhile, for those on the MARI network, the increase would be substantial, with feed and fuel costs increasing from PKR302/mmbtu and PKR1,023/ mmbtu to PKR580/mmbtu and PKR1580/mmbtu, respectively. For FFC & FATIMA, the current gas price increase would result in an additional production cost of urea by PKR529/bag and PKR414/bag, respectively. In the case of EFERT, it enjoys some insulation due to its reliance on PP12, urea production cost is expected to rise by PKR164/bag. On the other hand, FFBL is likely to see urea cost increase by PKR86/bag and cost of gas for DAP is likely to increase by ~PKR40/bag. We believe fertilizer industry has decent pricing power to pass on the cost pressure due to firm demand dynamics and significant discount between local and international urea prices. However, it's worth mentioning that the sector has already passed on some portion of the gas costs, and a complete pass-on of gas tariff is unlikely. Assuming that, if company's doesn't pass on the impact of this said hike then it would result in an annualized decline in EPS by PKR12.07 for FFC, PKR3.19 for EFERT, and PKR0.69 for FFBL.

Impact of proposed gas price hike on fertilizer space

		EFERT	FFC	FFBL	
		Urea	Urea	Urea	DAP
Feed Gas Prices	PKR/mmbtu	302	302	510	510
Proposed Feed Gas Prices	PKR/mmbtu	580	580	580	580
Change	%	*92%*	*92%*	*14%*	*14%*
Fuel Gas Prices	PKR/mmbtu	1,023	1,023	-	-
Proposed Fuel Gas Prices	PKR/mmbtu	1,580	1,580	-	-
Change	%	*54%*	*54%*		
Incremental Cost	PKR/bag	164	529	86	38
Current MRP	PKR/bag	3,411	3,210	3,595	12,510
Annualized EPS impact	PKR/sh	(3.19)	(12.07)	(0.69)	
Change in EPS	%	-14%	-31%	-7%	

Source: Insight research

Construction & allied industries

Increase in gas prices would have a marginal impact on the cement industry, as the sector has shifted towards utilizing waste heat recovery (WHR), solar power, and coal-based power plants. These alternative energy sources help insulate the sector from any gas price hikes. However, in the ISL cement universe, LUCK and DGKC are exposed to volatility in gas prices. Previously, the cement sector was procuring gas at PKR1,500/mmbtu, which has now increased to PKR4,400/mmbtu. The price hike would have a negative EPS impact of PKR11.7 and PKR1.5, respectively.

EPCL & LOTCHEM would have a negative impact of Increase in gas tariff, as they operate on import parity prices. Previously notified gas price for EPCL and LOTCHEM were PKR1,200/mmbtu and PKR 1,100/mmbtu, respectively, which has increased to PKR2,600/mmbtu and PKR2,050/mmbtu, respectively. The said increase will have a negative impact of PKR5.5/sh for EPCL and PKR0.96/sh for LOTCHEM.

Export oriented sector to also face the burnt

As per IMF's direction of abolishing subsidies for export oriented sector, the recent gas price hike has also been extended to export-oriented sector resulting in an increase form PKR1,100/mmbtu to PKR2,050/mmbtu, for process and captive, respectively. GATM is the only player in ISL textile universe to be impacted by this hike which is currently procuring gas at blended tariffs (75%/25%) of PKR1,760/mmbtu, the new gas price of PKR2,050/mmbtu would result in an increase of 25% in fuel and power cost for GATM. However, north players were getting subsidized gas at blended price (50%/50%).

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- Discounted cash flow (DCF)
- Relative Valuation (P/E, P/Bv, P/S etc.)
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Frequently Used Acronyms

TP	Target Price	**DCF**	Discounted Cash Flows	**FCF**	Free Cash Flows
FCFE	Free Cash Flows to Equity	**FCFF**	Free Cash Flows to Firm	**DDM**	Dividend Discount Model
SOTP	Sum of the Parts	**P/E**	Price to Earnings ratio	**P/Bv**	Price to Book ratio
P/S	Price to Sales	**EVA**	Economic Valued Added	**BVPS**	Book Value per Share
EPS	Earnings per Share	**DPS**	Dividend per Share	**DY**	Dividend Yield
ROE	Return on Equity	**ROA**	Return on Assets	**CAGR**	Compounded Annual Growth Rate

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Insight Securities (Pvt.) Limited

Suite 509, Business and Finance Centre,

I. I. Chundrigar Road , Karachi, Pakistan

+92-21-32462541-44