

Energy Sector Circular Debt

Resolution could take time

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Circular Debt: To settle or not to settle

- ECC, in its meeting held yesterday (3rd Sep, 2018), decided to assess the settlement made in 2013 to the energy sector, which will likely now delay the matter. The committee directed to hold an operational and financial audit of DISCOS with the audit of 4 highest loss making entities to be completed in 1 month and the audit of rest of the sector to be completed within 2 months after taking approval from the cabinet.
- To recall, circular debt has piled up to Rs594bn as of latest (excluding Rs582bn parked in PHPL). This includes Rs375bn receivables of the IPPs. The committee also decided to implement a strategy to reduce further pile up, which included severing illegal connections, installation of prepaid meters and immediate steps against power sector defaulters including ministries and government departments.
- After speaking with various stakeholders in the energy sector, we are of the view that the amount of circular debt settlement will be gradual and will not involve a large one-time as was the case in 2013. Few were of the opinion that the released amount will only be sufficient for the working capital requirements as against market expectations of higher payout.

Cash & PIB payment details of 2013 settlement

Rsbm	Cash	PIB	Total
IPPs	161	-	161
OGDCL	-	56	56
PPL	-	23	23
PSO	33	48	81
Total	194	128	322

Source: Ministry of Finance

Receivables as of Jul 2018

Rsbm	Receivables
Gencos	8
Fuel suppliers	107
IPPs	375
Nuclear Power	20
WAPDA	84
Total	594

Source: Media

Potential beneficiaries of circular debt settlement

- Our analysis is based on what had transpired in 2013. In 2013, the govt. had settled ~80% of total outstanding receivables. Moreover, in 2013 out of a total of Rs480bn, Rs138bn was settled through book adjustment and thus did not involve a cash or PIB transaction while the remaining Rs322bn was paid in cash and PIBs.
- This time around total outstanding amount is Rs600bn and we are assuming that ~80% (around Rs500bn) gets settled. We believe NPL, EPQL and SPWL would be the prime beneficiaries and are expected to release skipped/special dividend of Rs6-8, Rs3-4 and Rs2 per share respectively in case of our assumed settlement. On the other hand NCPL can also release its skipped dividend of Rs6/share if they are retaining short term borrowings Rs2.5bn.
- Among big players, KAPCO and HUBCO are likely to pay their outstanding fuel amount and short term borrowings as per our channel checks. To note, there is not any sizable decline in payout of these IPPs (HUBCO and KAPCO) as they are not concerned about their fuel payments due to their entitlement to guaranteed fuel supply from PSO.
- On earnings front, Cash payment will reduce earnings by 5-7% of IPPs like NPL, NCPL, EPQL and SPWL because these companies are earning KIBOR+4.5% on overdue receivables and paying KIBOR+1-2% on Short term borrowings/payables. While IPPs on older polices like HUBC, KAPCO, and PKGP will remain broadly neutral because interest earned and paid is almost same.
- As per recent filings of E&P companies, overdue receivables (inter-corporate circular debt) of PPL and OGDC have accumulated to approximately Rs200bn. On the other hand, PSO's overdue receivable stand at approximately Rs110-120bn. This is much higher than 2013 situation where overdue receivables of OGDC and PPL at time of circular debt resolution were around Rs100bn, while PSO's over-dues were around Rs80bn.

Potential beneficiaries of circular debt settlement

- On every Rs50bn PIBs settlement PSO has positive earning impact of Rs13/share while cash settlement of Rs50bn will reduce its finance cost by Rs9/share.
- We believe E&Ps will receive PIBs against their settlement amount, in line with last year. For Rs60/30bn PIB settlement OGDC and PPL will have meager impact of Rs1.2/1.3 per share, respectively, on their profitability.
- On economic front, upon clearance of circular debt in line with our assumption, the incremental impact on fiscal deficit will be ~1.5% of the GDP. Banks which are major lenders to power sector are also likely to have increased liquidity with this settlement, that might be used to further diversify their loan book.

Impact of settlement of circular debt

Impact of settlement of circular debt (Rsmn)

Company	Sector	Overdue Receivables	Short term borrowings	Overdue payables	Comment
HUBC	Power	88,030	31,112	79,129	Any amount received will likely be paid to PSO for outstanding fuel payments
KAPCO	Power	90,497	47,660	48,815	Settlement amount is expected to be utilized to pay fuel payments; there has been no decline in dividends
NPL	Power	10,832	4,074	438	Dividend payout as well as reducing short term borrowing are likely. We believe release of skipped/special dividend of Rs6.5/2-3 per share is possible.
NCPL	Power	8,350	8,389	451	Dividend payout as well as reducing short term borrowing are likely. The company can pay Rs6/share skipped dividend if Rs2.5bn in short term borrowing is retained
EPQL	Power	4,974	2,352	2,171	In 2013 EPQL received entire outstanding amount (including overdue and current) because of higher merit order. High probability of special dividend of Rs3-4/share in case company gets entire outstanding amount
KOHE	Power	4,000	4,791	-	Skipped dividend of Rs2/share; Can pay Rs3.5-4/share dividend in case of retaining short term borrowings
SPWL	Power	5,000	3,697	-	Skipped dividend of Rs2/share may be released but low likelihood of special dividend because of cash need for cement plant (Rs2bn)
PKGP	Power	2,712	10,320	2,301	Can release skipped dividend of Rs1/share; Less likelihood of special dividend because of high short term borrowings
PSO	Oil Marketing	109,573	156,526	31,945	On every Rs10bn PIB settlement, there is a potential positive earnings impact of Rs2.5/share. While every Rs10bn cash settlement there will be a cost saving of Rs1.8/share.
OGDC	Oil & Gas Exp.	109,105	-	-	On every Rs10bn PIB settlement there is a potential positive earning impact of Rs0.19/share.
PPL	Oil & Gas Exp.	106,979	-	-	On every Rs10bn PIB settlement there is a potential positive earning impact of Rs0.4/share.

Source: Company Accounts, Topline Research

The figures are as of latest financials available (Quarterly/Annuals)

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