Pakistan Strategy

Likely Gas Price Increase

Positive for Macros, Negative for Corporate Profits

Topline Research
research@topline.com.pk
Tel: +9221-35303330, Ext:133
Topline Securities, Pakistan

Govt. to raise gas prices by average 46%

- Reportedly, Prime Minister Imran Khan has given a go ahead to raise gas prices that were proposed by Oil and Gas Regulatory Authority (OGRA) few weeks back. This will be presented in next Economic Coordination Committee (ECC) meeting for official approval.
- This gas price rationalization is a bold step by the new government and is largely positive for the overall economy as the gas tariff differential which the Govt. is bearing for now will mostly be paid by consumers in future.
- We believe that higher gas tariff will reduce demand of household consumers that were getting gas at a huge discount, thereby rationalizing gas allocation among industrial and other sectors. Consequently, Pakistan dependency on high cost imported gas (RLNG) should come down in medium to long run, thus putting less pressure on external accounts.
- Though good for overall economy this will have negative impact on sectors like Steel, Fertilizer, Textile, Cement and Chemical due to their weak pricing power and relatively elastic demand. On the other hand, gas marketing companies (SNGP and SSGC) would be beneficiaries in terms of better cash flows and likely surplus in Gas Development Surcharge (GDS). Please refer to our table on next page for sector wise impact on earnings.
- Nonetheless, we expect a big jump of around 250bps in CPI inflation as Govt. plans to increase gas prices by upto 200% for lower slab which is part of CPI basket of Pakistan. This bodes well for the banking sector as higher inflation will lead to higher interest rates and thus better profits, we believe.
- Amid higher cash flows to Sui companies (as their GDS can notably become surplus) we expect it will help in resolving smaller portion of circular debt. Moreover, we believe that this hike in gas prices will improve gas collection to the tune of Rs250bn. This will cover existing outstanding gas differential of Rs100-120bn while remaining will be a surplus cash flow to the National kitty. Consequently, this could help the Govt. to reduce fiscal deficit by around 70bps.
- Apart from gas prices rationalization, PM was also briefed on the demand and supply situation in oil & gas sectors and previous Govt.'s inability to award any exploration license in past 5 years. Any development on exploration front will be positive trigger for domestic oil & gas exploration companies.

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Gas Price Hike Impact on Select Sectors		
Sector	**Impact**	**Comment**
Macro	Positive	Rationalization of gas allocation among industrial sectors, gas tariff differential to be paid by the Govt. which will help to lowering fiscal deficit (~70bps). However, given that around 200% gas price increase for lowest slab, this could result in ~250bps uptick in inflation.
Banks	Positive	Higher gas prices will lead to higher inflation, thereby higher interest rates
Sui Companies	Positive	Increase in gas prices will be cash positive for Sui companies which in return can lead to GDS payable going forward. GDS payables will have positive earnings impact of 5-10% on SNGP and SSGC.
Fertilizer	Negative	For 30% hike in gas tariff, companies will have to increase urea prices by Rs90/bag. EFERT and FATIMA will be least affected as their gas prices are based on concessionary rates and petroleum policy 2012. Given current headwinds in sector, we believe fertilizer producers will not be able to fully pass on this impact.
Cement	Negative	Given upcoming expansions and dull domestic demand, it will be difficult for Captive Power Plant producers to pass on any hike in gas prices. However, it is to be noted that Punjab cement producers are running their plant on RLNG (MLCF and DGKC) while LUCK is on domestic gas network. As per our calculations, a 30% increase in gas prices will have around 10% negative impact on LUCK's bottom-lines
Chemical	Negative	Companies like LOTCHEM and EPCL will be materially impacted as their revenues are indexed to international commodity prices (PTA and PVC). Any hike in gas prices will difficult to pas on. A 30% increase in gas prices can have negative impact of around 10-15% on earnings of LOTCHEM and EPCL.
Textile	Neutral to Negative	Most of the Punjab based textile companies are currently using RLNG instead of natural gas. However, South companies like GATM will have negative earnings impact of around 5-10%.

Source: Company Accounts, Topline Research

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