

June 10, 2010

Pakistan Market

WAPDA subsidy, tariff hike and impact



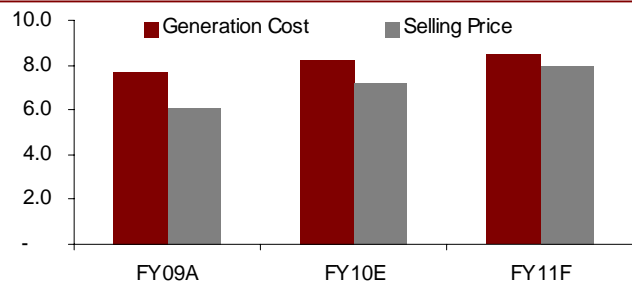
KSE100 Index: Closing 9678.38 ↓ (-84.79)

In the recently unveiled federal budget, the Finance Ministry has announced a significant reduction of 51% in the power subsidy bringing it down to Rs87.3bn. Of this, Rs40bn is allocated for the payment of interest on power sector TFCs, which leaves Rs47.3bn to partially absorb the pass through to the consumers. Post this announcement, investors are keen to understand the implications of this decision, which we believe, could lead to potential power tariff hikes, a rise in inflationary pressures and, on a positive note, constructive developments on the circular debt front.

11% tariff hike to maintain the target subsidy level

In order to remain within the budgeted subsidy levels for FY11, we expect a 11% power tariff hike in FY11. Our analysis is based on the weighted average generation cost from both hydel & thermal, and taking KESC's current tariff of Rs7.2 per unit as a proxy for the average per unit consumer price. Using FY11 oil price assumption of US\$77 per barrel and 65% thermal generation (including oil & gas), the average power generation cost comes to Rs8.5 per unit.

Generation Cost & Average Selling Price (Rs/KWh)

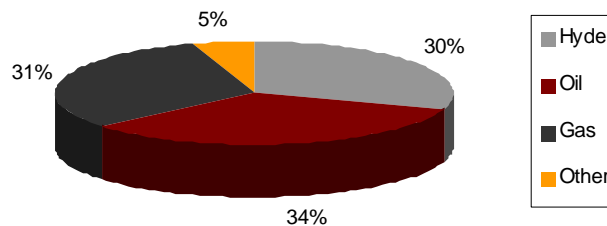


Source: JS Research

Given a budgeted subsidy allocation of Rs47.3bn (Rs0.6 per unit) for absorption of cost pass through in FY11, we estimate a further tariff hike of Rs0.8 per unit (11%) is required. As the IMF program already requires a further 6% hike in tariff, we

expect the GoP to announce a further increase of 5% to stay within the announced subsidy level.

Power Generation by source



Source: Energy Year Book

Fluctuating oil prices: Key risk to our analysis

Our analysis is sensitive to international oil price movements, as oil alone accounts for 34% of the country's power generation. Our estimates suggest that a 10% annualised increase in international oil prices could raise the total generation cost by around Rs0.3 per unit (additional burden of Rs2bn per month). Since oil price movements are inculcated monthly into the consumer power tariff, any added burden in case of soaring oil prices would be transferred to the consumers, and thereby keeping the government's subsidy target immune to such variations.

Oil price sensitivity to tariff hike

Arab Light Assumption (US\$ Per barrel)	Generation Cost (Rs Per KWh)	Expected Power tariff Hike (Rs Per KWh)
US\$ 69.3	8.2	7%
US\$ 77 (Base Case)	8.5	11%
US\$ 84.7	8.8	15%

Source: JS Research

Price hike is inflationary but +ve for energy chain

As per our estimates, a 10% rise in fuel and electricity would have a 0.4% direct impact on CPI. Having said that, we

believe, it would be a positive for the energy chain in the form of slowdown in circular debt accumulation and a possible pay off going forward. In the event of any resolution, we believe PSO, HUBCO, KAPCO, OGDC and refineries would be key beneficiaries among the listed companies.

Key Statistics (FY11)

	PE (x)	Dividend Yield	PBV (x)
OGDC	8.7	7.9%	3.5
PSO	4.4	8.9%	1.4
HUBC	6.0	15.9%	1.3
KAPCO	7.2	13.5%	1.6
NRL	4.3	12.5%	0.7
ATRL	8.4	5.5%	0.6

Source: JS Research

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Also in focus

Indus Motor to invest Rs1.6bn

Indus Motor (INDU) has approved an investment plan worth Rs1.6bn for the purchase of the latest stamping press machines and other equipment. Higher localization level on the back of this latest transfer of technology is expected to reduce the impact of exchange rate volatility on the company. At current levels, we have a 'Hold' stance on the scrip with a target price of Rs279.

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