ARIF HABIB LIMITED

REP-300

Gas Tariff Hike

WACOG Bill implementation enforced by OGRA

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Gas Tariff Hike
WACOG Bill implementation enforced by OGRA

The Economic Coordination Committee (ECC) has approved gas tariff for domestic consumers and general industries with an increase ranging from 8% - 235%. Please find the table on the right reflecting the proposed increase in gas prices effective 1st Jul'22.

The move was instigated by the latest Determination of Estimated Revenue Requirement for SNGP and SSGC (year 2023), whereby **OGRA has put into effect two bills passed earlier in the year pertaining to the gas sector.** To recall, the Senate, in Feb'22, had authorized the Regulator (OGRA) to determine the final consumer gas sale prices under the "Oil and Gas Regulatory Authority (Amendment) Bill, 2022" and approved the "Weighted Average Cost of Gas (WACOG) Bill" which pertained to the representation of RLNG price in the new weighted average gas cost.

As a result, the new notified consumer gas prices will now also reflect the augmenting share of RLNG (~23%) in the total sales mix. Hence **curbing the accumulation of the gas circular debt**, which arrived at north of PKR 1.2trn by the end of Mar'22, as per the Petroleum Division.

In lieu of the same, **a summary for gas price hike has sailed through the ECC**, although, it is **yet to be approved by the Cabinet**. Albeit, the likelihood of this being approved remains high, since the IMF has on multiple occasions sought a transformation in the energy sector whereby gas tariff hikes could become effective immediately once a summary from the Regulator is issued. There is a catch though, the government still retains the power to determine the individual gas prices for all consumers within 40 days of the summary of OGRA, granted, the gas utilities revenue requirement is met. This means certain consumers may still be protected through cross-subsidization, such as households consuming a lower quantum of gas.

Exhibit: Proposed Gas Rates

PKR/mmbtu	Existing Rates	Proposed Rates	Change
Domestic			
Minimum - up to 0.4 hm3	173	173	43%
Up to 0.5 hm3	121		
Up to 1.0 hm3	300	300	0%
Up to 2.0 hm3	553	696	26%
Up to 3.0 hm3	738	1,856	151%
Up to 4.0 hm3	1,107	3,712	235%
Above 4.0 hm3	1,460		
Bulk	780	928	19%
Special Commercial (Roti Tandoors)	697	928	33%
Commercial	1,283	2,321	81%
Power	857	928	8%
Power - Liberty	1,181	2,406	104%
Fertilizer - Feed (Engro)	117	140	20%
Fertilizer - Feed (others)	302	430	42%
Fertilizer – Fuel	1,023	1,857	82%
Cement	1,277	2,321	82%
General Industry (Non-Export)	1,054	1,650	57%
General Industry (Export)	819	1,450	77%
Captive (Non-Export)	1,087	1,650	52%
Captive (Export)	852	1,450	70%
CNG			
Region-I	1,371	2,321	69%
Region-II	1,350	2,321	72%

Source (s): OGRA, News Report, AHL Research

Gas Tariff Hike

Macro – Gas charges to increase by 54% in basket, CPI to increase by 45bps

- The total direct weight of gas price in the National CPI basket is ~0.7%. An increase in gas price for five quintiles by an average of 54% means inflation could escalate by ~45bps. However, the second-round effect of an increase in gas prices would be much higher as industrial users like fertilizer, textile, cement, steel, chemical, and general industries will gradually pass on the impact going forward. With the inflation level at 12.2% during FY22 we estimate our average CPI for FY23 to clock-in at 18.3% YoY.

Gas Tariff Hike

Gas utilities

- To recall, the difference between the prescribed prices and gas sale prices kept expanding each year with both SNGP and SSGC demanding radically high prescribed prices due to prior year adjustments (whereby consumer gas sale prices notified by the government did not match prescribed prices determined by OGRA). As a result, arrears from the government (reflected in other receivables) kept piling up. With this new amendment, final consumer prices will finally be adequate to meet the revenue requirement of Sui companies and hence, will improve their cash flow position.
- Moreover, for both the utilities, while OGRA had requested prices to be raised to generate PKR 547bn for 2023, the ECC decided to increase them to recover PKR 660bn (including some quantum of prior year adjustment to be made). This will be a sentiment booster for the sector as the companies had to rely on borrowing to carry out routine business in light of receivables from the government piling up historically. Therefore, this will be materially positive for SNGP and SSGC's cash flows.
- We also highlight that while the weighted average cost of gas at which UFG is calculated will go up, taking up the disallowed UFG in PKR million, earnings of the utilities will remain robust given improved cash flows which should translate to lower short-term borrowings. Additionally, we noticed that UFG on RLNG will continue to be passed through (forecast at 4.5% for SNGP) as per the DERR for 2023, hence removing the fear of an increase in UFG.
- An improved cash flow position will also open up room for further expansion in new pipeline construction projects (distribution network), which will augur well for the companies ROA based return.

Gas Tariff Hike
E&P, OMC's and Fertilizer

E&P

- E&P companies have been circular debt-stricken for a long time. Pertinently, gas revenue of OGDC and PPL contribute 49% and 66% to the total revenue. Thus, a hike in gas prices will be positive for these companies, as it will not only improve the cash flow position, but is likely to increase their payouts as well. To recall, as per latest available data, OGDC's overdue receivables are set at PKR 384bn, and PPL's at PKR 312bn as of Mar'22.

OMCs (PSO)

- PSO's overdue receivables from SNGP in lieu of gas circular debt have mounted to PKR 208bn, which had exacerbated the company's working capital problems. With a hike in gas prices, strain on cash flows will reduce. To recall, LNG sales contribute 22% to total sales.

Fertilizer

- Feed and fuel stock prices are expected to increase by 42% and 82% to PKR 430/mmbtu (current PKR 302/mmbtu) and PKR 1,837/mmbtu (current PKR 1,023/mmbtu), respectively. The impact of the hike would be significant as fertilizer manufacturers would have to jack up urea prices by an average of ~PKR 374/bag in order to nullify the impact. For EFERT, the impact would be slightly lower due to its partial gas dependency on PP12 policy (the company would need to augment prices by PKR 348/bag to completely pass on the impact). Meanwhile, impact on FFBL would only be on its feed gas (PKR 150/bag for urea and PKR 65/bag for DAP) amid its dependency is on coal-based power plant for power generation/fuel. It is pertinent to note that fertilizer manufacturers have already increased urea prices by PKR 350/bag, since the beginning of Jul'22.

Gas Tariff Hike

Cement and Steel

Cement

- Gas tariff for cement players using captive power plants has been recommended at PKR 1,650/mmbtu from the prevailing PKR 1,087/mmbtu (+52%). We highlight that very few key players have a captive gas or dual-fired power plant (namely LUCK, DGKC, MLCF and FCCL under the AHL cement universe). Albeit, only LUCK's dependency on gas based power generation remains notable. Therefore, our initial workings suggest that LUCK will have to raise prices by nearly PKR 18.3/bag in order to completely pass on the impact of higher gas prices (assuming 100% usage at its South plant and 50% at its North plant). However, if the company fails to do so, the company's bottom-line will be eroded by PKR 6.4/share. We believe LUCK will pass on the impact.

Steel

- It has been advised that gas tariff for industries (non-exports) be raised to PKR 1,650/mmbtu (+57%). Long steel players (manufacturers of rebars: ASTL and MUGHAL) use very limited gas during the reheating process. Amreli Steels Limited (ASTL) uses around 40 m3/ton. Whereas Mughal Iron and Steel Industries (MUGHAL) consumes 35 m3/ton for billet reheating. We believe hike in gas tariff will necessitate a PKR 1,225/ton increase in ASTL's rebar prices to completely pass on the impact. While MUGHAL is not under our formal coverage, our back of the envelope workings suggest that the impact on MUGHAL might be slightly more adverse since it has a 27MW captive gas power plant which increases the company's exposure to the gas price hike, therefore prices may have to be increased by PKR 5,650/ton.

Gas Tariff Hike
Textile and Chemical

Textile

- OGRA has proposed an increase in gas prices for export-oriented industry by 70% to PKR 1,450/mmbtu compared to PKR 852/mmbtu. This will have a magnified negative impact on Sindh-based textile companies including FML and GATM, as they have been using gas for power generation purposes and were being supplied natural gas at a cheaper rate of PKR 852/mmbtu, compared to textile industries in Punjab which were being supplied RLNG at USD 6.5/mmbtu. Moreover, our understanding is that once this tariff hike comes through, gas prices will be same for both Sindh and Punjab based textile manufacturers i.e. PKR 1,450/mmbtu.

Chemical

- The expected increase in gas price will negatively impact the chemical companies under AHL coverage (EPCL) as it fulfills the energy requirements through gas-based captive power plant. The current gas price for captive power plants (for EPCL) is PKR 1,087/mmbtu, which is expected to increase to PKR 1,650/mmbtu (+52%). Therefore, we estimate the hike in gas price to have a negative earnings impact in CY23E on EPCL of PKR 2.74/share (22%). It is pertinent to note, that EPCL will have to increase PVC prices by USD 86/ton to fully pass on the impact.

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Equity Valuation Methodology

AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- Discounted Cash Flow (DCF)
- Dividend Discount Model (DDM)
- Sum of the Parts (SoTP)
- Justified Price to Book (JPTB)
- Reserved Base Valuation (RBV)

Risks: The following risks may potentially impact our valuations of subject security (ies);

- Market risk
- Interest Rate Risk
- Exchange Rate (Currency) Risk

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In order to avoid any conflict of interest, we hereby disclosed that;

Arif Habib Limited (AHL) has shareholding in OGDC, PPL, NBP, AKBL, MLCF, FCCL, PSO, UNITY and SNGP.