

Day Break

Friday, 19 October 2018

COMPANY UPDATE

The Hub Power Company Limited

Power Generation & Distribution

Recommendation	BUY
Target Price:	130.9
Last Closing: 18-Oct-18	83.5
Upside:	56.7
Valuation Methodology:	Dividend Discount Model (DDM)
Time Horizon:	Jun-19

Market Data

Bloomberg Tkr.	HUBC PA
Shares (mn)	1,157.2
Free Float Shares (mn)	694.3
Free Float Shares (%)	60.0%
Market Cap (PKRbn USDmn)	96.7 737.3
Exchange	KSE ALL
Price Info.	90D 06M 12M
Abs. Return	(1.7) (16.9) (19.9)
Lo	84.4 84.4 84.4
Hi	98.1 104.9 109.0

Key Company Financials

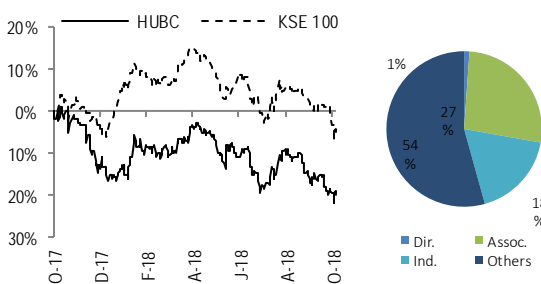
Period End: Jun

PKRbn	FY18A	FY19E	FY20F	FY21F
Total Revenue	100.0	85.3	80.4	84.3
Net Income	11.1	12.9	19.4	19.9
EPS (PKR)	9.6	11.2	16.7	17.2
DPS (PKR)	7.4	8.0	12.0	14.0
Total Assets	159.6	186.0	158.3	127.8
Total Equity	35.4	36.4	37.2	38.0

Key Financial Ratios

ROE (%)	31.2	35.5	52.1	52.3
P/E (x)	8.7	7.5	5.0	4.9
P/B (x)	1.4	2.7	2.7	2.6
DY (%)	8.9	9.6	14.4	16.8

Relative Price Performance



About the Company

The Company was incorporated in Pakistan on August 01, 1991 as a public limited company. Its GDR are listed on the Luxembourg Stock Exchange. The principal activities of the Company are to develop, own, operate and maintain power stations.

Source: Bloomberg, PSX & IGI Research

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Power Generation & Distribution

HUBC: Estimates trimmed as reliance on ST borrowings rises, maintain Buy

- The Hub Power Company Limited's (HUBC) reported 4QFY18 consolidated earnings of PKR 2.78bn (EPS PKR 2.41) down 11%YoY, resultantly taking FY18 PAT to PKR 11.06bn (EPS PKR 9.56), up +3%YoY. FY18 DPS came in at PKR 7.40/share.
- We have marginally trimmed our EPS estimates for HUBC by 1% on average due to greater reliance on ST borrowings and higher long term borrowings for investments in growth project CPHGC. In other developments, HUBC has announced intention to commence due diligence of ThalNova Power Thar Private Limited, to acquire ~37% equity stake in the business.
- We take this opportunity to roll over our Target Price to FY19, while revising upward our Risk-free rate to 9.0% (from 8.5% previously). This is owing to 275bps CY18TD rise in interest rates. Our new June'19 TP for HUBC is PKR130.9/share (down by 6%). HUBC has dropped 8% from its CYTD high which implies a "BUY" stance on the name. HUBC offers upside of +56.7% and trades at an FY19E D/Y of 9.6%.

Flat earnings in FY18 at PKR 9.56/share, DPS clocks in at PKR 7.4

The Hub Power Company Limited's (HUBC) reported 4QFY18 consolidated earnings of PKR 2.78bn (EPS PKR 2.41) down 9%YoY, resultantly taking FY18 NPAT to PKR 11.06bn (EPS PKR 9.56), flattish growth of +3%YoY. Results were accompanied with final cash dividend of PKR 2.80/share, taking full-year payout to PKR 7.4/share (payout ratio: 77%). Strain on dividend payouts is evident, particularly as HUBC looks towards internal financing for equity stake in its associated undertakings (namely: CPHGCL).

We attribute decline in 4QFY18 earnings largely to 19%YoY rise in finance costs to PKR 1.19bn due to greater reliance on ST borrowings to fund working capital needs. This was in addition to lower dispatch (FY18: 49.5%, against 65% SPLY) at Hub plant on lower demand by WAPDA which was partially tempered by 64%/99% utilization at Narowal and Laraib respectively (FY17: 71%/98%). FY18 receivable position deteriorated further to PKR 82bn (Overdue: PKR 74bn compared to PKR 66bn in SPLY), levels last seen in FY12 (pre-PML-N) when circular debt ballooned to PKR 480bn.

Exhibit:

Financial Highlights (Consolidated)

PKR mn	4QFY18	4QFY17	YoY	FY18	FY17	YoY
Turnover	26,213	27,049	-3%	99,999	101,188	-1%
Operating Costs	21,325	22,220	-4%	81,720	83,929	-3%
Gross Profit	4,889	4,829	1%	18,279	17,260	6%
General & Admin expenses	412	385	7%	1,525	1,365	12%
Financing Cost	1,185	998	19%	4,432	4,081	9%
PBT	3,246	3,407	-5%	12,150	11,708	4%
PAT	3,022	3,284	-8%	11,665	11,348	3%
PAT - Attributable to HUBC	2,779	3,061	-9%	11,057	10,689	3%
EPS (PKR)	2.41	2.64		9.56	9.24	
DPS (PKR)	2.80	2.50		7.40	7.50	

Source: Company Financials & IGI Research

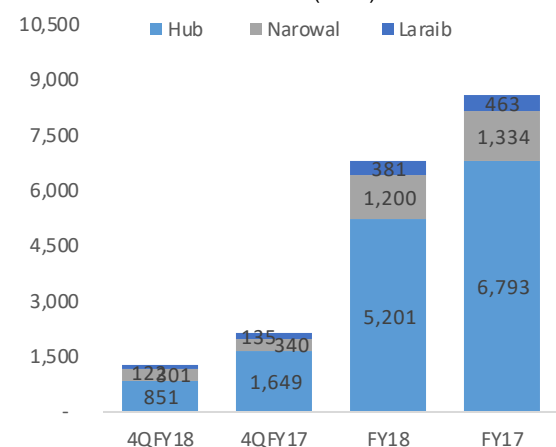
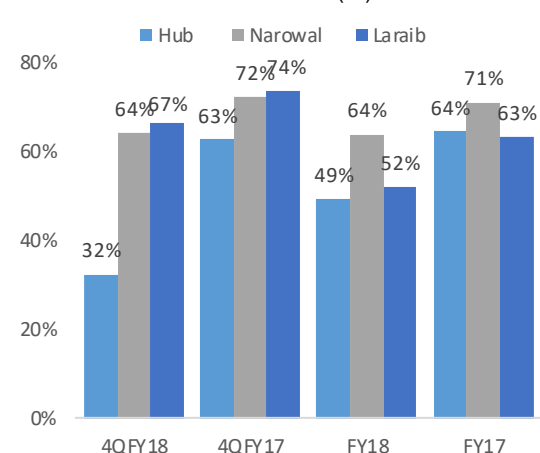
No of Shares: 1,157.15 mn

Exhibit: Time line of Projects

Project	Financial close	Commerical Operation
CPHGC	Jun-17	Aug-19
TEL	Sep-18	Dec-20
SECMC	Apr-16	Jun-19

Exhibit: Segment-wise Profitability (PKR/share)

Segment	4QFY18	4QFY17	FY18	FY17
Hub Plant	1.46	1.84	6.48	7.39
Narowal Plant	0.74	0.70	2.47	1.86
Laraib	0.64	0.58	1.58	1.71
HPSL	0.04	0.02	0.36	0.10
Elimination/Unallocated	(0.48)	(0.50)	(1.34)	(1.82)
HUBC Earnings	2.40	2.64	9.56	9.24

Exhibit: Generation Plant-wise (Gwh)**Exhibit: Load Factor - Plant-wise (%)****Reliance on debt financing spikes in FY18**

HUBC witnessed a significant 19%YoY rise in finance costs to PKR 1.18bn during FY18. This was largely due to higher utilization of short term borrowings because of delay in payment from CPPA-G and higher long term borrowings for investments in growth project CPHGC (via HPHL), TEL and SECMC. With no meaningful resolution of circular debt in sight, we expect cashflows to remain constrained in the medium-term, with reliance on ST borrowings to remain elevated.

Demand from WAPDA continues to decline for Hub Base and Narowal plants

With gradual phase-out of RFO based energy, we expect HUBC's base plant and Narowal plant's contribution to the national grid to inevitably decline. HUBC's plant utilization have dropped from 65% in FY17 to as low as 49.5% in FY18. This was particularly affected by COD of two new hydel power plants -Neelum Jhelum Hydro Power Project: 969MW and Tarbela Extension 4: 1,410MW. Although this is also partially due to shut down of RFO based plants in Nov'17 in order to contain oil imports. HUBC's utilization levels dropped to 27% during this period (2QFY18). We expect demand from WAPDA to remain sporadic depending on availability of cheaper alternatives going forward.

Macro-economic adjustments have little bearing on IPPs, Risk Free Rate revised upwards

Amid dollar denominated returns, IPP's tend to ride out any bouts of swift currency devaluations. The PKR has depreciated 27% Dec'17-to-date which has resulted in ROE expansion for all IPPs. The central bank has raised interest rates 275bps CY18TD to 8.5%. We have therefore adjusted our Policy Rate to 8.50% and Risk-free rate to 9.0% from 8.0% previously.

Outlook

Concerns on dividend payout for RFO based IPPs should continue in the medium term, in our view. HUBC's payout ratio has dropped from 98% over the last 10 years to 77% in FY18 and we expect this to contract further in FY19f (72%). The inflection point is expected to appear as CPHGC achieves COD which should unburden HUBC's internal cashflows, currently being utilized for equity financing of the same. At current price of PKR 83/share we see limited downside risk in HUBC. Primarily we say this due to attractive dividend yield in offering in year 2020. For year 2018, current yield stands at 9.6% which is roughly equal to 12M T-Bill at xx%. However, considering CPHGC commencing operation in 2020, we see dividends propping up to 12/share, which at current rate offers a healthy 14% DY. Given further monetary tightening on cards in 2020, we see 100-150bps rise in policy rate, this will jack up 12M T-bill in the region of 11-12%, compared to HUBC 14% dividend yield in 2020.

Recommendation

We have taken the opportunity to roll over our TP to Jun'19, however, adjustment in Risk Free Rate brings our new TP to PKR 130.9/share (down 6% from previous estimates). Despite near term headwinds, we maintain our **"BUY"** call on the company as the stock has corrected 8% from its CYTD high and offers +56.7% upside from its last closing. The company is currently trading at a FY19F P/E of 7.5x and offers a healthy dividend yield of 9.6%.

Source: Company Financials, IGI Research

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Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
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Time Horizon: Jun – 2019

Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):

DDM (Dividend Discount Model)

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