# Company Update | Pakistan Research

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# HUBC: Caught between a rock and a hard place

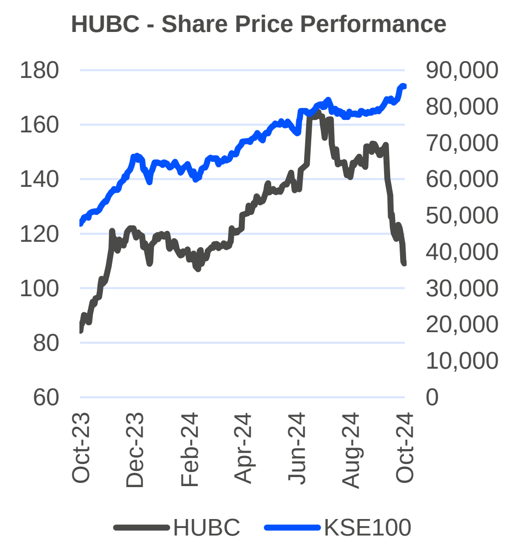
## Hub Power Company Limited

PSX: HUBC | Bloomberg: HUBC PA | Reuters: HPWR: PSX

- Rising electricity tariffs and plunging offtakes have compelled the government to revisit its contracts with the IPPs. The government has tabled several proposals, the most notable of which is the conversion of existing IPPs to take and pay arrangement. It has also targeted RFO-based projects, established under the Power Policy 1994 and 2002, for voluntary early termination.
- Caught in the eye of the storm is HUBC, whose base plant was the first IPP established under the Power Policy 1994. The plant's generation capacity has deteriorated due to aging and currently ranks low in NTDC's dispatch system, which makes it economically unfeasible for offtakes.
- The company is considering prematurely terminating its base plant's power purchase agreement (PPA), leading to a weak outlook in the wake of significant reduction in earnings.
- HUBC is facing significant risks of early termination of its base plant's PPA, as well as the potential termination of Narowal's PPA, which could lower the dividend yield to 4.4% in FY26 (Scenario C).

| Base Case (PKR mn) | FY25 | FY26 | FY27 |
|---|---|---|---|
| EPS (Cons.) (PKR/sh) | 53.22 | 59.95 | 65.88 |
| EPS (Standalone) (PKR/sh) | 20.17 | 33.22 | 36.48 |
| DPS (PKR/sh) | 17.18 | 27.22 | 26.98 |
| Valuation – Jun'25 | 176.93 | - | - |
| Debt | 32,672 | 24,682 | 44,089 |
| Assets | 156,250 | 155,379 | 154,707 |
| Debt-Asset Ratio | 20.9% | 15.9% | 28.5% |

*Source: Company Accounts, Akseer Research*




*Source: Company Accounts, Akseer Research*

## Overview

High electricity tariffs have been the talk of the town lately on all economic forums. The government has adopted a harsh stance against the IPPs in an effort to deal with redundant capacities, especially given falling grid offtakes. The primary objective is to moderate the increase in capacity charges to rationalize tariff for the end consumers.

At the heart of this effort lies all RFO-based plants, with a particular focus on plants set up under 1994 policy due to low generation efficiency and limited remainder lives under their respective PPAs. One of these targets is HUBC with a remaining PPA life of 2.2 years and an average utilization of 0% in the last 12 months. Premature termination of its PPA remains a real possibility for which a board meeting has been scheduled on 10 October 2024 (today) to consider the proposed terms for termination.

Interestingly, the government is persuading companies (including HUBC) to terminate its PPA voluntarily and transition to a take-and-pay arrangement. The voluntary termination would essentially limit the legal recourse available to the IPPs under the current power purchase agreement.

The transition from take-or-pay to take-and-pay has severe financial implications for HUBC's base plant. Below are the three scenarios showing the impact of changes in the contractual provisions.

## Scenario A: Early termination of the base plant PPA

In a take-and-pay arrangement, the obligation to pay is linked to the consumption of electricity instead of the available capacity. Transition to a take-and-pay contract would render the base plant redundant, with no prospects of financial recovery.

If the contract is terminated in 2QFY24, this will lead to 83% reduction in earnings on a standalone basis compared to the baseline earnings and 98% reduction in dividends for FY25. Similarly, the debt-asset ratio will increase from 20.9% to 29.7%.

| Scenario A (PKR mn) | FY25 | FY26 | FY27 |
|---|---|---|---|
| EPS (Cons.) (PKR/sh) | 36.87 | 35.84 | 41.61 |
| EPS (Standalone) (PKR/sh) | 3.48 | 8.90 | 12.06 |
| DPS (PKR/sh) | 0.36 | 5.12 | 4.43 |
| Valuation – Jun'25 | 139.49 | - | - |
| Debt | 46,463 | 37,879 | 42,547 |
| Assets | 156,250 | 155,379 | 154,707 |
| Debt-Asset Ratio | 29.7% | 24.4% | 27.5% |

*Source: Company Accounts, Akseer Research*

## Scenario B: Early termination of the base plant PPA and overdue LPS written off

News sources have cited that the government also plans to renege on its sovereign guarantee for overdue receivables, particularly the late payment markup that HUBC receives on its overdue receivables. As of Jun-24, outstanding receivables of HUBC stand at PKR 62.7bn (PKR 53.5bn is overdue), of which the late payment markup accounts for PKR 25.6bn.

If the government pays off accumulated capacity payment invoices worth PKR 37.2bn but refuses to recognize late payment markup invoices, then HUBC will have to book a provision expense of PKR 25.6bn (PKR19.7/sh). Though this provisioning will not have a cash flow impact, the company's debt-to-asset ratio may rise to 52.3%, leading to shariah compliance issues (Meezan Shariah Screening benchmark D/A is 37%).

| Scenario B (PKR mn) | FY25 | FY26 | FY27 |
|---|---|---|---|
| EPS (Cons.) (PKR/sh) | 34.28 | 32.12 | 39.28 |
| EPS (Standalone) (PKR/sh) | (19.54) | 5.05 | 9.60 |
| DPS (PKR/sh) | - | 4.81 | 8.79 |
| Valuation – Jun'25 | 142.55 | - | - |
| Debt | 50,274 | 43,932 | 46,323 |
| Assets | 96,040 | 94,398 | 93,486 |
| Debt-Asset Ratio | 52.3% | 46.5% | 49.6% |

*Source: Company Accounts, Akseer Research*

## Scenario C: Early termination of Narowal PPA

HUBC's Narowal plant is another RFO-based plant which is up for phased termination due to its obsolescence.

In this scenario, we have analyzed Narowal's PPA termination in early FY26 along with termination of base plant contracts in Oct-24. This would result in a further earnings attrition of PKR 1.4bn (PKR 1.14/sh) in FY27, taking the total earnings impact of early termination for FY27 to PKR25.56/sh. NEL's net receivable position (adjusted for short term borrowing and payables) is in the positive territory and stands at PKR 12bn, hence the dividend impact of contract termination is not significant in the short term. In contrast, the net receivable position for HUBC stands at PKR -4.5bn which strains its payout ability.

| Scenario C (PKR mn) | FY25 | FY26 | FY27 |
|---|---|---|---|
| EPS (Standalone) (PKR/sh) | 3.42 | 8.84 | 10.92 |
| DPS (PKR/sh) | 0.30 | 5.06 | 3.28 |
| Debt | 46,475 | 37,894 | 42,560 |
| Assets | 156,250 | 155,379 | 154,707 |
| Debt-Asset Ratio | 29.7% | 24.4% | 27.5% |

*Source: Company Accounts, Akseer Research*

## Outlook

HUBC is facing significant risks of early termination of its base plant's PPA, as well as the potential termination of Narowal's PPA, which could adversely affect its profitability outlook. The company may have to significantly reduce its payouts to service the debt levels on its standalone books. In this regard, the dividend yield in scenario C falls to 4.4% in FY26. The joint venture arrangement with BYD may act as a saving grace for the company's earnings going forward. However, with earnings shrinking, we expect that funding upcoming capex requirements will be challenging.

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|---|---|
| Buy | Greater than or equal to +15% |
| Hold | Between -5% and +15% |
| Sell | Less than or equal to -5% |

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