

Pakistan Economy

Gas price increase is finally here!

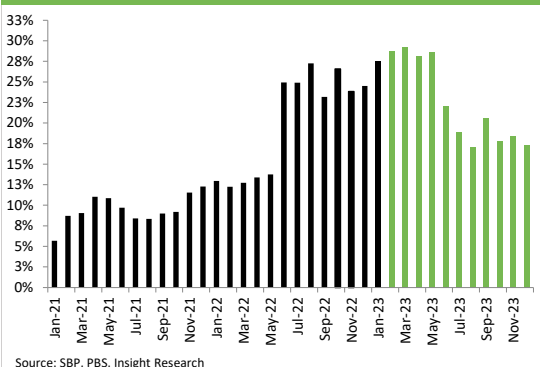
In a recent development, ECC has finally approved the much awaited and long overdue increase in natural gas prices, effective from Jan'23. The exercise was pending for several months, resulting in accumulation of gas circular debt, which has now reached a whopping PKR1.6tr. Rationalization of energy tariffs is key demand of IMF and was necessary for the pending ninth review of the program. The increase in gas tariff will help in slowing down the pace of accumulation of gas circular debt, thus improving the liquidity position of gas utility companies (SSGC & SNGP) and will unlock the valuation of cash strapped exploration companies (PPL & OGDC).

Inflationary pressure to follow: As per news flows, gov't have increased gas prices in range of 8%-112% for different consumers categories. The recent hike in gas price will result in an increase of ~50bps on average inflation estimate for remaining part of the current fiscal year. However, the said increase will have second round impact, which tends to be more persistent and sticky. To note, gov't has imposed PKR500/month fixed charge on domestic non-protected sector. In addition, the proposed hike in gas price will increase cost of urea production by ~PKR420/bag, which is likely to pass on by the manufacturers. This will negatively impact the rural inflation, which is already facing a difficult time due to rising core inflation, recorded at ~19.4% in Jan'23.

Fertilizer feed & fuel gas to witness an increase of 69% & 47%: Gas price increase was long overdue and last gas tariff hike was witnessed in Sep'20 where gas tariff for fertilizer sector was increased by meager PKR2/mmbtu for feed and fuel. Since then, feed and fuel prices have been stagnant. Recently in July'22 ECC approved gas prices hike but it was not implemented. On the flip side, industry players have increased urea prices to PKR2,440/bag in Jan'23 compared to PKR1,815 in SPLY mainly due to rising cost pressures.

ECC's recent decision to increase feed and fuel prices for fertilizer industry by 69% & 47%, respectively, will increase cost of urea production by PKR420/bag for FFC. We believe fertilizer industry have decent pricing power to pass on the cost pressure due to significant discount between local and international urea prices and firm demand. On company specific basis, this development is neutral for FFC. Whereas, EFERT enjoys competitive advantage with reference to industry gas cost as a proportion of its feed gas is priced at PP-12, therefore, uptick in gas prices will result in lower cost impact on EFERT i.e PKR315/bag vs. FFC:415/bag. This will result in positive annualized EPS impact of PKR1.8/sh on EFERT. Furthermore, impact on FFBL is expected to be negligible as the positive impact of lower increase in gas cost of urea will be diluted by the subsequent increase in production cost of DAP and its import parity based pricing. Nevertheless, government's intervention and price capping to facilitate farmers could negatively impact the industry's profitability.

Economy: Inflation Expectation (YoY)



Source: SBP, PBS, Insight Research

Per bag increase in cost of production of urea

Company	PKR/bag
FFC	415
EFERT	310
FFBL	275
FATIMA	375

Source: Insight Research

Impact of proposed gas price hike on fertilizer space

		EFERT	FFC	FFBL	
		Urea	Urea	Urea	DAP
Feed Gas Prices	PKR/mmbtu	302	302	302	302
Proposed Feed Gas Prices	PKR/mmbtu	510	510	510	510
Change	%	69%	69%	69%	69%
Fuel Gas Prices	PKR/mmbtu	1,023	1,023	-	-
Proposed Fuel Gas Prices	PKR/mmbtu	1,500	1,500	-	-
Change	%	47%	47%	-	-
Incremental Cost	PKR/bag	310	415	273	113
Annualized EPS impact	PKR/sh	1.8	-	-	0.05

* We expect industry to increase urea prices by PKR400-420/bag

Lower than expected increase for manufacturing sector: As per news flows, gas price for cement sector is likely to increase by 17% to PKR1,500/mmbtu. In our coverage universe, DGKC & LUCK are exposed to volatility in gas prices. These companies have minimal reliance on system gas and as per our estimates both companies will have negative impact of ~0.5/sh & 2.0/sh, respectively, on annualized basis.

Similarly, gas prices for export-oriented sector is likely to increase by 34%/29% for process and captive, respectively from PKR852/mmbtu and PKR819/mmbtu to PKR1,100/mmbtu. GATM is the only player in our textile coverage, which will be impacted by this hike and will have negative EPS impact of PKR1.3. To note, for zero rated industry (Punjab), the rate likely be maintained at US\$9/mmbtu if subsidy is maintained by the Govt. otherwise, they will be charged at notified tariff of gas/LNG.

In chemical space, EPCL was procuring gas at PKR1,087/mmbtu, which is expected to be revised at PKR1,200/mmbtu. The increase of PKR113/mmbtu will have a negative EPS impact of PKR0.50/sh for EPCL. Similarly, gas prices for LOTCHEM are expected to revise up to PKR1,100/mmbtu, increasing by PKR146/mmbtu. The said hike will have a negative EPS impact of PKR0.33/sh.

Proposed increase in gas tariff (PKR/mmbtu)

	Existing rate	Proposed rate	PKR ▲	%▲
Domestic (Residential) Sector Protected				
Up to 0.25 hm ³ /month	121	121	-	0%
Up to 0.5 hm ³ /month	121	150	29	24%
Up to 0.6 hm ³ /month	300	200	(100)	-33%
Up to 0.9 hm ³ /month	300	250	(50)	-17%
Non-Protected				
Up to 1 hm ³ /month	300	400	100	33%
Up to 1.5 hm ³ /month	553	600	47	8%
Up to 2 hm ³ /month	553	800	247	45%
Up to 3 hm ³ /month	738	1,100	362	49%
Up to 4 hm ³ /month	1,107	2,000	893	81%
Above 4 hm ³ /month	1,460	3,100	1,640	112%
Bulk	780	1,600	820	105%
Special Commercial (Roti Tandoor)	697	697	-	0%
Commercial	1,283	1,650	367	29%
Power				
KE, SNPC, EPQL	857	1,050	193	23%
Liberty	1,181	2,406	1,225	104%
Fertilizer				
Feed (Engro)	117	140	23	20%
Feed (FFBQL)	302	510	208	69%
Fuel	1,023	1,500	477	47%
Cement	1,277	1,500	223	17%
Export Industries				
Process	819	1,100	281	34%
Captive	852	1,100	248	29%
Non Export Industries				
Process	1,054	1,200	146	14%
Captive	1,087	1,200	113	10%
CNG	1,371	1,805	434	32%

Source: News, Insight research

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Frequently Used Acronyms

TP	Target Price	DCF	Discounted Cash Flows	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DDM	Dividend Discount Model
SOTP	Sum of the Parts	P/E	Price to Earnings ratio	P/Bv	Price to Book ratio
P/S	Price to Sales	EVA	Economic Valued Added	BVPS	Book Value per Share
EPS	Earnings per Share	DPS	Dividend per Share	DY	Dividend Yield
ROE	Return on Equity	ROA	Return on Assets	CAGR	Compounded Annual Growth Rate

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