Pakistan Oil and Gas

Sajjad Hussain
sajjadhussain@alfalahclsa.com
+92-21-35645067

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Revision in gas prices eradicates CD flow

2HFY24 cash flow recovery expected above 100%

The govt has increased gas prices effective 1st Feb'2024 which may have interesting effects on the circular debt for the remainder FY24 and especially for FY25. The govt has increased gas prices to cover the revenue shortfall for FY24, incorporating the impact of delayed gas price increases in Nov'23 (4 months) and Feb'24 (1 month). This will result in 2HFY24 cash flow recovery above 100%. This implies that CD for 7MFY24 will be retired through this surplus cash flow. The most interesting part is that if these gas prices persist throughout FY25 (post 30th June'2024), there will be a surplus of PKR283bn at current (FY24) revenue requirement. A sensitivity analysis was performed, which showed that even if the revenue requirement for FY25 rose by 30%, there may be no accumulation of circular debt in the entire FY25.

RLNG diversion included in the revenue requirement: There has been a key development in the revised revenue requirement of SNGP on 2nd Feb'24 wherein, the company was allowed to incorporate PKR232bn under RLNG diversion to the domestic sector. To note, the amount was previously ignored leading to accumulation of circular debt.

Figure 1

RLNG Diversion cost - SNGP

PKRmn	FY24	
	2nd Jun'23	2nd Feb'24
Requested	252,046	232,928
Allowed	-	231,916
Circular debt Contribution	**252,046**	**1,012**

Source: Alfalah CLSA Research

2HFY24 cash recovery beyond 100%: In the 1HFY24, the govt was late (Delay of 4 months) to implement the requested adjustment in prices and again in 2HFY24 (Delay of 1 month). To compensate for these delays, the required gas price escalated higher than it would have been if the price adjustments occurred on time. This will also result in higher OGDC and PPL receivables for 1HFY24, evident from PKR48bn increase in receivables in 1QFY24. However, since the revenue requirement for the entire FY24 has now been built in prices, all circular debt pile up from the 1HFY24 will be recouped in cash in the 2HFY24, leading to cash recovery beyond 100%.

Figure 2

Circular debt flow FY24

	1HFY24	2HFY24	FY24
Time weighted Revenue	354,653	575,209	929,863
Revenue Requirement*	450,985	450,985	901,969
Surplus/(Deficit)	-96,331	124,225	27,894

Source: Alfalah CLSA Research
*Equally divided

Reduction in circular debt stock possible in FY25: At current prices, the annualized run rate of revenue stands at PKR1,185bn, whereas the current revenue requirement for the system (SNGP & SSGC) stands at PKR902bn. Assuming the revenue requirement for FY25 remains at the same level as FY24, there will be a surplus of PKR283bn in the system for FY25. We performed a sensitivity analysis to gauge the effect of increase in revenue requirement (due to various factors e.g. PKR/USD, Oil prices, Higher RLNG diversion etc) on circular debt flow. Even if FY25 revenue requirement were to increase by 30%, the E&Ps should still have 100% cash translations of all gas invoices generated for the year.

Figure 3

Full year revenue at current prices

	Consumption TBU	Revenue (PKRmn)
Domestic		
- Protected	93.10	25,603
- Non Protected	210.60	454,106
Bulk	13.17	38,196
Special Tandoor	3.00	4,080
Commercial	12.50	48,754
Process - General Industry	50.25	108,035
Captive - General Industry	21.20	58,308
Process - Zero rated Industry	8.59	18,469
Captive - Zero Rated Industry	46.07	126,679
CNG	16.95	63,559
Cement	1.31	5,742
Fertilizer		
- Feed - General	17.11	27,317
- Feed - EFERT Concessionary	31.00	49,507
- Fuel	3.50	5,590
Power station	35.98	37,777
Total variable revenue		1,071,721
Fixed charge		114,048
Total Revenue		**1,185,769**

Source: Alfalah CLSA Research

An interesting situation will arise if the revenue requirement increases by less than 30%. In this case, there shall be a surplus in the system which complicates the situation in regard to the law. As per our understanding, OGRA's approved revenue requirement (translated into consumer gas tariffs) should not result in either deficit or surplus for that given year. This could lead to a downward revision in gas prices post 1st Jul'24. Even if prices are not revised downward, there will always be the complication of GDS, whereby all surplus revenues generated in the system have to be transferred to the provinces.

However, all these complications can be addressed simply by deliberately increasing the revenue requirement beyond the core requirement for that year to incorporate the shortfall of the previous years (CD retirement). This should not lead to any surpluses in the system on paper.

Figure 4

Circular debt flow FY25

Revenue requirement increase	0%	10%	20%	30%	40%
Revenue requirement	901,969	992,166	1,082,363	1,172,560	1,262,757
Revenue at current prices	1,185,769	1,185,769	1,185,769	1,185,769	1,185,769
Surplus/ (Deficit)	283,800	193,603	103,406	13,209	(76,988)

Source: Alfalah CLSA Research

How do OGDC and PPL benefit? If OGRA decides to include prior year's shortfall in FY25's revenue requirement, then any amount considered under the head may be used to retire the outstanding receivables of both OGDC and PPL. We present a sensitivity of additional cash flows based on equal cash distribution.

Figure 5

Circular debt flow FY25					
Revenue requirement increase	**0%**	**10%**	**20%**	**30%**	**40%**
Surplus/ (Deficit)	283,800	193,603	103,406	13,209	(76,988)
CD stock retirement					
OGDC	141,900	96,802	51,703	6,605	(38,494)
PPL	141,900	96,802	51,703	6,605	(38,494)
Incremental cash flow/sh					
OGDC	33.0	22.5	12.0	1.5	-8.9
PPL	52.2	35.6	19.0	2.4	-14.2

Source: Alfalah CLSA Research

Additional revenue sources available: Please note these calculations are premised on the consumer gas tariffs notified by the OGRA. However, during the year there is a blend of RLNG charged, especially to industries, to recoup the RLNG diverted to domestic consumers. Since RLNG diversion is now a part of OGRA's revenue requirement, the blended rate may push the surplus for remainder FY24 and FY25 higher than our estimates.

Outlook: We have a 'BUY' call on both OGDC and PPL in the context of improved cash flows and the possibility of circular debt stock reduction. At our target price of PKR170/sh and PKR150/sh, OGDC and PPL offer a total return of 59.2% and 50.7%, respectively.

Key assumptions

- Effective gas rates for Protected and Non-protected domestic consumers are simple average of all slabs.
- Effective fixed charge for Protected and Non-protected domestic consumers are simple average of all slabs.
- The effect of blended RLNG provided to commercial and industrial consumers have not been taken in our calculations.
- All cashflows are directed to OGDC and PPL
- SSGC's composition of protected and non-protected consumers is assumed same as SNGP

Key Risk:

- Stay orders, delaying the implementation of new prices
- Downward adjustment in prices post 1st July'24
- Excess PKR depreciation
- Unfavorable movement in oil prices
- Excess diversion of RLNG to domestic consumer

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