



# State owned E&Ps

## Government is finally showing some interest in resolving E&Ps circular debt

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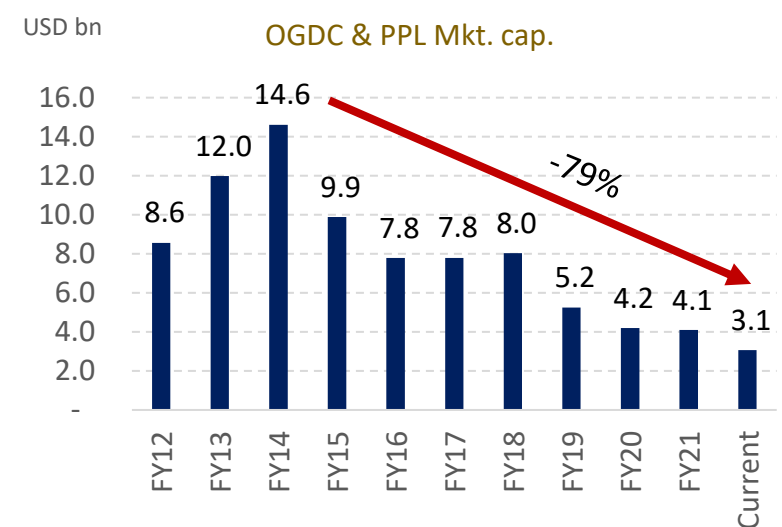
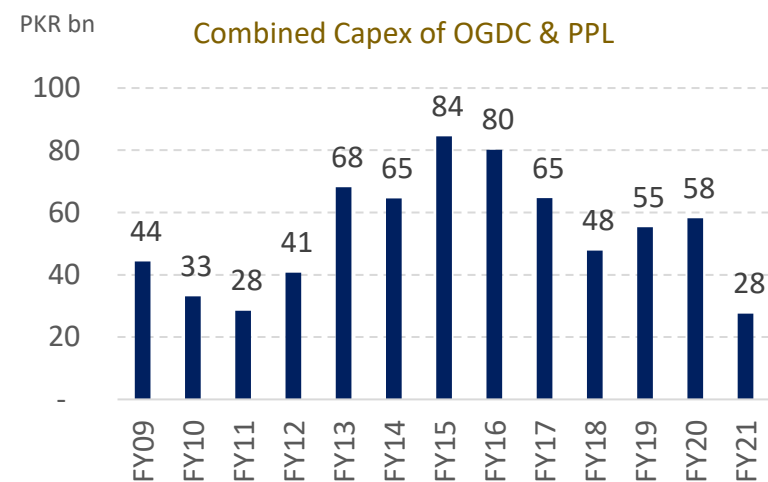
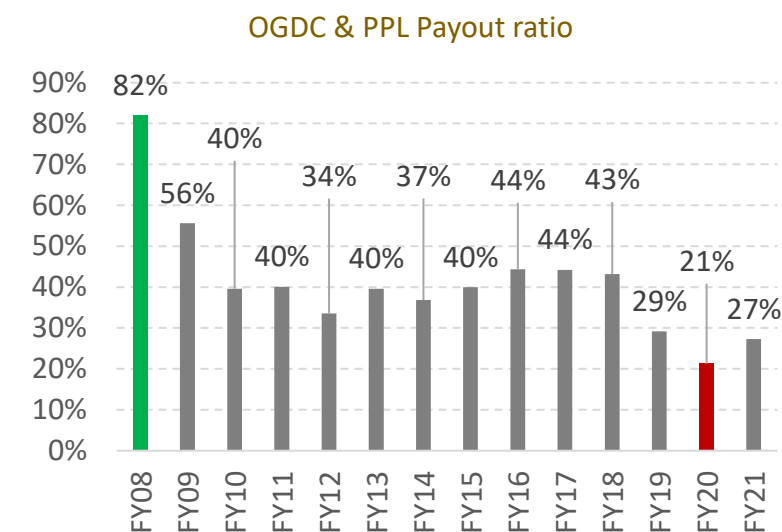
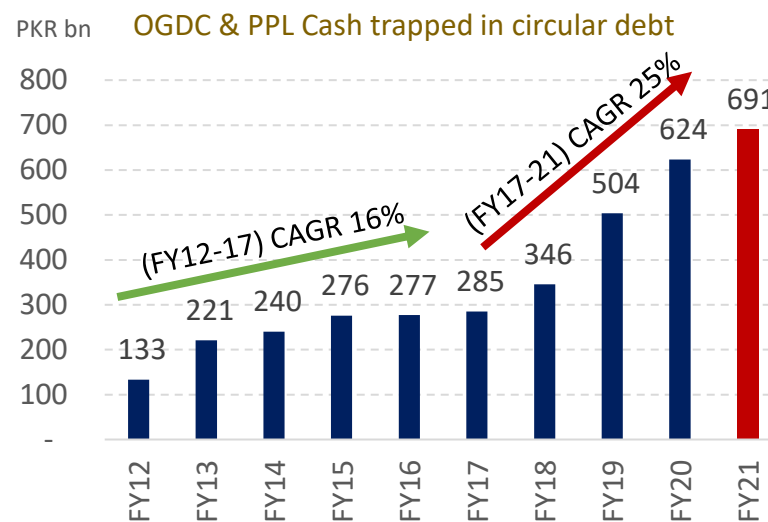
*Prices as of 3<sup>rd</sup> December, 2021*

## Summary

- Recently, the Advisor to Prime Minister on Finance and Revenue stated that listed state owned E&Ps can reduce their circular debt by declaring large dividends, use the dividend payable to the GoP to offset its receivables and stop charging penal interest on their circular debt stock.
- This proposal is slightly different from the previous proposals, which would have required an injection / fiscal cost of PKR 117bn based on Sep-21 accounts of the E&P companies.
- The proposal means that the government is not willing to incur any fiscal cost, local E&Ps would not get any liquidity injection and would in fact have to use their cash balances to pay dividends to private sector shareholders. On the flipside, the listed state-owned E&Ps are more interested in further beefing up their cash reserves, which are up by PKR 62bn since FY18.
- Any large dividends from E&P companies would be contingent upon either E&P companies setting aside their conservative mindset or the GoP agreeing to incur a fiscal cost through a cash injection. We believe the latter will be a better approach.
- OGDC's and PPL's overdue receivables stood at PKR 589bn as of Sep 30, 2021. For OGDC, an additional PKR 131bn are stuck in quasi GoP TFCs and related accrued markup. This takes the total stock of E&Ps circular debt to PKR 720bn, equivalent to 46% of the total asset base of these companies.

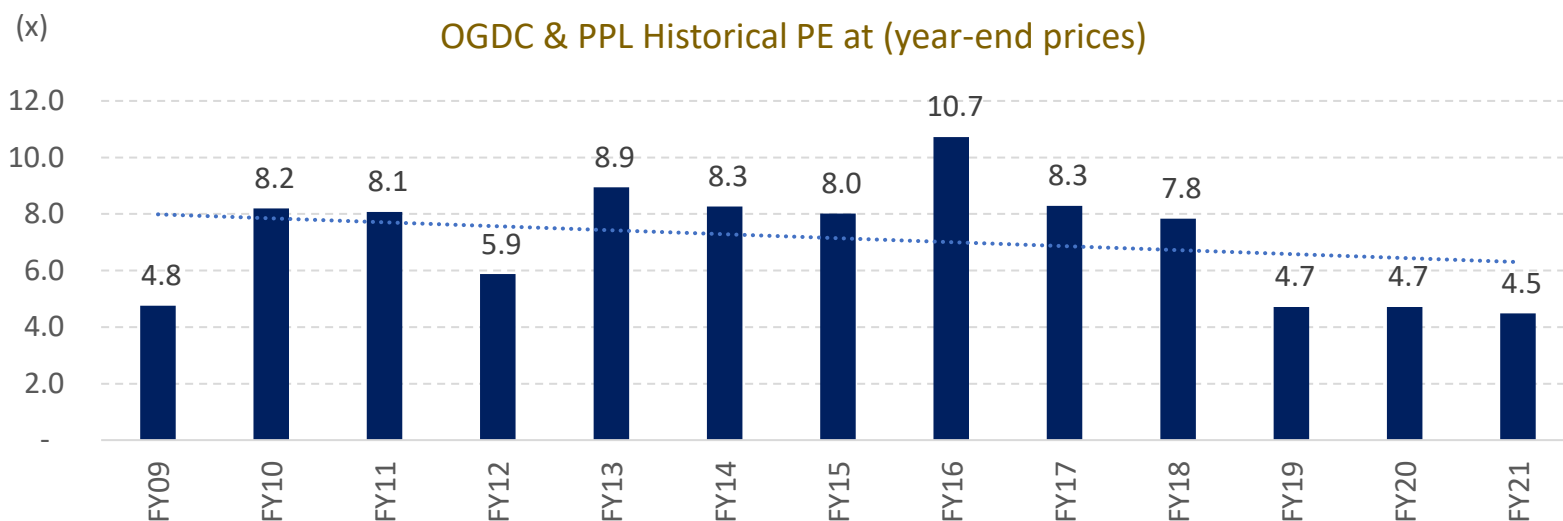
## Circular debt burden on E&P companies has worsened since FY18

- The circular debt situation for OGDC & PPL has worsened even more since FY18. Average annual accumulation of overdue receivables for OGDC and PPL stood at ~PKR 108bn during FY18-21, versus an average of ~PKR 11bn in the previous years.
- Resultantly, both OGDC and PPL have reduced their dividend payouts despite rising profits. The combined payout ratio has come down from 44% in FY17 to 27% in FY21.
- Furthermore, the situation has also affected the capital expenditure plans of both companies, with combined capex declining from PKR 85bn in FY15 to PKR 28bn in FY21.
- The situation also adversely impacted the stocks' price performance and the market capitalization of both the companies has come down to USD 3.1bn, compared to USD 14.6 bn at the end of FY14.



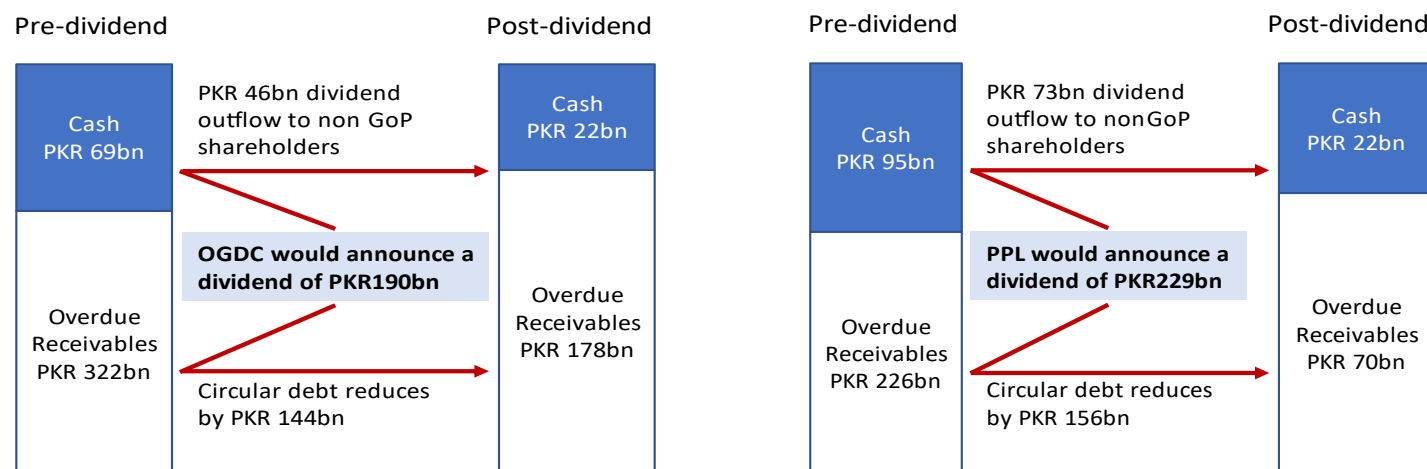
## Government is finally showing some interest in resolving E&Ps circular debt

- Recently, the Advisor to Prime Minister on Finance and Revenue stated that state owned E&Ps can reduce their circular debt by declaring large dividends, use the dividend payable to the GoP to offset their circular debt receivables and stop charging penal interest on their circular debt stock. He also hinted that the government could settle PKR 300-400bn or ~51-68% of E&Ps circular debt through this arrangement.
- This development is an evidence that the government is finally assigning some priority to gas related circular debt that hurts the E&P companies and is affecting their valuations. The listed, state-owned E&P companies are currently trading at 2.8x FY22 earnings which limits the government's capacity to use secondary offerings / GDRs as a source to finance fiscal deficit.
- To reduce circular debt by PKR 300bn through the above approach, E&P companies would have to announce a dividend of PKR 419bn. The cash balances with OGDC and PPL would reduce to PKR22bn each.



OGDC – potential flows as per Fin Min's plan

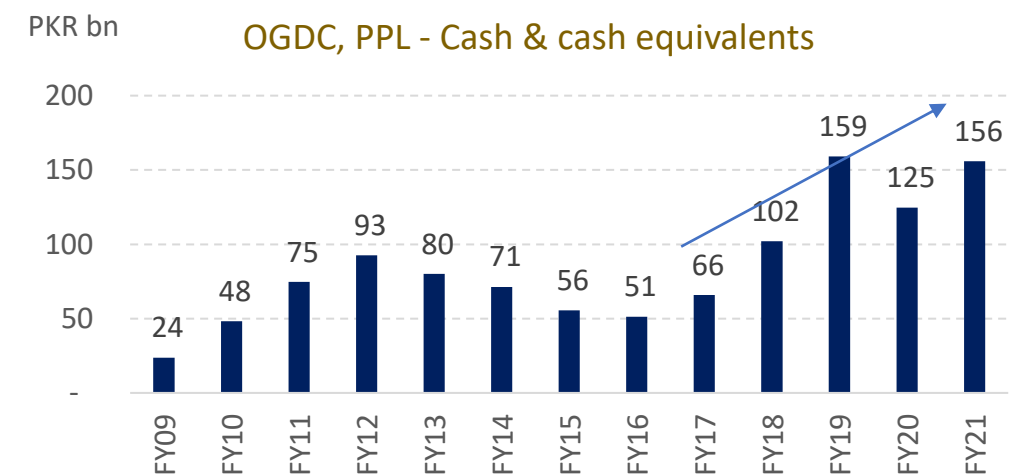
PPL – potential flows as per Fin Min's plan



## One-off dividend to settle PKR 300 - 400bn circular debt. What are the possibilities?

- If we target a PKR 300bn reduction in circular debt, OGDC and PPL will have to declare a combined one time dividend of PKR 419bn (PKR 44/share for OGDC and PKR 84/share for PPL). We have prorated the split of PKR 300bn between OGDC and PPL, based on their existing cash balances and target post dividend cash balance of PKR 22bn each, corresponding to ~80% of their FY18-20 annual capex.
- OGDC's circular debt will come down by PKR 144bn or 45% whereas PPL's would fall by PKR 156bn or 59%.
- With the government's share of dividends being used to offset the circular debt, dividend outflow to private sector shareholders will be PKR 119bn combined (PKR 73bn for PPL and PKR 46bn for OGDC).
- Since this payout would substantially reduce cash balances of OGDC and PPL, hence, the conservative business approach of OGDC's and PPL's management would be a key stumbling block in this proposal going through. Its important to note here that OGDC and PPL have recently been stocking up cash on their balance sheets.
- There is also a strong likelihood that instead of single large dividend, E&Ps would be more comfortable in a staggered reduction, spread across a few years.

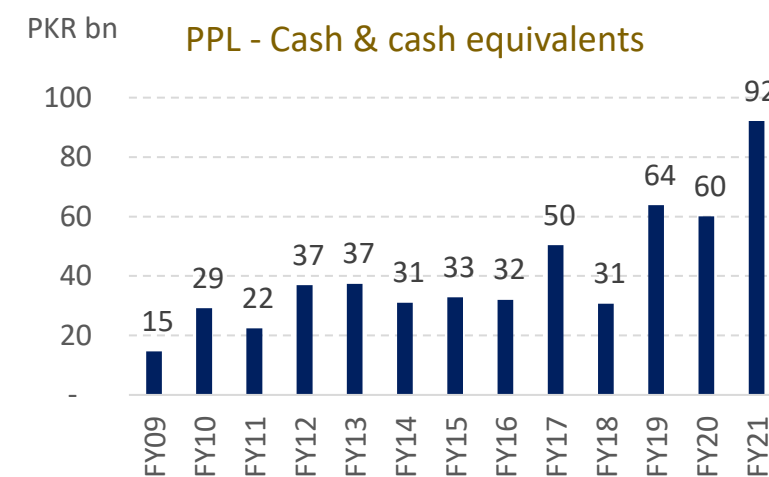
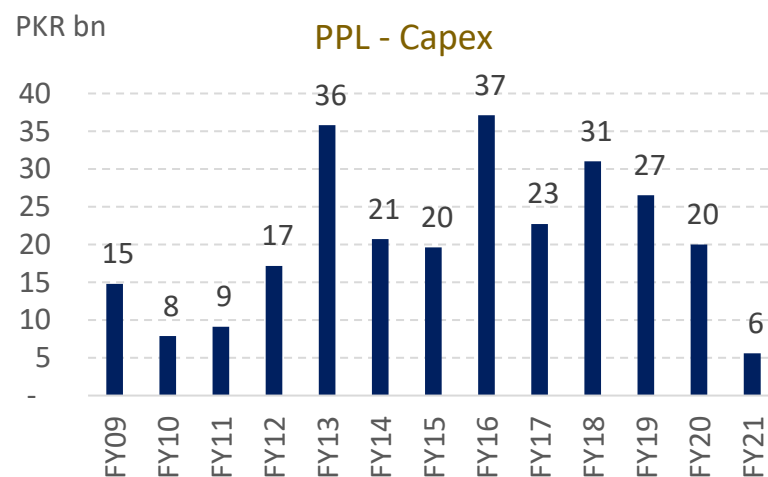
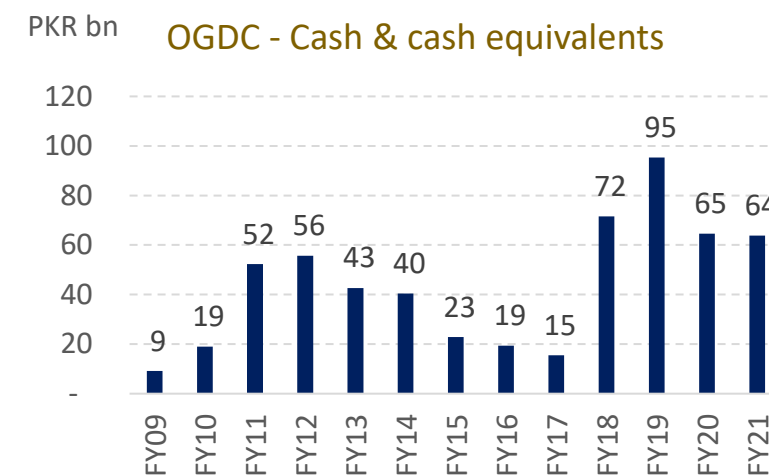
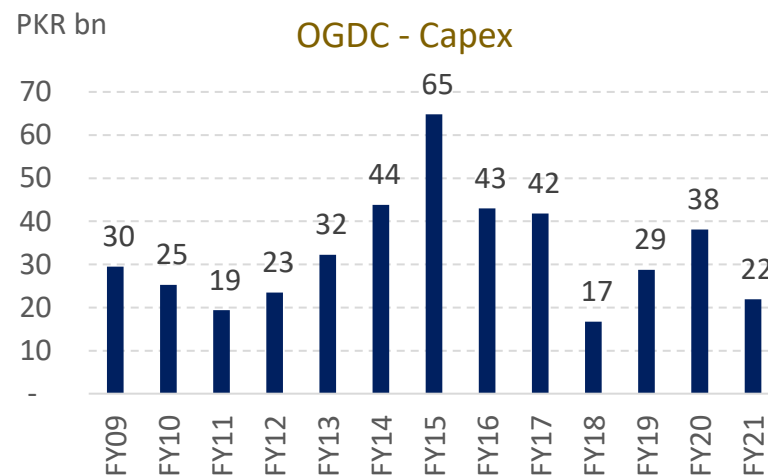
Receivables of State-Owned E&Ps stuck in Circular Debt			
(PKR bn)	OGDC	PPL	Total
<b>Overdue Receivables (Sep 30, 2021)</b>	190	229	419
Share of Dividend			
GoP including PC	144	156	<b>300</b>
Shareholders other than GoP	46	73	119
<b>Total dividend to be declared</b>	<b>190</b>	<b>229</b>	<b>419</b>
Actual dividend outflow (To private investors)	46	73	119
<b>E&amp;Ps cash and cash equivalents (Sept 30, 2021)</b>	69	95	164





## E&P companies have recently been building up cash buffers

- In last 5 years, amid significant reduction in payout and capex, OGDC's and PPL's cash and cash equivalents have increased significantly, suggesting that state owned E&Ps are more interested in building up their cash reserves.
- OGDC's capex has come down to PKR 22bn in FY21 from PKR 65bn in FY15 whereas its cash and cash equivalents reached PKR 64bn in FY21 as against PKR 23bn in FY15.
- Similarly, PPL's capex plunged to mere PKR 6bn during FY21 vs PKR 37bn in FY16. However, cash and cash equivalent increased to PKR 92bn in FY21 compared to PKR 32bn in FY16.



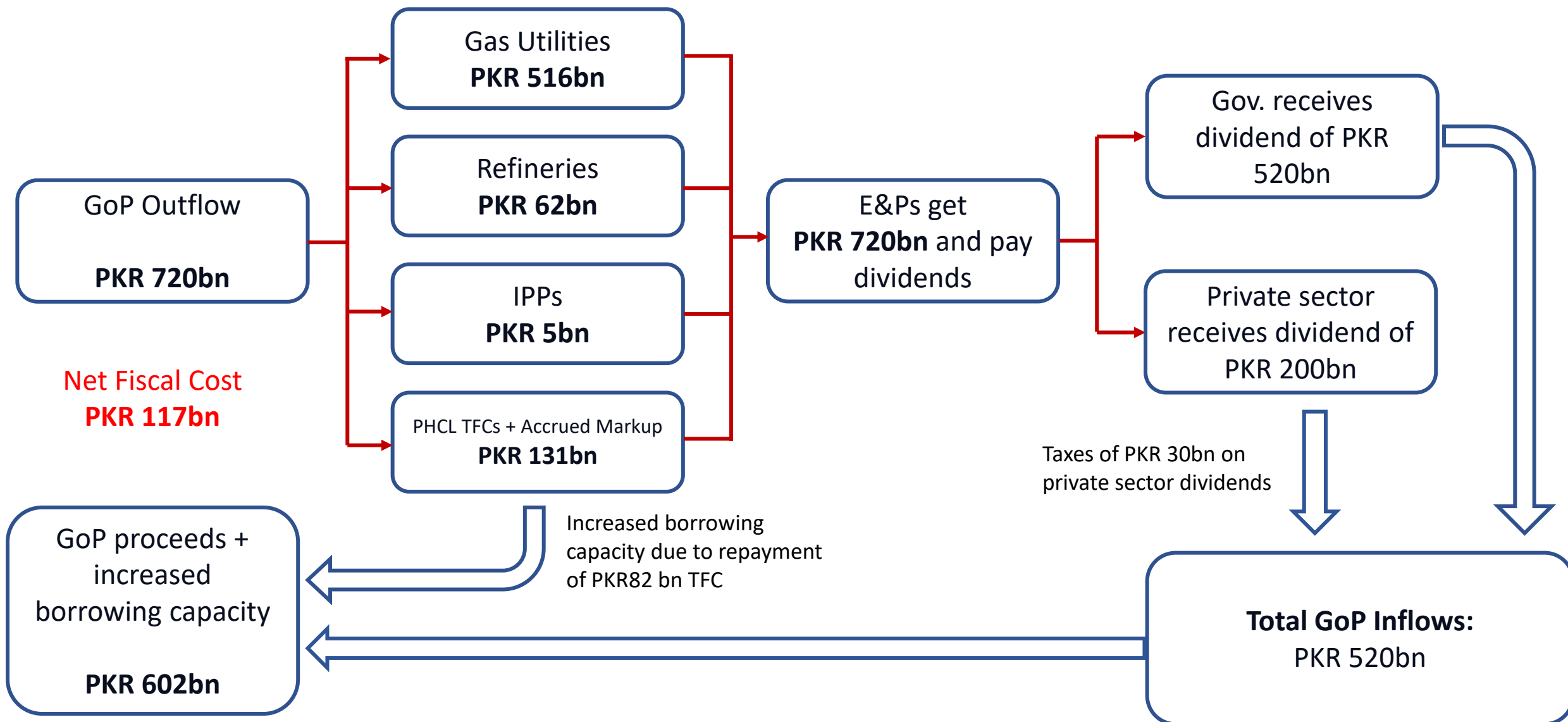
## A better approach: PKR117bn net fiscal outlay can reduce circular debt by PKR 720bn

- The total asset base of the two listed state-owned Oil & Gas Exploration firms, OGDCL and PPL stood at PKR 1.5tn end of Sep-21 (June-21: PKR 1.4tn).
- Out of this, PKR 720bn or 46% is tied in circular debt (June-21: PKR 692bn, 45%), which is roughly 132% and 136% of yesterday's market capitalization of OGDCL and PPL respectively. Additionally, OGDCL and PPL had cash balances of PKR 16 / PKR 35 per share as of Sep 30, 21 amounting to 20% and 47% of their yesterday's market capitalization.
- If the government pays off OGDCL's and PPL's entire circular debt of PKR 720bn and instructs these entities to pay it out as cash dividends, the **net fiscal outlay will likely be a mere PKR 117 billion.**
- An ideal approach could be to announce a plan to clear this stock of circular debt in 3 annual tranches. This will help in share price discovery and allow the government to undertake the IMF mandated stake sale at attractive prices. Policy makers should look into this.

<b>Circular Debt &amp; E&amp;Ps' Balance Sheet Summary – Sep-21</b>		<b>OGDCL</b>	<b>PPL</b>	<b>Total</b>
<b>Receivables of Listed E&amp;Ps stuck in Circular Debt</b>				
PHCL TFCs + Accrued markup	PKR bn	131	0	131
Overdue Receivables	PKR bn	322	266	589
<b>Total Assets</b>	<b>PKR bn</b>	<b>991</b>	<b>558</b>	<b>1,548</b>
Assets trapped in Circular Debt	PKR bn	453	266	720
% of total Assets		46%	48%	46%
PKR/share		105	98	
<b>Share of Dividends assuming circular debt is cleared, and proceeds are paid out as dividends</b>				
Government of Pakistan including PC	PKR bn	340	180	520
Shareholders other than GoP	PKR bn	113	87	200
<b>Total</b>	<b>PKR bn</b>	<b>453</b>	<b>266</b>	<b>720</b>
<b>Impact of taxes on Dividends</b>				
Government of Pakistan including PC	PKR bn	17	13	30
Shareholders other than GoP	PKR bn	(17)	(13)	(30)
<b>Total</b>	<b>PKR bn</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net Flows</b>				
Government of Pakistan including PC	PKR bn	357	193	550
Shareholders other than GoP	PKR bn	96	74	170
<b>Total</b>	<b>PKR bn</b>	<b>453</b>	<b>266</b>	<b>720</b>
Fiscal Cost	PKR bn	125	74	199
Less: Additional Capacity created on PHCL	PKR bn			(82)
<b>Net Fiscal Cost</b>	<b>PKR bn</b>			<b>117</b>

Source: Company Accounts, Akseer Research  
PC - Privatization Commission

## A better approach: Mapping fund flows for clearing the entire stock of circular debt of listed E&Ps





## Can there be a permanent fix?

- **Utilizing distributable cashflows to arrest pileup of circular debt**
  - Assuming oil prices at USD 60/bbl, combined average annual operating cashflow of OGDC and PPL is likely to be ~PKR 244bn for FY22.
  - Excluding PKR 80bn for capex (peak annual capex was PKR 84bn during FY15) and PKR 10bn for potential working capital, OGDC and PPL should have distributable cashflows of **PKR 153bn** annually. Out of this, GoP's share of dividends will be PKR 103bn per annum.
  - Average annual accretion of circular debt (FY18-21) on the balance sheet of OGDC and PPL have been ~PKR 108bn per annum with average oil prices of USD 59/bbl.
  - If the GoP allows E&P companies to offset the dividend payable to GoP with the circular debt receivables, E&P companies can potentially eliminate annual circular debt accretion, versus an annual average of PKR 108bn during FY18-21.
- **Managing OGDCL and PPL specific circular debt can lead to massive savings**
  - Reduction in circular debt by ~PKR 300bn would save PKR 36bn in interest on circular debt overdues assuming a penal interest rate of 12%.
  - Substantial recovery in share prices of OGDC and PPL which will pave the way for privatization.

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