ARIF HABIB LIMITED

K-Electric Limited

26-May-2025

NEPRA approved KEL's Transmission and Distribution Multi Year Tariff

REP-300

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K-Electric Limited

NEPRA approved KEL's Transmission and Distribution MYT

NEPRA has approved K-Electric's multi-year distribution tariff for the period FY24 to FY30. K-Electric had proposed a seven-year tariff control period to facilitate long-term investments. However, the regulator has yet to approve the investment plan, and any revisions to it may impact our projected earnings. For FY24, the average distribution tariff has been set at PKR 3.31/KWh, while the Use of System Charge (UoSC) has been determined at PKR 1,348.66/kW/month.

The Authority approved key elements including;

- **Tariff control period:** the Authority has decided to allow a tariff control period of seven (07) years for the distribution tariff to K-Electric from FY24 to FY30.
- **Debt to equity structure:** The Authority has decided to allow a debt to equity ratio of 70:30 for the MYT control period of seven (07) years from FY24 to FY30.
- **Cost of local debt:** The Authority has decided to allow cost of local debt as 3M KIBOR+2.0% spread.
- **Cost of foreign debt:** the Authority has decided to allow cost of debt for foreign financing based on 3M LIBOR or SOFR + 4.5% spread and hedging cost, if applicable.
- **FY24 Regulatory Asset Base (RAB):** For FY24, K-Electric's average Regulatory Asset Base (RAB) has been set at PKR 83.1bn for calculating the Return on Regulatory Asset Base (RoRB). Based on the approved debt-to-equity ratio of 70:30, this translates to a debt portion of PKR 58.1bn and an equity portion of PKR 24.9bn.
- **Return on Equity:** The Authority has approved a USD-based Return on Equity (RoE) of 14.00% (requested: 16.67%) for K-Electric's distribution segment, which translates to 29.68% in PKR terms for FY24.
- **Average Cost of Debt:** K-Electric's average cost of debt for FY24 has been calculated at 24.46% and will apply to 70% of the approved average RAB, subject to adjustment in line with the prescribed mechanism. Accordingly, the total Return on Rate Base Cost of Debt (RoRBCoD) has been determined at PKR 14.2bn for the year.
- **O&M savings:** O&M savings should be shared in the ratio of 50:50 between consumers and KE.
- **T&D losses:** The Authority has allowed K-Electric to adjust for actual units sent out based on approved T&D losses (13.8%), including related cost recoveries for distribution and supply in line with other DISCOs.
- **Adjustment of distribution loss target due to change in voltage wise sales:** The Authority has decided not to permit such adjustments at this stage, in line with the prevailing practice for XWDISCOs.
- **Use of System Charge:** The UoSC has been calculated to be PKR 1,348.66/kW/month (average MDI: 2,684 MW).

Exhibit: Distribution Tariff

Component	Unit	FY24
Units Sentouts		**17,767**
KE System	GWh	7,471
Power Purchase	GWh	1,758
CPPA-G	GWh	8,538
Units Sold		**15,182**
T&T	%	0.75%
Distribution losses	%	13.80%
Total T&D Losses	%	14.55%
Total T&D Losses	GWh	2,585
Margin		
O&M	PKR mn	26,016
O&M Capex	------	225
Working Capital	------	(1,273)
Depreciation	------	8,797
RORB	------	21,615
Gross Margin	------	**55,380**
Other Income	------	(5,096)
Net Margins	------	**50,284**
PYA		-
Total Revenue Requirement		**50,284**
Total Average Tariff	**PKR/KWh**	**3.31**

Source (s): NEPRA, AHL Research

Exhibit: Use of system charge

Description	PKR mn
O&M	6,661
CAPEX nature O&M	185
Other income	(1,591)
RoRB - Cost of borrowing local	19,089
RoRB - Cost of borrowing foreign	4,991
RoRB - Cost of equity	10,278
Depreciation	3,654
Working capital	180
Total	**43,447**

Source (s): NEPRA, AHL Research

K-Electric Limited

NEPRA approved KEL's Transmission and Distribution MYT

To recall, on Oct 22, 2024 NEPRA had approved K-Electric's (KEL) generation tariff for its power plants.

Brief Takeaways of Generation Tariff

The key takeaways from tariff decision are as follows:

- **Return on Equity:** NEPRA has authorized a 14% USD-based RoE for KEL's power plants, earlier it was 15%.
- **Tariff Control Period:** Most of KEL's plants have a 7-year tariff control period, except for BQPS-III, which has an 11-year control period aligned with debt servicing.
- **Operating Mode:** The tariff operates on a "Take or Pay" model for all power plants, with KE handling the fuel arrangements.
- **Debt-to-Equity Ratio:** NEPRA has maintained the 70:30 ratio for plants.
- **Savings Sharing Mechanism:** A savings-sharing model has been implemented, where 60% of fuel and O&M cost savings are allocated to consumers. However, for BQPS-I, only 50% of fuel savings are shared with consumers.
- **Tax and Additional Charges**: NEPRA has approved KEL's request for the tax on foreign lender interest payments as a pass-through cost.
- **Black Start charges:** The authority mentioned that the decision on Black Start and Startup charges will be made separately, after a third-party evaluation.
- **Must Run Status:** KEL has a "Take or Pay" agreement for the supply of RLNG from Pakistan LNG Limited (PLL), which is set to expire in Dec'25. KEL requested the regulatory authority to grant "must-run" status for the plant and allow the associated costs to be passed through. However, the authority has decided not to give the 'must run' status to RLNG plants under the current arrangement.
- **Earning Impact:** Based on the tariff, we project FY24 earnings at PKR 1.79/share. However, elevated distribution losses exceeding the allowed limit and low recovery rates pose downside risks to profitability. We conducted a sensitivity analysis (table on the right) across various levels of T&D losses and recovery ratios. Based on our assumptions, earnings range from PKR 0.94/share at 16.8% T&D losses and a 96% recovery ratio to PKR 1.34/share at 15.3% T&D losses and a 98% recovery ratio.

Exhibit: Expected earnings of KEL

Description	FY24e	
	PKR bn	PKR/share
Expected Earnings	**49,305**	**1.79**
EPS sensitivity at distribution losses and recovery		
Distribution losses: 13.8%, Recovery 100%		1.79
Distribution losses: 14.8%, Recovery 99%		1.59
Distribution losses: 15.3%, Recovery 98%		**1.34**
Distribution losses: 15.8%, Recovery 97%		1.14
Distribution losses: 16.8%, Recovery 96%		0.94

Source (s): NEPRA, AHL Research

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Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as Dec 2025 for Target Price. In addition, return excludes all type of taxes. For more details, kindly refer the following table;

Rating	Description
BUY	Upside* of subject security(ies) is more than +15% from last closing of market price(s)
HOLD	Upside* of subject security(ies) is between 0% and +15% from last closing of market price(s)
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Equity Valuation Methodology

AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- Discounted Cash Flow (DCF)
- Dividend Discount Model (DDM)
- Sum of the Parts (SoTP)
- Justified Price to Book (JPTB)
- Reserved Base Valuation (RBV)

Risks: The following risks may potentially impact our valuations of subject security (ies);

- Market risk
- Interest Rate Risk
- Exchange Rate (Currency) Risk

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