COMPANY UPDATE

POL

Offering a stable stream of dividend income

Equity Research | Oil & Gas Exploration Companies | Monday, 15 July, 2019

We initiate our coverage on Pakistan Oilfields Limited (POL) with a DCF based Jun-20 TP of Rs.446 which provides an upside potential of 12%. A dividend yield of 18%, if incorporated gives a total return of 30%

In spite of a challenging macroeconomic environment, the company managed to grow its revenues and earnings at a 2-year CAGR of 15% and 25% respectively

Going forward, the company expects its revenues and earnings to grow at a 4-year CAGR of 25% and 13% respectively as the depreciation of exchange rate, increased exploration and development activities would further enhance the profitability of the company

Furthermore, debt free structure, stable outlook for crude oil prices and reduction in terrorism has made the valuation of the company much more attractive

Sector Overview

Pakistan had paid USD 4.3 billion for the crude oil imports and over USD 2 billion for gas (LNG) during 2018 as imported crude and refined petroleum products make 82-83 percent of Pakistan's consumption. As per a statement given by the officials of Petroleum Division in the Senate Committee; Pakistan's oil and gas reserves will finish after 10 to 13 years. Pakistan has 1,197 million barrel of oil reserves with the current speed of consumption. Out of this, 865 million barrels have been extracted while 332 million barrels remain as reserves. Out of the total 57 million cubic feet of gas discovered, 36 million has been extracted. The rest 21 million remains in the reserves that will be able to satisfy the demand for the next 13 years. The current demand for gas stands at 1,000 million cubic feet per day which are expected to go up to 3,600 by 2030. As for petroleum products, domestic production only meets 15 percent of the total demand. The country used 26.4 million tons of petroleum products in 2016-17 with 85 percent of it being imported. Pakistan has a total of 8.8 million gas consumers with an annual addition of 0.5 million consumers.

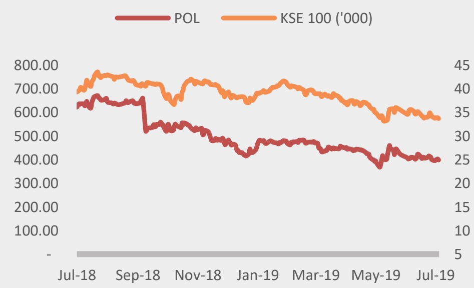
Natural gas plays a major role in the energy matrix of Pakistan. It accounts for almost 32 percent of the total primary energy supply mix in Pakistan and is 20th largest gas consumer of the word, with an established natural gas industry. Pakistan's gas consumption is nearly the same as in France, which is a developed and industrialized country. This shows how much gas Pakistan is misusing or wasting. There was a time when Pakistan was self-sufficient in gas. However, increased demand fostered by lack of alternative fuels and price subsidies coupled with diminishing production constrained by unattractive fiscal terms have resulted in systematic and power shortages.

Over the past half century, the petroleum industry has played a significant role in national development by making large indigenous gas discoveries. With looming energy crises and the ongoing growing demand for oil and gas in Pakistan, the exploration and production of oil & gas, or upstream has garnered considerable interest from investors (both local and foreign). Amid the improved security situation, Pakistan is now attracting the oil and gas exploration companies to invest in its oil and gas sector. A group of US-based oil and gas exploration companies have expressed their keen interest in investing in exploring hydrocarbon deposits in Pakistan in partnership with a state-owned domestic firm. Furthermore, a leading company of China has also expressed its readiness to invest in natural gas exploration and production sector of Pakistan.

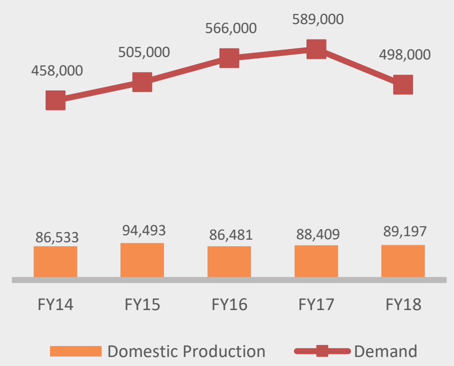
Key Statistics

Symbol	POL
TP - Jun 20	446.00
LDCP	398.40
Upside	12%
Free Float (Mn)	130
Market Cap. (Rs.mn)	113,088

Symbol	P. E
POL	8.37
OGDC	7.14
MARI	7.06
PPL	6.27



Pakistan Crude Oil Production vs Demand(bpd)



Sources: ACPL Research, Company Financials, PEB 2018, CEIC, PSX)

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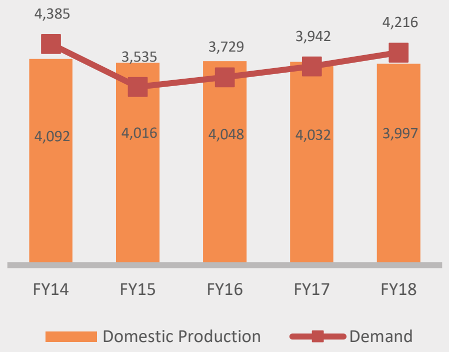
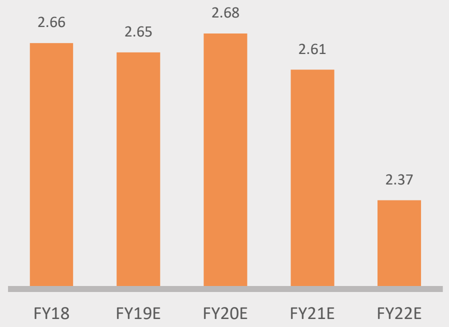
Key Statistics

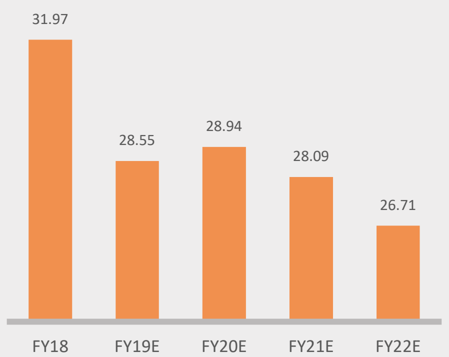
Pakistan Natural Gas Production vs Demand (mmscfd)



POL Crude Oil Production (mn, bbl)



POL Natural Gas Production (bcf)



Sources: ACPL Research, Company Financials, PEB 2018, CEIC, PSX)

Currently, around 17 local and foreign E&P companies are operating in Pakistan amongst which four companies are listed on Pakistan Stock Exchange. The Oil and Gas (O&G) sector operates under the Federal Ministry of Energy (Petroleum Division). Pakistan Petroleum Policy 2012 offers one of the best incentives for E&P companies. Government of Pakistan guarantees the purchase of whatever is produced by the O&G companies, at the well head. All proceeds to foreign companies are paid in USD. (Pakistan - Oil and Gas Equipment, 2018) (Oil & Gas Sector, 2017) (Mettis Global, 2019) (ProPakistani, 2019) (Pakistan Energy Book, 2018)

Company Overview

Pakistan Oilflelds Limited (POL), a subsidiary of The Attock Oil Company Limited (AOC), was incorporated on November 25, 1950. In addition to exploration and production of oil and gas, POL also manufactures LPG, Solvent Oil and Sulphur. POL markets LPG under its own brand named POLGAS as well as through its subsidiary CAPGAS (Private) Limited. POL also operates a network of pipelines for transportation of its own as well as other companies' crude oil to Attock Refinery Limited. In 2005, the Company acquired a 25% share in National Refinery Limited, which is the only refining complex in the country producing fuel products as well as lube base oils. (Company Website, n.d.)

Operational Performance

The Company's share in production, including that from joint ventures, in 9MFY19 averaged 7,228 barrels per day (bpd) of crude, 88.27 million standard cubic feet per day (mmscfd) of gas, 167.62 metric tons per day (MTD) of LPG, 1.84 MTD of Sulphur and 66 bpd of solvent oil.

Development activities are being done on 6 fields including Balkassar, Pindori, Tal block, Adhi, Jhal Magsi South and Ratana. Whereas, the exploratory blocks under Pakistan Oilfields Limited include Ikhlas, DG Khan, Margala, Tal, Gurgalot, and Hisal.

The exploration activities resulted in a discovery in operated area in Adhi South X-1 in FY18. The company also produced for the first time from SUL west dome in Kandhkot, which has also increased the company's reserves base.

Furthermore, Pakistan Oilfields Limited (POL) has also discovered an oil reserve in Khyber Pakhtunkhwa recently with an initial flow of 27 bpd.

Financial Performance

54% revenue of the company comes from the sale of crude oil, 26% comes from natural gas, 19% from LPG, 1% from solvent oil and 0.02% from Sulphur. The financial performance of oil and gas exploration companies in Pakistan are highly dependent on international crude oil prices. Therefore, the recovery in oil prices started from FY16 caused the company's revenue to grow at a 2-year CAGR of 15% to Rs33bn in FY18. Going forward, we expect the revenue to grow at a 4-year CAGR of 11% to Rs49bn by FY22 on account of stable oil prices in international market, devaluation of rupee and stable recoverable crude inventories held by the company. The calculation has been done by assuming the Arab Light crude oil price at $69 per barrel in FY19 and $65 per barrel in subsequent years.

The company posted the gross margin of 53% in FY18, just near to its 5-year average of 52%. Going forward, we expect the gross margin to remain stable at around 55% on account of reduced operating cost.

Other income of the company constitutes around 10% of its revenue. The major portion of the other income comes from bank deposits, exchange gains and dividend income from subsidiaries. The company posted the other income of Rs3bn in FY18. Going forward, we expect the company to post other income of around Rs4.6bn in FY19 on account of higher interest rate and huge exchange gains.

The bottom line of the company has grown at a 2-year CAGR of 25% to Rs11bn in FY18. Currently, the net margin of the company stands at 35%. Going forward, we expect the bottom line to grow at a 4-year CAGR of 13% to Rs18.5bn by FY22. Whereas, the net margin is expected to average at 36% during the same period.

Crude Oil Price Outlook

After weeks of gloom, the oil market is tightening up once again. OPEC admitted this week that it may need to keep the production cuts in place, perhaps beyond the latest extension, because of soaring production from U.S. shale. A combination of geopolitical tension in the Persian Gulf, outages in Venezuela and Iran, a pending interest rate cut by the Federal Reserve, and the brewing storm in the Gulf of Mexico has led to strong price increases in oil over the last few days. However, we expect the recent surge in oil prices is temporary and will fade away within few months on account of following assumptions.

The concerns are rising over the demand of crude oil if economic growth slows as the US and China ramp up tariffs on each other's goods in a trade war that could hit worldwide economic growth. Furthermore, the IMF has also revised down its global growth outlook from 3.5% to 3.3% which will definitely hurt the crude oil demand as well.

Furthermore, OPEC wants the crude oil prices to go higher as the economies of OPEC members are highly dependent on oil exports. For this purpose, the OPEC and its allies (Russia) decided to extend the production cut. On the other hand, USA wants the oil prices to remain lower in order to avoid inflationary pressure on US economy. Moreover, there are also some political goals behind US stance as the conflicts between some middle east countries and US are not hidden from anyone.

If we analyze the historical oil production of US and S. Arabia in chart, we come to know that the US oil production was far below than that of S. Arabia 5 years back. However, US has been uninterruptedly increasing its oil production and by doing so, it became the world's largest oil producer by crossing S. Arabia back in 2017. It can be clearly seen in the chart that S. Arabia has cut its production in 2019 over demand concerns due to global slowdown but, US is still increasing its production in order to fill the supply gap created by OPEC cut, sanctions on Venezuela & Iran and middle east tensions. Currently, US is the world's largest oil producer with total output of 12.3 million bpd and is solely capable of manipulating the crude oil prices. Therefore, we expect the US stance on oil prices would prevail and the current upside in oil prices would only be prolonged as long as the storm is brewing in Mexico. However, we expect the prices of WTI and Arab light to hover around $50 and $60 respectively.

Debt Free Capital Structure

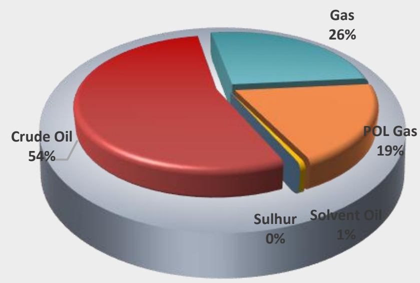
In today's high-cost money environment where the policy rate has reached 12.25% from the bottom of 5.75% within a year and expected to rise further in future as well, debt-free companies are the only suitable options for risk-averse investors. PPL is wholly equity financed company. Hence, it has a debt-free structure and free from related cash flow distress and default risks.

High Dividend Yield as Consistent Income

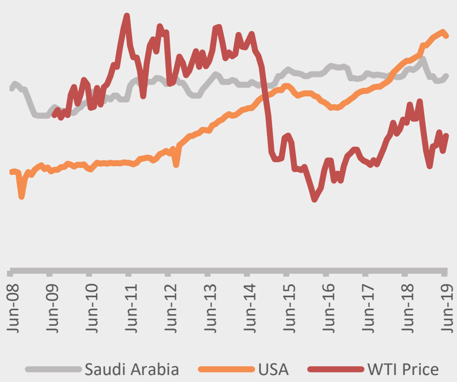
One of the simplest ways for companies to communicate financial well-being and shareholder value is to say, "the dividend check is in the mail." POL had announced the annual dividend of Rs42.5 (106% payout ratio) in FY18 which makes a dividend yield of around 11%. Hence, during the period of uncertainty and high volatility in the stock market, POL is one of the best options to secure a regular stream of income in the form of high expected dividend yield of around 17% in FY20.

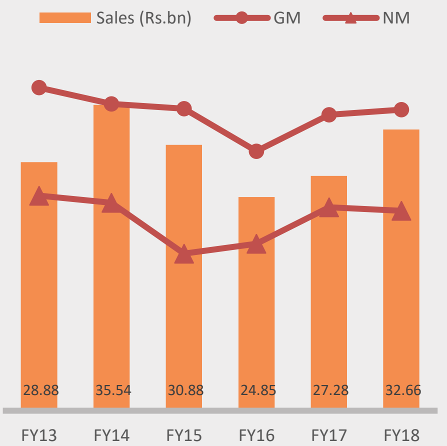
Key Statistics

Components of Sales



Saudi Arabia vs USA Oil Production





Sources: ACPL Research, Company Financials

Key Statistics

Investment Perspective

The company has an edge of having dollar denominated revenue in such environment where the domestic currency has been depreciated over 50% since last 1.5 year. Further depreciation is still on the cards as the government has decided to keep the rupee near to its fair value. Furthermore, debt free structure, stable outlook for crude oil prices and reduction in terrorism has made the valuation of the company much more attractive.

Valuation

POL is currently trading at FY20E PE of 5.85x. We have a **BUY** stance on the script with a DCF based Jun-20 TP of Rs.446 which provides an upside potential of 12%. Furthermore, it also offers a dividend yield of 18% which makes the total return of 30%.

Key Risks to Valuation

- Appreciation of PKR
- More than expected drop in oil prices
- Deterioration of law and order situation in Sindh & Balochistan

Key Ratios

Profitability Ratios		FY14A	FY15A	FY16A	FY17A	FY18A	FY19E	FY20E	FY21E	FY22E	FY23E
GP Margin	%	53.49	52.68	45.25	51.58	52.46	55.31	56.39	56.52	56.48	55.01
NP Margin	%	36.26	27.39	29.11	35.48	34.85	33.77	39.15	36.26	37.84	37.02
OP Margin	%	45.13	35.34	34.17	42.83	39.83	45.19	45.78	45.52	47.58	46.11
ROE	%	36.62	26.14	23.99	30.73	34.74	46.46	61.71	60.07	62.86	48.66
ROCE	%	32.38	23.27	18.21	24.68	26.42	27.70	28.14	29.10	29.78	23.04
ROA	%	22.27	15.26	12.98	16.79	16.22	16.04	18.31	17.24	17.53	13.62

Liquidity Ratios		FY14A	FY15A	FY16A	FY17A	FY18A	FY19E	FY20E	FY21E	FY22E	FY23E
Current	x	2.53	2.37	2.22	2.22	1.72	2.82	2.81	2.67	2.68	2.60
Quick	x	1.91	1.65	1.55	1.70	1.42	2.44	2.46	2.34	2.36	2.35

Activity Ratios		FY14A	FY15A	FY16A	FY17A	FY18A	FY19E	FY20E	FY21E	FY22E	FY23E
Inventory Turnover	x	171.06	149.87	94.94	91.33	126.89	140.97	141.70	137.19	134.21	116.31
Inventory Days		4.59	5.15	7.02	8.25	6.05	5.79	5.91	6.12	6.25	6.97
Receivables Days		52.31	41.10	49.00	44.06	92.10	92.10	92.10	92.10	92.10	92.10
Payables Days		127.67	121.78	148.91	159.27	375.30	295.40	343.70	369.63	385.41	473.70
Operating Cycle		-70.77	-75.54	-92.88	-106.95	-277.15	-197.50	-245.69	-271.41	-287.06	-374.62

Investment Ratios		FY14A	FY15A	FY16A	FY17A	FY18A	FY19E	FY20E	FY21E	FY22E	FY23E
DPS		52.50	40.00	35.00	40.00	42.50	55.15	71.54	67.49	68.51	51.36
Div. Yield	%	13.18	10.04	8.79	10.04	10.67	13.84	17.96	16.94	17.20	12.89
Dividend Cover	x	0.86	0.74	0.73	0.85	0.94	0.95	0.95	0.95	0.95	0.95
Retention	%	-15.64	-34.23	-37.34	-17.31	-5.97	-5.00	-5.00	-5.00	-5.00	-5.00
Payout	%	115.64	134.23	137.34	117.31	105.97	105.00	105.00	105.00	105.00	105.00
No. of Shares	('m)	283.86	283.86	283.86	283.86	283.86	283.86	283.86	283.86	283.86	283.86
EPS		45.40	29.80	25.48	34.10	40.10	52.52	68.13	64.28	65.25	48.92
BVPS		123.99	114.02	106.23	110.96	115.44	113.04	110.41	107.01	103.79	100.53
P/E	x	8.78	13.37	15.63	11.68	9.93	7.59	5.85	6.20	6.11	8.14
Sales per share		125.20	108.79	87.54	96.11	115.08	155.52	174.04	177.25	172.43	132.14
P/BV	x	3.21	3.49	3.75	3.59	3.45	3.52	3.61	3.72	3.84	3.96
P/S	x	3.18	3.66	4.55	4.15	3.46	2.56	2.29	2.25	2.31	3.02

Source: ACPL Research, Company Financials

Financial Projections

Rupees' millions	FY14A	FY15A	FY16A	FY17A	FY18A	FY19E	FY20E	FY21E	FY22E	FY23E
Revenue	35,540	30,881	24,848	27,280	32,665	44,145	49,402	50,314	48,945	37,508
Operating Cost	-7,608	-8,726	-8,872	-8,384	-8,456	-11,429	-12,789	-13,025	-12,671	-9,710
Excise Duty	-282	-251	-265	-272	-308	-350	-392	-399	-388	-298
Royalty	-3,439	-2,610	-2,021	-2,344	-3,778	-4,547	-5,088	-5,182	-5,041	-3,863
Amortization of dev. and decom. costs	-5,201	-3,027	-2,448	-2,209	-2,987	-3,404	-3,274	-3,267	-3,199	-3,004
Gross profit	**19,010**	**16,267**	**11,243**	**14,072**	**17,136**	**24,415**	**27,858**	**28,440**	**27,645**	**20,633**
Exploration Cost	-1,710	-4,729	-2,052	-1,468	-2,990	-2,707	-3,275	-3,533	-2,411	-1,845
Administrative Expenses	-122	-140	-140	-109	-170	-212	-237	-242	-235	-180
Other Charges	-1,140	-486	-560	-809	-967	-1,545	-1,729	-1,761	-1,713	-1,313
Profit from operations	**16,038**	**10,913**	**8,491**	**11,685**	**13,009**	**19,951**	**22,616**	**22,904**	**23,286**	**17,295**
Other income	1,823	1,563	1,411	1,473	3,262	4,625	3,725	1,987	1,970	1,824
Finance cost	-654	-987	-1,022	-746	-1,919	-2,325	-734	-734	-734	-734
Profit before income tax	**17,207**	**11,489**	**8,880**	**12,412**	**14,353**	**22,251**	**25,607**	**24,157**	**24,522**	**18,385**
Income tax expense	-4,319	-3,031	-1,646	-2,734	-2,969	-7,343	-6,267	-5,912	-6,001	-4,499
Profit for the year	**12,887**	**8,459**	**7,234**	**9,679**	**11,384**	**14,908**	**19,340**	**18,245**	**18,521**	**13,885**
EPS	**45.40**	**29.80**	**25.48**	**34.10**	**40.10**	**52.52**	**68.13**	**64.28**	**65.25**	**48.92**
EBITDA	**14,765**	**9,489**	**6,913**	**10,128**	**11,421**	**18,333**	**20,967**	**21,224**	**21,574**	**15,551**

Source: ACPL Research, Company Financials

Horizontal Analysis

Horizontal Analysis	FY14A	FY15A	FY16A	FY17A	FY18A	FY19E	FY20E	FY21E	FY22E	FY23E
Revenue	23.07%	-13.11%	-19.54%	9.79%	19.74%	35.15%	11.91%	1.85%	-2.72%	-23.37%
Operating Cost	0.56%	14.69%	1.67%	-5.51%	0.87%	35.15%	11.91%	1.85%	-2.72%	-23.37%
Excise Duty	6.38%	-11.09%	5.67%	2.55%	13.28%	13.80%	11.91%	1.85%	-2.72%	-23.37%
Royalty	25.77%	-24.10%	-22.57%	16.00%	61.17%	20.34%	11.91%	1.85%	-2.72%	-23.37%
Amortization of dev. and decom. costs	153.51%	-41.80%	-19.14%	-9.74%	35.19%	13.97%	-3.82%	-0.22%	-2.07%	-6.10%
Gross profit	**16.90%**	**-14.43%**	**-30.89%**	**25.16%**	**21.77%**	**42.48%**	**14.10%**	**2.09%**	**-2.79%**	**-25.37%**
Exploration Cost	-4.61%	176.56%	-56.60%	-28.45%	103.64%	-9.46%	20.98%	7.87%	-31.77%	-23.47%
Administrative Expenses	31.04%	14.26%	-0.03%	-21.87%	55.55%	24.96%	11.91%	1.85%	-2.72%	-23.37%
Other Charges	20.18%	-57.42%	15.40%	44.36%	19.51%	59.83%	11.91%	1.85%	-2.72%	-23.37%
Profit from operations	**19.44%**	**-31.95%**	**-22.20%**	**37.62%**	**11.33%**	**53.36%**	**13.36%**	**1.27%**	**1.67%**	**-25.73%**
Other income	-6.70%	-14.26%	-9.73%	4.40%	121.45%	41.76%	-19.46%	-46.65%	-0.88%	-7.41%
Finance cost	-21.25%	50.92%	3.55%	-26.97%	157.11%	21.18%	-68.43%	0.00%	0.00%	0.00%
Profit before income tax	**18.25%**	**-33.23%**	**-22.71%**	**39.78%**	**15.63%**	**55.03%**	**15.08%**	**-5.66%**	**1.51%**	**-25.03%**
Income tax expense	16.04%	-29.84%	-45.68%	66.07%	8.60%	147.33%	-14.65%	-5.66%	1.51%	-25.03%
Profit for the year	**19.02%**	**-34.36%**	**-14.48%**	**33.80%**	**17.62%**	**30.96%**	**29.73%**	**-5.66%**	**1.51%**	**-25.03%**
EPS	**19.02%**	**-34.36%**	**-14.48%**	**33.80%**	**17.62%**	**30.96%**	**29.73%**	**-5.66%**	**1.51%**	**-25.03%**
EBITDA	**18.28%**	**-35.73%**	**-27.15%**	**46.50%**	**12.77%**	**60.52%**	**14.37%**	**1.22%**	**1.65%**	**-27.92%**

Source: ACPL Research, Company Financials

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DEFINITION OF TERMS

TP	Target Price	CAGR	Compound Annual Growth Rate	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DCF	Discounted Cash Flows
PE	Price to Earnings Ratio	PB	Price to Book Ratio	BVPS	Book Value Per Share
EPS	Earnings Per Share	DPS	Dividend Per Share	ROE	Return of Equity
ROA	Return on Assets	SOTP	Sum of the Parts	LDCP	Last Day Closing Price

VALUATION METHODOLOGY

To arrive at our Target Price, Abbasi & Company (Private) Limited uses different valuation methods which include:

I. Discounted Cash Flow Model
II. Dividend Discount Model
III. Relative Valuation Model
IV. Sum of Parts Valuation

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Stock Rating	Expected Total Return
BUY	Greater than 15%
HOLD	Between -5% to 15%
SELL	Less than and equal to -5%

Sector Rating	Sector Outlook
Overweight	Positive
Market Weight	Neutral
Underweight	Negative

Ratings are updated to account for any development impacting the economy/sector/company, changes in analysts' assumptions or a combination of these factors.

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