Oil and Gas Development Company Limited

(Initiating coverage)

Recommendation: BUY

Fair Value: Rs 143/share

- OGDC, the largest Oil & Gas exploration company in Pakistan, accounts for 37% and 32% of the country's overall oil and gas recoverable reserves respectively.
- The company's management has accelerated exploration and drilling activities in the recent past to increase oil and gas production to 136,830 bpd and 2,963MMscfd respectively by the year FY10-11.
- Keeping in view oil & gas discoveries success ratio in Pakistan which stands at 1:4, far better than the global success ratio of 1:10, we believe that the massive drilling & exploration activities would enable the company to achieve its somewhat optimistic five year strategic targets.
- In our view, OGDCL is expected to be one of the major beneficiaries of the upcoming Petroleum Policy 2007.
- For FY06-07, we expect the company to post an EPS of Rs11.97 as against an EPS of Rs10.69 posted in FY05-06, translating into 12%YoY increase.
- At present levels, the stock trades at prospective earnings multiple of 10 times and is offering a dividend yield of 7.8%.
- According to our forecast, during FY07-10 the topline of the company is expected to grow at a CAGR of 18.6% while earnings are likely to increase at a CAGR of 16.5%.
- Using the DCF model, at a WACC of 16.3% and terminal growth rate of 5%, our fair value for the stock is Rs143/share and US$23.54/GDR.
- At the existing price level, the stock offers potential upside of 20% from our fair value and dividend yield of 7.8% to shareholders. Thus, we advise BUY at the current market price.

Key Valuation Statistics @ 119.60	FY05A	FY06A	FY07F	FY08F	FY09F	FY10F
Earnings Per Share- diluted (Rs)	7.67	10.69	11.97	13.34	15.40	19.73
Price Earnings Ratio (x)	15.60	11.19	9.99	8.97	7.76	6.06
Dividend Per Share (Rs)	7.50	9.00	9.25	10.00	10.00	12.00
Dividend Yield (%)	6.3%	7.5%	7.7%	8.4%	8.4%	10.0%
Return on Equity (%)	41.4%	49.8%	49.5%	49.7%	49.1%	55.3%
Return on Capital Employed (%)	49.6%	56.1%	54.3%	47.3%	44.1%	51.8%
Book Value Per Share (Rs)	19.35	23.59	24.80	28.89	33.80	37.52
Price to Book Value (x)	6.20	5.10	4.80	4.10	3.50	3.20
EV/EBITDA (x)	8.54	6.58	5.86	4.94	4.30	3.29

PE, PBV and Div Yield are calculated on the closing market price of April 10, 2007

Source: Company Report & IGI Research

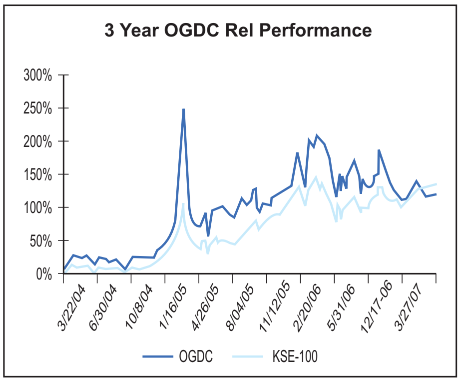
KSE code	OGDC
Bloomberg code	OGDC PA
Reuters code	OGDC KA
Market Cap in Rs	513bn
Market Cap in US$	8.45bn
Outstanding Shares	4.30bn
Free Float	14.98%
KSE100 Index Weight	17.65%
10 Ordinary Shares	one GDR
Outstanding GDRs	40.85mn
Market price per GDR	US$19.35
Fair Value per GDR	US$23.54
Potential Upside	21.00%

12 Month Price Data

High	Rs168.8/share
Low	Rs113.2/share
Average	Rs133.7/share

12 Month Volume Data

Max	113.54mn shares
Min	0.688mn shares
Average	24.04mn shares



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IGI Securities

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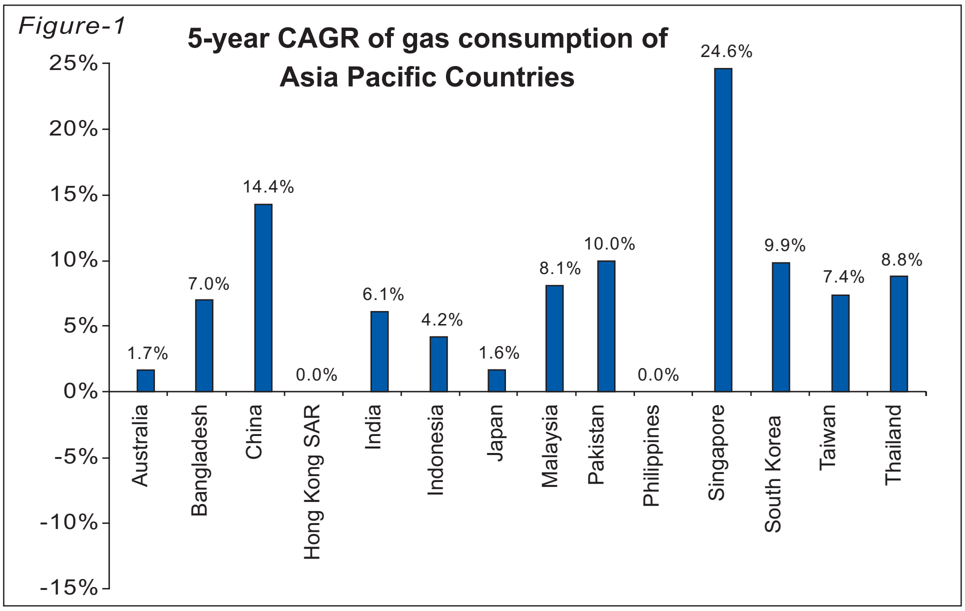
All prices are as of April 10, 2007

Spotlight on E&P Sector of Pakistan

During the past five years, gas consumption in Pakistan grew at a CAGR of 10%, which is the third highest in the Asia Pacific region…

Pakistan's GDP during the past five years grew at an average of 5.8%. During this period the large scale manufacturing sector depicted an average annual growth of 9.32%. The rapid growth witnessed by the industrial sector is one of major driving forces behind the surge in demand for energy products seen in the past few years. Since FY01, Pakistan's overall energy consumption has been growing at a compounded annual growth rate (CAGR) of 5.4%, which surged to 57.85mn ton of oil equivalent (TOE) in FY06 from 44.4mn TOE consumed in FY01. The country's total energy requirement is expected to surge to 80mn TOE by FY10. During FY01-06 demand for gas, coal, hydro electricity, nuclear electricity and LPG posted CAGR of 10%, 15%, 12.4%, 4.5% and 11.4% respectively, however, oil consumption plunged 3.2%. The growth in the country's gas consumption is the third highest in the Asia Pacific region after Singapore and China. Besides the growth in overall energy demand due to economic activity, another key driving force behind the robust increase in gas consumption is relatively greater and comparatively cheaper availability of gas in the country.

Figure-1



Source: BP Statistical Review of World Energy 2006

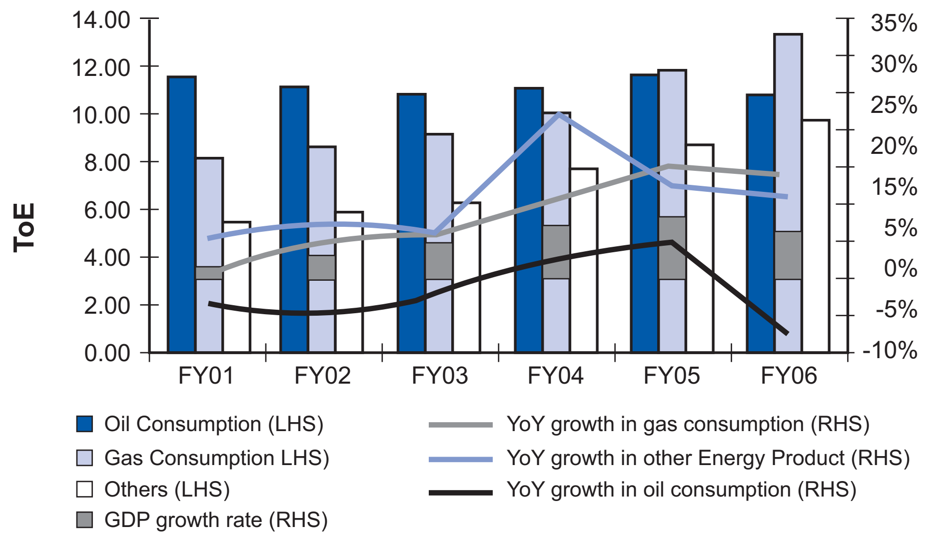
In FY05-06, gas consumption in Pakistan surged to 29.18mn TOE, witnessing an increase of 4.4%YoY…

Pakistan's dependence on gas is increasing at a rapid pace. In FY06, the share of natural gas in primary energy supplies was 50.4% followed by oil, which was 28.4%. In FY06, gas consumption witnessed a growth of 4.4%, which rose to 29.18mn TOE as against 27.95mn TOE consumed in FY05. It is expected that the country's overall gas requirements would surge to 39mn TOE by FY2010. Presently, Pakistan barely satisfies its gas requirements through domestic production. According to the Energy Year Book 2006, the country has 32.58tcf (612.4mn TOE) natural gas balance recoverable reserves and 0.53tcf (15.3mn TOE) associated gas balance recoverable reserves, which would be sufficient for almost 21years to satisfy the country's gas requirements at current consumption level.

Pakistan satisfies only 20% of its total crude oil demand through domestic production…

During FY06 oil consumption witnessed a marginal increase and stood at 16.4mn tones as against 16.3mn tones consumed in FY05. During the same period, Pakistan's domestic oil production stood at 3.2mn tones, which is equivalent to 20% of the country's annual oil demand. As per the Energy Year Book 2006, Pakistan has 324.5mn barrel (43.53mn tones) of recoverable oil reserves, which would be sufficient to satisfy Pakistan's domestic oil requirements for the next 13 years at present consumption level. It can be seen glaringly in the following graph that the demand for energy products, particularly of gas has significantly outperformed the country's GDP growth rate while oil consumption has declined mainly due to massive surge in global crude oil prices. However, overall growth in demand for energy products moved almost in line with the country's GDP growth rate during past five years.

Figure-2 **Consumption Pattern of Energy Products Relative to GDP growth during FY01-06**



Source: Energy Year Book 2006

In Pakistan, success ratio of oil & gas discoveries is 1:4, which is far better than the global success ratio of 1:10…

Pakistan is an under explored country and therefore, offers significant growth potential in this area. The success ratio of new discoveries in the country presently stands at 1:4, which is considered to be one of the best in the world. In our view, as oil & gas discovery activities speed up in the country, the success ratio would decline, going forward. However, we believe that the success ratio would continue to remain relatively attractive, as the country's present success ratio is far better than the average global success ratio presently standing at 1:10. The main reason behind the country's better success ratio is the fact that there exist huge untapped oil & gas reserves, which have not yet been capitalized.

The attractive success ratio coupled with the government's investment friendly policies would encourage domestic as well as foreign oil & gas exploration companies to invest aggressively in this area. In Pakistan crude oil prices are linked with Arabian/Persian Gulf crude oil and E&P companies get C&F prices with preset quality discounts applied. No other adjustments are applied.

Compared to the prevailing Petroleum Policy 2001, the upcoming Petroleum Policy 2007 is expected to be relatively more investment friendly…

Moreover, gas prices are notified semiannually by the Oil and Gas Regulatory Authority (OGRA) in accordance with the preset Gas Pricing Policy. The first wellhead Gas Pricing Policy in Pakistan (gas price paid to the producer) was announced in 1985 and since then it has been revised from time to time. Every subsequent policy has been more favorable for E&P companies (For gas pricing policies 1985 to 2001, see table # 1 on the next page). Presently, Petroleum Policy 2001 is implemented and the draft of Petroleum Policy 2007 has been approved by the Prime Minister, which is expected to be finalized shortly. The draft Petroleum Policy 2007 has proposed some higher fees and taxes/duties for carrying out exploration activities in Pakistan. It imposes some stringent requirements, like 10year experience to apply for acquiring any field/block for exploration activities and 3% taxes/duties on imports of machinery and other equipment used for exploration activities. In our view, the draft may not bode well for E&P companies with relatively lesser experience. However, we believe that the final draft is likely to offer some considerable benefits to E&P companies having presence in this business for the past many years. The key amendment to be introduced in the Petroleum Policy 2007 is the rise in reference crude oil price, which is likely to entice both domestic and foreign E&P companies to invest heavily in this largely untapped sector. Moreover, we believe that OGDCL would be one of the major beneficiaries of the upcoming Petroleum Policy, as the company has already acquired exploration licenses to undertake substantial drilling and exploration activities in the country. (Note: The Petroleum Policy 2007 would be applicable on new oil and gas discoveries)

Table-1 **Snapshot: Gas Pricing Policies 1985-2001**

Petroleum Policy 1985

First Gas pricing policy was announced in 1985, which is applicable on gas fields discovered between1985-1991. According to the policy: Wellhead gas prices were linked to 66% of High Sulphur Fuel Oil (HSFO) price less negotiated discounts.

Petroleum Policy 1991

Second Gas pricing policy was announced in 1992, which remains applicable on gas fields discovered between1991-1992. According to the policy: Wellhead gas prices were linked to 75% of High Sulphur Fuel Oil (HSFO) price less negotiated discounts.

Petroleum Policy 1992

Third Gas pricing policy was announced in 1992, which is applicable on gas fields discovered during middle of 1992-1993 According to the policy: Wellhead gas prices were linked to 100% of High Sulphur Fuel Oil (HSFO) price less negotiated discounts.

Petroleum Policy 1993

Fourth Gas pricing policy was announced in 1993. This policy was different from previous policies as for the first time floor was introduced. The policy is applicable on gas field discovered during mid of 1993 and 1994. According to the policy: Wellhead gas prices linked to 100% of HSFO price with floor price of US $ 80 per ton and 50% beyond US $ 80 per ton.

Petroleum Policy 1994

In the Petroleum Policy 1994, further amendments were made to the gas pricing policy 1993. According to the policy, based on geological prospects and available gas transmission infrastructure network, the country was divided into three prospective zones. Wellhead prices were linked to 67.5%, 72.5% and 77.5% of the price of a basket of imported crude for discovery in Zone III, II and I respectively.

The policy is applicable on gas fields discovered between 1994 and 1997

Gas Pricing Policy 1999

In this policy, wellhead gas prices were set using price formula based on ruling prices. Applicable well gas pricing formula is as follows:

Ruling Price ($/barrel)	Applicable Price
Crude oil prices $10 or below	$10 per barrel or 100%.
Crude oil prices between $10 and $15	100% of the ruling price.
Crude oil prices between $15 and $20	$15 plus 50% of the amount by which the price exceeds $15 per barrel.
Crude oil prices between $20 and $25	$17.5 per barrel plus 30% of the amount by which crude oil prices exceeds $20/barrel.
Above $ 25	$19 per barrel plus 20% of the amount by which crude oil prices exceeds $25/barrel.

Petroleum Policy 2001

Gas pricing formula of 1999-2000 was further improved in this policy and floor price at $10 per barrel on C&F basis and ceiling price at $36 per barrel on C&F basis were introduced. The prices formula is given below. Quality discount is applied on the applicable prices.

Marker Price ($/barrel)	Applicable Price
Crude oil prices below $10	$10 per barrel
Crude oil prices over $10 and up to $16	100% of the marker price
Crude oil prices over $16 and up to $21	$16 per barrel plus 50% of the amount by which price exceeds $16 per barrel.
Crude oil prices over $21 and up to $26	$18.5 per barrel plus 30% of the amount by which the price exceeds $21 per barrel.
Crude oil prices over $26 and up to $36	$20 per barrel plus 20% of the amount by which crude oil prices exceeds $26/barrel.
Crude oil prices over $36	$22 per barrel. This price is fixed as there is ceiling at $36 per barrel.

Sources: Ministry of Petroleum & Natural Resources and IGI Research

E&P Sector: Hedge against economic fluctuations

In our view, among all listed sectors at the local bourse, E&P is one of the least vulnerable sectors to economic fluctuations…

Presently, E&P sector has cumulative market capitalization of US$12.45bn, which is 23.5% of the entire market capitalization and 26.5% of the KSE-100 index capitalization. Among all the listed sectors at the local bourses, in our view, the E&P sector is the least vulnerable to economic fluctuations. This is due to the fact that Pakistan meets only 20% of its overall oil demand through domestic production. Secondly, the country's gas consumption is rising at a rapid pace and presently, Pakistan barely satisfies its gas demand from local production. The government is considering all possible options to meet the country's mounting future gas demand. The likely construction of Iran-Pakistan-India (IPI) gas pipeline is one prominent effort in this regard. Aforesaid facts signify that even if the GDP growth rate of Pakistan drops from 6-8% to 2-3%, going forward, it will have relatively less impact on the offtake of domestically produced oil & gas.

We expect the rupee to depreciate 4%-5% in CY07 against the US$...

Analyzing key macro economic indicators, we are of the view that the rupee is most likely to depreciate by 4-5% in CY2007 which may have some adverse impact on the equity market. Nontheless, this bodes well for the E&P sector as their revenues are positively related to any upsurge in US dollar against the Pak rupee.

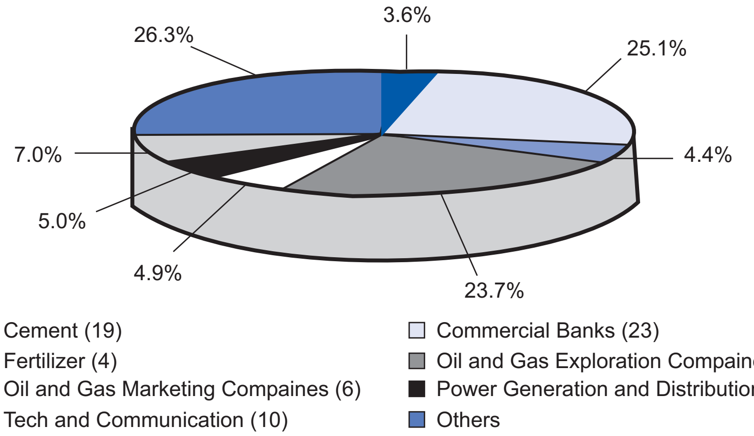
In our view, the E&P sector provides a perfect hedge against any economic uncertainty…

A probability of a slump in a country's economic cycle always persists, which can only be minimized, nontheless, cannot be ruled out completely. Keeping in view aforesaid facts, we believe that prudent investors should give more weightage to those sectors that are relatively less vulnerable to economic fluctuations. In our view, E&P sector in Pakistan is one of the sectors trading at local bourses, which is least vulnerable to the economy fluctuations and provides a perfect hedge to the investment portfolio against any unlikely economic instability.

E&P sector has strong positive correlation with the KSE-100 index mainly because of its huge market capitalization…

Despite the fact that the performance of this sector does not depend much on the country's economic scenario, however, analyzing the BETA of E&P stocks, we find that there exists a strong positive correlation between the sector and the equity market. The rational behind strong positive correlation between E&P stocks and the KSE-100 index is the sector's huge market capitalization, as only four E&P companies occupy 26.5% weightage in the index. This has a significant influence on the index's movements and thus, results in a strong positive correlation between the two.

Figure-3 **Market Capitalization of Key Sectors at KSE**



Sources: KSE & IGI Research

OGDC: A Company Overview

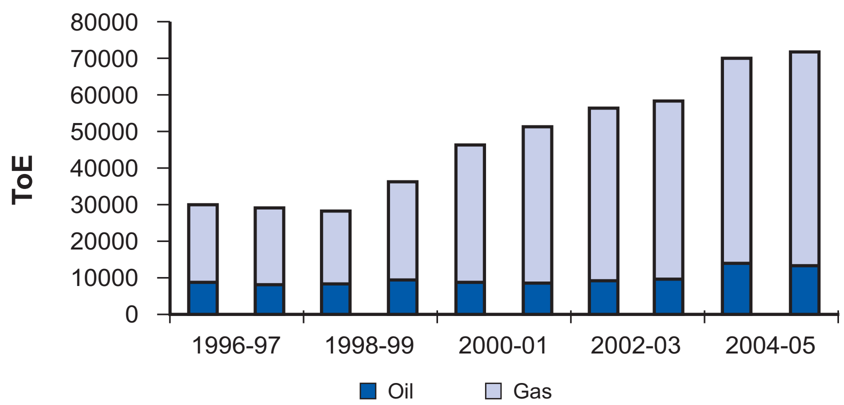
OGDC contributes 37% and 32% to the country's overall oil and gas reserves respectively…

Oil & Gas Development Company Ltd (OGDC) is the largest oil and gas exploration company in Pakistan. The company has the largest exploration acreage in the country covering 33% of the total acreage awarded. During the month of February 2007, the company's average per day production level was 45,748 barrels of oil, 1,155 MMcf of gas, 438 metric tons of LPG and 72 metric tons of Sulphur, which includes its shares in various joint ventures. Presently, the company has recoverable oil and gas reserves of 130mn barrels and 9.7tcf, which are equivalent to 37% and 32% of the country's oil and gas recoverable reserves respectively. At present, 80% of the company's production is driven from gas and 18% comes from crude oil while the remaining 2% comes from LPG, Sulphur and White Oil products. Moreover crude oil, because of relatively better margins contributes almost 44% to the company's revenues while gas adds 48% to the topline.

■ 10 Year Overview: A Performance Flashback

During the past 10years, the company's oil production increased at a CAGR of 5.2% while gas production witnessed double digit growth, increasing at a CAGR of 11.58%. Over a decade, gas contributions to the company's total volumetric sales increased from 69% in 1996-97 to 80% in 2005-06, however, crude oil share plunged from 26% to 18%.

Figure-4 **Per day Oil & Gas Production by OGDCL since FY 1997-98**

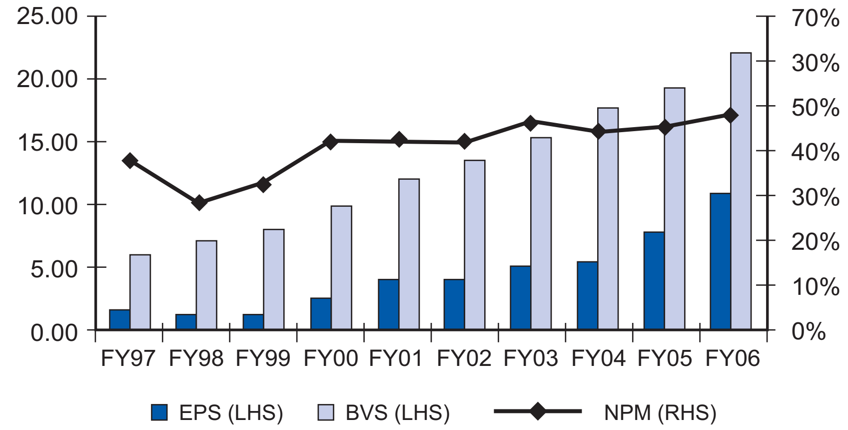


Source: Annual Report 2006

The impact of significant improvement in the company's operating performance can be witnessed by the company's financial performance. During the decade under review, total balance sheet size posted a CAGR of 11.24%, which surged to over US$2bn (PKR: Rs121.3bn). The Break up value of the company improved from Rs5.90/share in 1996-97 to Rs22.03/share in 2005-06, increasing at a CAGR of 15.77%.

Over a decade, the topline (net sales) of the company grew at a CAGR of 21.87%, which jumped to Rs96.76bn in FY2006 from Rs16.32bn in FY1997. During the decade under review, net profit margins improved from 38% to 48%. Moreover, the bottomline of the company climbed to Rs45.97bn from Rs6.14bn in 1996, portraying a CAGR of 24%.

Figure-5 **10 years EPS and BV/S at a glance**



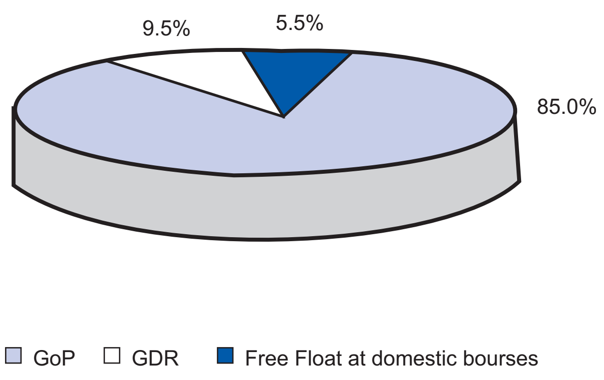
Source: Annual Report 2006

■ Shareholding Pattern: Decline in the Government's Holdings

The Government of Pakistan presently holds 85.02% stake in the company…

Till October 2003, the Government of Pakistan had a 100% stake in the company. In 2nd Quarter FY03-04 the government offloaded 4.98% of its holdings through IPOs at the local bourse and finally on 19th January 2004 the company was formally listed on all three stock exchanges of Pakistan. Recently, in 4th Quarter 2006, the GoP issued the company's GDR, which reduced the government's holding by almost 9.5%. Coupled with this, the Government also offered 0.5% of its holding to local retail investors through a secondary offering.

Figure-6 **Shareholding Pattern in OGDCL**



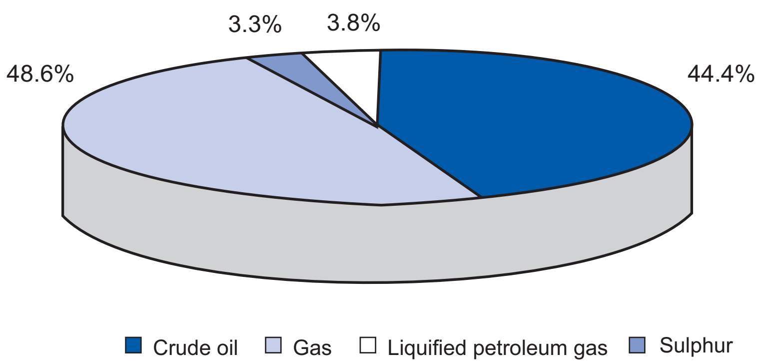
Source: Company Report 1H06-07

Performance Review 1H06-07

Net average realized oil & gas prices during 1H06-07 were US$55.10/bbl and Rs 146.68/Mcf respectively…

Recently, OGDC announced financial results for the half-year ended July-Dec 2006. The topline of the company climbed to Rs49.5bn as against Rs42.7bn reported in the corresponding period last year, witnessing an increase of 16%YoY. During the period under review, net average realized oil & gas prices were US$55.19/bbl and Rs146.68/Mcf as against US$48.32/bbl and Rs128.51/Mcf realized during the corresponding period last year, witnessing an increase of 14.2%YoY and 14.13%YoY respectively.

Figure-7 **Contribution of Energy Products to OGDC's Revenue in 1H06-07**



Source: Company Report 1H06-07

Four new discoveries were made during 1H06-07…

During 1H06-07, OGDC's gas production declined 3.46%YoY…

During the period under review, Chanda-2, Sono-8 and Pashki North East-01were put into regular production. Moreover, 15wells were spud while the target for the entire FY07 is 41 wells. Four new discoveries were made during the first six months of FY07 at Mela-1, Pasakhi North East-1, Nim West-1 and Unar-1, which are expected to shortly increase the company's per day production of oil by 5,895 barrels, gas by 32MMCF and condensate by 150 barrels. In 1H06-07, the company's oil, LPG and sulphur production witnessed an increase of 3.77%YoY, 6.71%YoY and 17.31%YoY respectively. However, production of gas plunged 3.46%YoY.

Table-2 **OGDC per day Production in 1H06 & 07**

	Jul-Dec 2006	Jul-Dec 2005	%chg YoY
Barrels of Oil	39,578	38,139	3.77%
MMcf of gas	894	926	-3.46%
LPG	366	343	6.71%
Sulphur	61	52	17.31%

Source: Company Report 1H06-07

Exploration and prospecting expenditures witnessed massive jump of 110%YoY…

During the period under review, exploration & prospecting expenditures depicted a massive jump of 110%YoY, which increased to Rs3.86bn as against Rs1.84bn posted in the comparable period last year. Financing cost recorded exponential growth as it increased from mere Rs3.6mn in 1st half FY06 to Rs222mn in 1st half FY07. Despite the fact that profit before tax increased by 8.0%YoY, the provision for taxation reduced by 5.12%YoY. Due to massive ongoing and upcoming expansions, the company has deferred some portion of taxes.

For 1H06-07, the company posted an EPS of Rs5.37, a jump of 13.83%YoY…

Due to higher exploration and prospecting expenditures, profitability margin has reduced from 47.6% to 46.7%. Overall, due to an increase in topline and decline in the effective tax rate, the bottomline grew 13.83%YoY, as it increased to Rs23bn **(EPS: Rs5.37)** from Rs20.3bn **(EPS: Rs4.72)** posted in the corresponding period last year. During the period under review, the company has paid two interim cash dividend of 17.5% (DPS: Rs1.75) each.

Rs mn

Table-3 **Income Statement Highlights July-December 2006**

	July-Dec 2006	July-Dec 2005	% Chg YoY
Net Sales	49,526	42,668	16.07%
Royalty	5,458	4,766	14.52%
	44,068	37,902	16.27%
Operating expenses	7,919	6,506	21.72%
Exploration and prospecting expenditure	3,864	1,841	109.89%
Transportation charges	512	462	10.82%
	12,295	8,809	39.57%
	31,773	29,093	9.21%
General & Administrative expenses	423	443	-4.60%
Finance Cost	222	3.6	6058.3%
WPPF	1,666	1,543	7.99%
	2,311	1,990	16.13%
	29,463	27,103	8.70%
Other income	2,197	2,210	-0.59%
PBT	31,660	29,313	8.00%
Provision for Taxation	8,547	9,008	-5.12%
Profit After Taxation	23,113	20,305	13.82%
EPS in Rs	**5.37**	**4.72**	**13.82%**
DPS in Rs	**3.50**	**3.00**	**16.67%**
Effective Tax Rate	27.0%	30.7%	-12.15%
Operating Profit Margin	64.2%	68.2%	-5.91%
Net Profit Margin	46.7%	47.6%	-1.94%

Sources: 1H06/07 Company Report

Earnings Expectations FY2006-07

For the entire FY06-07, we expect the company to post an EPS of Rs11.97, an increase of 12%YoY…

According to our forecast, for the entire FY07, the company is expected to post PAT of Rs51.47bn (EPS: Rs11.97) as against Rs45.9bn (EPS: Rs10.69) posted in FY06, translating into a growth of 12%YoY. We also expect the company to pay 62.5% (DPS: Rs6.25) cash dividend in addition to already paid interim dividend of 35%, taking the total cash dividend for FY06-07 to 92.5% (DPS: Rs9.25).

Despite the fact that the company's exploration and prospecting expenditures are likely to increase by 108%YoY and financial costs are expected to grow exponentially, the company would still manage to post some gain in its earnings on year-on-year basis.

Revenues are likely to surge to Rs117bn as against Rs96.7bn reported in the corresponding period last year, an increase of 21%YoY. Key reason behind the topline growth is the increase in crude oil production which, as per our expectations, is likely to increase by almost 10%YoY.

Rs mn

Table-4 **Income Statement Highlights July-June 2006-07**

Amount in PKR million	FY07 Expected	FY06 Actual	%Chg YoY
Net Sales	**116,709**	**96,755**	**20.6%**
Royalty	12,838	10,872	18.1%
	103,871	**85,883**	**20.9%**
Operating expenses	19,096	15,046	26.9%
Exploration and prospecting expenditure	7,661	3,681	108.1%
Transportation charges	1,413	942	50.0%
	75,701	**66,215**	**14.3%**
General & Admin expenses	1,772	1,072	65.3%
Finance cost	350	10	3409.5%
WPPF	4,164	3,469	20.0%
	6,285	4,551	38.1%
	69,416	**61,664**	**12.6%**
Other income	4,267	4,248	0.5%
Profit before taxation	**73,683**	**65,912**	**11.8%**
Provision for taxation	22,213	19,944	11.4%
Profit after taxation	**51,470**	**45,968**	**12.0%**
Diluted EPS in Rs	**11.97**	**10.69**	**11.97%**
Dividend Per Share in Rs	**9.25**	**9.00**	**5.56%**
Effective Tax Rate	**30.15%**	**30.26%**	**-0.37%**
Net Profit Margin	44.10%	47.51%	
Operating Profit Margin	64.86%	68.44%	

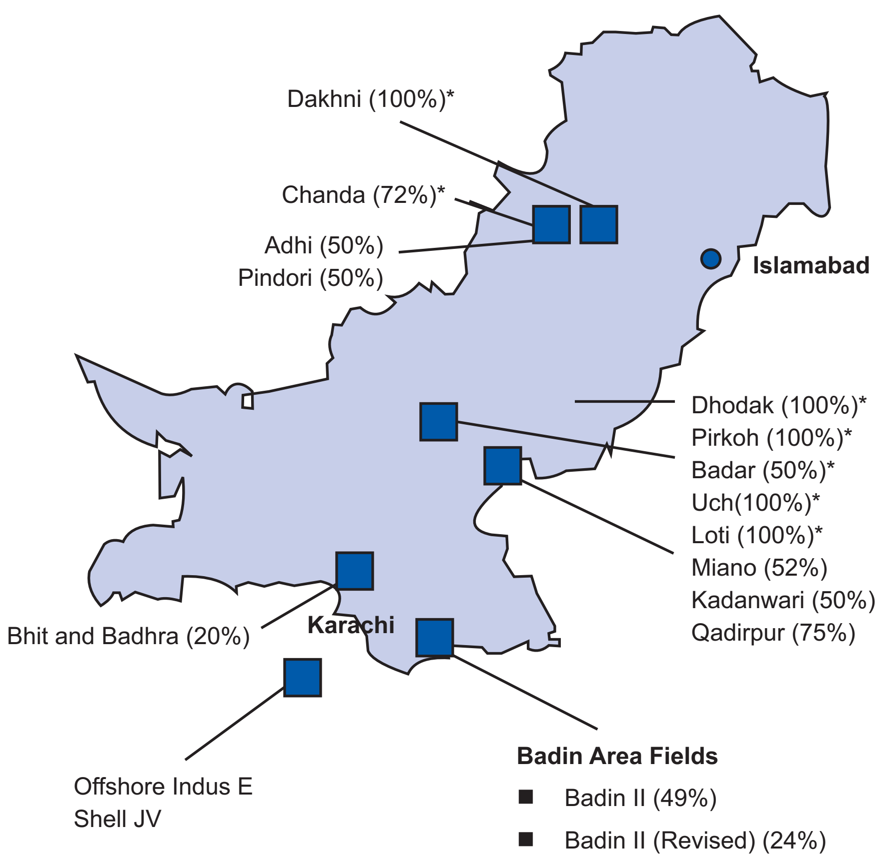
Sources: IGI Research and Company Report

Key Oil & Gas Fields Analysis

OGDC's gas fields are highly concentrated with only two fields accounting for more than 75% of the company's total gas reserves…

OGDC has 67 oil & gas fields (41 are operated and 26 are non-operated fields). 31 operated fields are presently in production. Uch and Qadirpur are two major gas fields having more than 75% of the company's total balance recoverable reserves. Bobi, Chanda, Dakhni Dhodak, Pasakhi and Tando Allam are the company's major oil fields (each having balance recoverable reserves of more than 5mn barrel) having almost 45% of the company's total balance recoverable reserves. Among non-operated fields, Adhi, Pindori, Miano, Loti, Manzalai and Makori are the company's major oil and gas fields.

Figure-8 **Location of Major OGDCL Operations**



** Operating Field*

Sources: OGDCL HY06/07 Presentation

■ Uch & Qadirpur: Flagship gas fields

Uch and Qadirpur together contribute more than 70% to the company's overall gas production…

The company's gas reserves and production are highly concentrated as only two fields, namely Uch and Qadirpur together account for more then 70% of the company's total gas production. Uch field is located at a distance of 60 km from Sui gas field, district Dera Bughti in Baluchistan Province and OGDC has 100% ownership in the field. The gas from this field was first discovered in 1955. According to the Energy Year Book 2006, as on June 30th

2006, Uch has balance recoverable gas reserves of 4.51tcf, which is equivalent to 45% of the company's total balance recoverable reserves. Presently, OGDCL gets US$3.9223/ MMBTU for gas produced from this field. During the past 5years, gas production from Uch increased at CAGR of 10.1%. The Uch II development plan is presently underway and is scheduled to be completed by early CY09. This is likely to enhance gas production by 200mmcfd.

Qadirpur is going to provide 100MMscfd gas to the new state of the art fertilizer plant being set up by Engro Chemical…

Qadirpur gas field is located at a distance of 8 km from Ghotki in Sindh Province. The field was discovered in March 1990 and OGDCL has 75% ownership in the field. The field has balance recoverable gas reserve of 3.58tcf, which contributes 27.6% to the company's total gas recoverable reserves. During the past 5years, the gas production from the field increased at a CAGR of 6.9%. The field also produces crude oil and has balance recoverable oil reserves of 2mn barrels. Qadirpur capacity enhancement project is currently underway. The enhancement project has two phases, which are expected to come online in December 2007 and September 2008. The total estimated cost of the project is around US$160mn. The project would enable the company to maintain plateau of gas production of 650 MMscfd and would also increase the gas production by 100MMscfd. The enhancement project is expected to be completed by 2008, which would meet the demand of the new state of the art fertilizer plant being set up by Engro Chemical, Pakistan's premier fertilizer manufacturer.

■ Qadirpur Gas Pricing Controversy

During CY06, wellhead gas prices of Qadirpur created some major controversies. In the wellhead gas pricing policy effective for 1HCY06, OGRA increased Qadirpur gas prices by 35% from Rs168.88/MMBTU to Rs233.94/MMBTU mainly on the back of significant increase in the prices of HSFO. However in the subsequent wellhead gas pricing policy effective for 2HCY06, gas price for the field was reduced by 30.5% to Rs162.54/MMBTU. The rational behind such a massive decline in the prices is the agreement between the company and OGRA that if prices of HSFO go above $200/ ton, then steep discount would be applied subject to negotiations between the company and OGRA. However, according to the management of OGDC, no negotiations were held and OGRA unilaterally reduced wellhead prices of Qadirpur by 30%. The management of OGDC has filed a petition against this action of OGRA and a final decision is still awaited. (See page # 26 to analyze the impact of this decision on the company's bottomline)

■ Wellhead Gas Prices of Key Fields

Qadirpur wellhead gas prices were first increased by 35% and then reduced by 30.5% by OGRA without having any negotiations with OGDCL's management…

Recently, OGRA has notified wellhead gas prices of OGDC's major fields effective for Jan-June 2007. According to the notification, wellhead gas prices of Uch were kept intact at US$3.9223 per MMbtu while prices of Qadirpur reduced marginally by 0.03% from Rs162.54 per MMbtu to Rs162.49 per MMbtu. Wellhead gas prices for most of the company's major gas fields, for the period Jan-June 2007, were revised upward in the range of 1-2%. However, prices of two of the company's gas fields namely, Sadkal and Sari have been revised downward by 8.33% and 4.72% respectively on half year basis.

Table-5		Price Effective		
Field Name	**Units**	**01.07.06**	**01.01.07**	**%Chg HoH**
Adhi	Rs per MMBTU	88.62	89.9	1.44%
Dakhani	Rs per MMBTU	88.71	89.73	1.15%
Daru	Rs per MMBTU	77.99	78.89	1.15%
Dhodak	Rs per MMBTU	177.24	179.3	1.16%
Loti	Rs per MMBTU	83.34	84.31	1.16%
Meyal / Dhulian	Rs per MMBTU	77.55	78.59	1.34%
Miano	$ per MMBTU	3.2179	3.2939	2.36%
Nandpur Panjpir	Rs per MMBTU	224.5	227.1	1.16%
Pirkoh	Rs per MMBTU	83.34	84.31	1.16%
Qadirpur	Rs per MMBTU	162.54	162.49	-0.03%
Sadkal	Rs per MMBTU	274.22	251.37	-8.33%
Sara / Suri	Rs per MCFT	87.58	88.61	1.18%
Sari Hundi	Rs per MMBTU	262.6	250.2	-4.72%
Sawan	$ per MMBTU	3.2179	3.2939	2.36%
Uch	$ per MMBTU	3.9223	3.9223	0.00%
Chanda	$ per MMBTU	2.7168	2.7069	-0.36%

Source: OGRA and IGI Research

■ Non Operating Fields

Adhi is considered to be Pakistan's largest oil field in terms of balance reserves …

Adhi, Pindori, Manzalai and Makori are the company's major non operating oil and gas fields. Adhi is operated by Pakistan Petroleum Limited (PPL) and OGDC has 50% stake in the field. In terms of balance recoverable oil reserves, the field is considered to be the country's largest oil field having oil reserves of 37.6mn bbl (equivalent to 11.7% of the country's oil reserves). In FY06 the field produced 1.25mn bbl oil and during the past 5years oil production from the field increased at CAGR of 7.0%. Pindori is operated by Pakistan Oilfields Limited (POL) and OGDC has 50% ownership in the field. The field has balance recoverable crude oil reserves of 36mn bbl, which is the second highest in the country. In terms of crude oil productions, Pindori is the largest oil field in Pakistan. During FY06, the field produced 3.34mn bbl oil, which accounts for 14% of the country's overall oil production in FY06. In the past 5years, crude oil production from this field increased at CAGR of 16.8%. The field contributed almost 13% to OGDC's total volumetric crude oil sales in FY06.

Discovery at Tal Block is considered to be one of the largest discoveries made in the country's history…

Manzalai and Makori come under the Tal Block, which is operated by MOL (Hungarian oil & gas exploration company) and OGDC has 27.56% ownership in the block. The recent discovery at Tal is considered to be one of the largest oil & gas discoveries made in Pakistan. According to the Energy Year Book 2006, Manazalai and Makori have proven recoverable oil reserves of 28.78mn bbl and 29.86mn bbl respectively, which together account for 18% of the country's overall crude oil reserves. Both these fields have proven gas reserves of 2.5tcf, which is equivalent to 7.5% of the country's total gas reserves.

Crude Oil Fields: Relatively Less Concentrated

Dhodak and Chanda together account for 23% of OGDC's overall balance recoverable crude oil reserves…

Dhodak and Chanda are the company's key oil fields in terms of production as well as reserves. Dhodak is 100% owned by OGDCL while in Chanda the company has 72% stake. In FY06, Dhodak and Chanda produced 942 thousand and 958 thousand barrels of crude oil respectively, which together accounted for almost 13% of the company's total annual crude oil production during the year. Dhodak and Chanda have recoverable oil reserves of 19.587mn bbl and 9.838mn bbl respectively, together accounting for 23% of the company's cumulative oil reserves. Oil being a higher margin product, the contributions of these oil fields to the company's revenues is much more than their contributions to the volumetric sales. Bobi, Dakhni, Pasakhi and Tando Allam are few other major operated oil fields, each having crude oil reserves of more than 5mn bbl. These four fields together have 28mn bbls of crude oil reserves, which is equivalent to 21% of the company's overall oil reserves.

Table-6 **Major Oil fields of OGDCL**

Field Name	Operator	OGDC's Share	Original Recoverable Reserve (in mn barrel)	Total Production (in mn barrel)	Balance Reserves (in mn barrel)	Balance Reserves as a % of Original Reserves
Adhi	PPL	50%	55.1	17.47	37.63	68.30%
Bobi	OGDCL	100%	10.95	3.55	7.40	67.60%
Chanda	OGDCL	72%	12.00	2.16	9.84	82.00%
Dakhni	OGDCL	100%	10.97	4.37	6.59	60.10%
Dhodak	OGDCL	100%	30.00	10.41	19.59	65.30%
Fimkassar	OGDCL	100%	15.26	12.98	2.28	14.90%
Kunar	OGDCL	100%	14.56	10.45	4.11	28.20%
Lashari Centre	OGDCL	100%	11.97	8.19	3.78	31.50%
Pindori	POL	50%	55.00	18.97	36.03	65.50%
Manzalai	MOL	28%	29.00	0.22	28.78	99.20%
Makori	MOL	28%	30.00	0.14	29.86	99.50%
Pasakhi	OGDCL	100%	29.30	23.35	5.95	20.30%
Qadirpur	OGDCL	75%	3.80	1.78	2.01	52.90%
Rajian	OGDCL	100%	6.98	5.45	1.52	21.80%
Ratana	OPI	25%	4.10	1.30	2.80	68.30%
Rind	BP	49%	3.17	1.31	1.86	58.60%
Sono	OGDCL	100%	14.90	11.95	2.94	19.70%
Tando Alam	OGDCL	100%	22.56	14.61	7.95	35.20%
Thora	OGDCL	21%	20.95	16.58	4.36	20.84%
Toot	OGDCL	20%	15.84	12.65	3.18	20.09%
Zaur	BP	49%	9.36	4.50	4.86	51.93%

Source: Energy Year Book 2006 and IGI Research

Recent Discoveries & Upcoming Projects

During the current financial year, OGDCL has successfully made four discoveries namely, Mela, Pasakhi North East, Unar – 1 and Nim West – 1. Some discoveries made in the recent past have had significant impact on the company's production and consequently the company's present per day production has increased significantly during the month of February 2007.

Recently the company has acquired 70% working interest along with operating rights in Guddu Block…

Some of the major projects are presently underway (details of which can be seen in the table below). On 1st March 2007, OGDC has officially announced the acquisition of 70% working interest along with operating rights in Guddu Block from IPR Transoil Corporation (IPRTOC). The Guddu Block covers an area of 2093.4 sq. kms over the Sindh and Punjab provinces of Pakistan. The Block lies in the Middle Indus Basin within the largest gas producing fields of Pakistan i.e., Sui, Qadirpur, and Mari. The Joint Venture of OGDCL, IPRTOC and Government Holdings Private Limited (5% carried) is committed to drill an exploratory well in the said block during the current calendar year.

The company has finalized an agreement with Petrobras for offshore oil exploration in the Indus Offshore Block…

In addition to this, the company is also involved in offshore drilling and has signed agreements with internationally renowned Oil & Gas exploration companies in this regard. Recently, OGDC and Petrobras Oil & Gas B.V. have finalized an assignment agreement for offshore oil exploration in the Indus offshore block 1-2265 (Offshore Indus - G). Out of its 100% working interest, OGDC has assigned 50% to Petrobras.

Table-7 **Major Upcoming Projects**

Projects	Expected date of Completion	Estimated Cost	Prod Capacity
Chanda Development Project	2nd Half FY07	$ 9 mn	LPG: 25 MTD Gas: 8.5 MMscfd
Dakhni Expansion Project	Bids to be invited afresh	$ 29.67 mn	Oil: 720 BPD Gas: 12MMscfd LPG: 12 MTD Sulphur: 80 MTD
Qadirpur Capacity Enhancement	a) September 2008 b) December 2007	$ 160 mn	a) To maintain plateau of gas production 650 MMscfd b) Additional 100 MMscfd gas
Dhodak Expansion Project	Bids to be invited afresh	$ 50 mn	Oil: 4000 BPD Gas: 64 MMscfd LPG: 258 MTD
Uch-II Development Project	March 2009 (As conveyed by PPIB)	$ 250 mn	Gas: 200 MMscfd
TAY Development Project	Bids to be invited afresh	$ 54.1 mn	Oil: 2500 BPD Gas: 28 MMscfd LPG: 85MTD
Sinjhoro	Bids to be invited afresh	$ 89 mn	Oil: 2940 BPD Gas: 25 MMscfd LPG: 224 MTD

Source: Ministry of Petroleum & Natural Resources

Five-year Strategic Targets

According to the management, the company is on track in pursuing its strategy to enhance oil & gas production at a CAGR of 14% and 13% respectively by end June 2009. Moreover, the company has some challenging targets to accomplish in the next five years. The followings are the company's strategic plans and targets to be achieved by FY10-11.

- Increase in exploration program to drill 50 wells, including nine contingent wells in Balochistan in 2006-07 and total of 378 wells to be drilled by the year FY10-11.

The company is planning to increase oil and gas production by more than 200% by year end FY2010-11…

- 250 Million Barrels of Oil / Condensate to be added to the present reserves by year end 2010-11. Moreover, 4355 Billion Cubic Feet of Gas to be added to the current reserves by year end 2010-11.
- Increase in oil & condensate production presently from 45,000 BPD to 136,830 BPD by year end 2010-11.
- Boost in gas production currently from 1000 MMscfd to 2,963 MMscfd by the year end 2010-11.
- Early commercialization of discoveries. New oil discoveries to commence commercial production within one year while gas discoveries to start production within three years and offshore discoveries to be online within five years.

OGDC has set Capex target of US$1.9bn to be spent on exploration and drilling activities by FY08-09…

In order to achieve the aforementioned targets, the company has undertaken massive drilling and exploration activities. While the company has remained underinvested for the past many years, the management eventually decided to take a u-turn and is going to spend heavily on drilling and explorations activities. During the ongoing FY06-07, the company has planned to spend more than US$400mn and subsequently in the next couple of years, the company is going to spend an additional of US$1.5bn on drilling and exploration.

Analyzing the company's strategic targets and looking at its Capex plan, we believe that the exploration program to drill 50wells in FY 2006-07 and target to drill 328 more wells in the next four years would be somewhat challenging, though not very difficult to achieve. Moreover, strategic target to add 4,355 bcf gas to the current reserves, increasing gas production to 2,963MMscfd and commercializing gas reserves in 3years, would be challenging. However, keeping in view untapped gas reserves potential in the country, we believe that these targets can be achieved, provided the company's present ratio of successful discoveries either remains intact or atleast is in line with Pakistan's success ratio, going forward.

Moreover, targets to enhance oil reserves by 250mn bbl, increase in oil & condensate production to 136,830bpd and commercialization of oil discoveries in one year looks somewhat optimistic. In our view, these oil targets would be a big challenge for the company to achieve. Furthermore, we believe, in order to achieve these optimistic targets, the company would have to undertake major offshore drilling activities.

Impact of Rising Capex on the Company's Earnings:

According to the company's accounting policy which states that:

"Explorations & development activities are accounted for "successful efforts" methods whereby cost of property acquisitions, successful exploratory wells and all development wells, including shut-in wells, are capitalized and amortized on unit of production method. Unsuccessful exploratory wells are charged to income when declared to be non-productive. All exploration costs other than these related to exploratory drilling are charged to revenue for the year, when incurred." (*Sources: Annual Report 2005)*

Thus, in case of any major failure, the bottlomline of the company would be adversely affected going forward. The higher Capex would increase indirect cost, which translates into higher exploration and prospecting expenditure and would consequently have negative impact on the bottomline.

Massive exploration activities are likely to exert some pressure on earnings during the initial period, nonetheless, going to have significant positive impact from FY10-11 onwards…

In addition to this, depreciation and amortization expense would also increase, which would exert some downward pressure on the company's earnings, going forward. Coupled with this, for financing such a massive Capex plan, the company would have to liquidate its short term investments, which would shrink other income. In addition to this, there is a likelihood that the company may go for gearing or would delay some of its payables, which would increase financial charges and thus, negatively affect the bottomline.

Moreover, if the company's success ratio remains intact or at least is in line with Pakistan's success ratio, then the massive expenditures on exploration activities is likely to have significant impact on the company's financial performance beyond FY2010 and would enable the company to continue outperforming the country's GDP growth rate.

Revenue & Earnings Forecast FY07-10

According to our forecast for FY07-10, OGDC's revenues are expected to potray a CAGR of 18.65%, which is expected to jump to Rs192bn in FY09-10 from Rs97bn in FY05-06. Exploration and prospecting expenses are likely to increase significantly during FY07-09, however, expected to decline in FY09-10. Operating expenses, mainly due to higher amortization and depreciation expenses, are expected to grow at a CAGR of 21%. Moreover, other income is anticipated to decline mainly on account of expected liquidation of short term investments for financing massive exploration activities.

According to our estimates, the company's earnings are expected to post a CAGR of 14% during FY07-10…

Overall, profits before taxes are expected to increase at a CAGR of 17.8%, which is likely to surge to Rs124bn in FY09-10 from Rs66bn reported in FY05-06. Profit after taxes are expected to surge to Rs84bn in FY09-10 compared to Rs46bn posted in FY05-06, translating into a CAGR of 16.5%. In our view, cash payout is expected to remain in the range of 90%-100% (DPS: Rs9.00-Rs10.00) till FY08-09, however, we anticipate cash dividend of 120% (Rs12.0) in FY09-10.

Massive exploration activities would enable the company's earnings to grow at almost 14% beyond FY10…

Moreover, the probability to witness the outcome of massive drilling and explorations activities (worth US$1.9bn) on the company's earnings during FY07-10 is very low. However, we strongly believe that once these massive ongoing and upcoming drilling & exploration activities would be completed by FY09-10, it would facilitate the company's bottomline to grow at a terminal growth rate of at least 5% beyond FY10.

Rs mn

Table-8 **Income Statement Highlights FY 07-10**

	FY07F	FY08F	FY09F	FY10F
Net sales	116,709	137,914	158,713	191,734
Royalty	12,838	15,171	17,458	21,091
	103,871	122,743	141,255	170,643
Operating expenses	19,096	22,635	26,823	31,868
Exploration & prospecting exp	7,661	10,470	10,027	3,953
Transportation charges	1,413	1,625	1,869	2,149
	75,701	88,013	102,536	132,673
General & Admin expenses	1,772	2,073	2,404	2,683
Finance cost	350	1,050	1,400	1,400
WPPF	4,164	4,841	5,639	7,297
	69,416	80,049	93,092	121,293
Other income	4,267	2,926	2,944	2,964
Profit before taxation	73,683	82,975	96,036	124,257
Provision for taxation	22,213	25,616	29,790	39,420
Profit after taxation	51,470	57,359	66,247	84,837
Diluted EPS in Rs	11.97	13.34	15.40	19.73
Dividend Per Share in Rs	9.25	9.25	10.00	12.00
Net Profit Margin	44.10%	41.59%	41.74%	44.25%
Operating Profit Margin	64.86%	63.82%	64.60%	69.20%
Payout Ratio	77.29%	69.36%	64.92%	60.84%

Sources: IGI Research

Key Assumptions

Arabian crude oil prices, volumetric growth in oil & gas production, wellhead gas prices and terminal growth rate are the few key assumptions that have the most significant impact on revenues and earnings of the company and consequently on the fair value of the stock. In the following paragraphs we have briefly discussed aforesaid key assumptions.

■ Arabian Crude Oil Prices

Arabian crude oil prices are expected to decline by 3% per annum…

During CY06, crude oil prices in the international market witnessed massive fluctuations (see page 23 for details). In CY06 average Arabian crude oil prices stood at US$60.90/bbl. During 1QCY07, average Arabian crude oil prices were US$54.55/bbl. In our base case scenario, we expect average annual Arabian crude oil prices to be $57.55/bbl in FY07 and later on are expected to be $52.99/bbl in FY08. Moreover, beyond FY08, we expect average Arabian crude oil prices to decline by 3% p.a. and are assumed to be $51.40/bbl and $49.86/bbl in FY09 and FY10 respectively.

Issue of global refinery constraints is expected to be resolved in the next couple of years…

Our rationale behind the decline in international crude oil prices is based on the fact that the recent upsurge in crude oil prices is driven by two key factors, which are: significant growth in energy demand by China and India due to their robust economic performance and the global refinery constrains. In our view, pace of economic growth in China and India would slowdown to some extent, going forward. Secondly, the issue of global refinery constraints has already started to be addressed and some massive refinery projects are currently underway particularly in the South Asian region, which are likely to start commercial operations in the next couple of years. Our expected average quarterly crude oil prices during FY07-10 can be seen in the table below.

US$/bbl

Table-9 **Expected Arabian Crude Oil Prices FY07-10**

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Avg Annual Price
FY07	65.58	56.05	54.55	54.00	57.55
FY08	52.92	53.19	53.45	52.39	52.99
FY09	51.34	51.59	51.85	50.82	51.40
FY10	49.80	50.05	50.30	49.29	49.86

Sources: IGI Research

■ Wellhead gas prices

Wellhead gas prices are expected to fluctuate in the range of 0.25-0.50% on semiannual basis…

The Oil and Gas Regulatory Authority (OGRA) semiannually notifies wellhead gas prices of gas fields in accordance with the applied petroleum policies. On 1st March 2007, OGRA has notified gas wellhead prices effective for Jan-June 2007. According to the notification, average wellhead gas prices of OGDCL's major fields were increased by 1.25%, however, prices of key gas fields of Uch was kept intact while well head gas prices of Qadirpur field were reduced by 0.03% (for further details please refer table # 14 on page 24). In our base case scenario, we have assumed that going forward average wellhead gas prices of the company's major fields (including key fields Uch and Qadirpur) would fluctuate in the range of 0.25-0.50% on semiannual basis.

Volumetric Growth

During FY08-10, Oil and gas production is expected to increase at 3year CAGR of 14% and 15% respectively…

According to our estimate the company's oil and gas production during FY07 would be almost 43,000 bpd and 960mmcfd in the ongoing FY07. Moreover, going forward, crude oil production is expected to grow at 3year CAGR of 14% while gas production is expected to increase at 3year CAGR of 15%. LPG production is expected to increase from currently 343MTD to 922MTD by FY10, which is broadly in line with the company's estimates. Despite the fact that the company has undertaken massive drilling and exploration activities, nontheless, the probability to witness any significant impact of these on the company's revenue during FY07-10 is very low.

Figure-9a **Average per day Crude oil production**

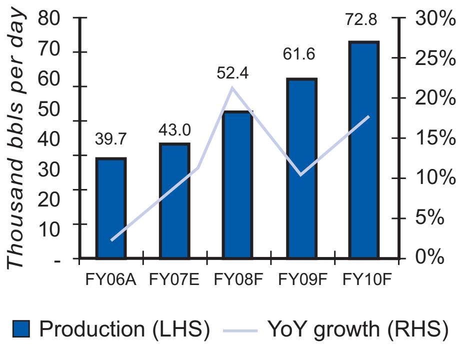
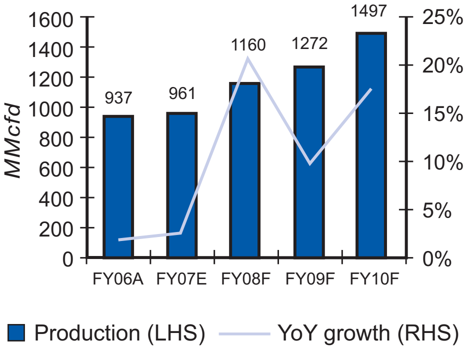


Figure-9b **Average per day gas production**



Sources: IGI Research

Terminal Growth Rate

Earnings are expected to grow at a terminal rate of 5%...

In the past ten years, the financial performance of the company has significantly outperformed the country's GDP growth rate and we believe that due to massive expenditure on exploration activities, the company would continue to outperform the country's GDP growth going forward. The probability to witness outcome of massive drilling and explorations activities (worth US$1.9bn) on the company's earnings during FY07-10 is very low. However, we believe that the ongoing and upcoming exploration and drilling activities would facilitate the company's bottomline to grow at a terminal rate 5% beyond FY2010. (For sensitivity analysis see table # 11 on the next page).

Valuation & Recommendation: Buy @ 119.60

The stock offers potential upside of 20% coupled with a dividend yield of 7.8%...

Using Discounted Cash Flows (DCF) model, at the WACC of 16.3% and terminal growth rate of 5%, our fair value for the scrip is Rs143 per share and US$23.54 per GDR. At present levels, the stock offers potential upside of 20%. Moreover, the stock offers an expeted annual return of 28% (potential capital gain of 20% and dividend yield of 7.8%) and, thus we advice investors to BUY at present levels.

Rs mn

Table-10 **DCF Valuation**

	FY07F	FY08F	FY09F	FY10F
EBIT	73,683	82,975	96,036	124,257
Adjustments				
Less: Taxes paid	(17,770)	(17,770)	(31,279)	(39,420)
Add: Depreciation	2,851	3,120	3,396	3,674
Add: Amortization	4,302	5,243	6,165	7,282
	63,066	73,567	74,318	95,793
Changes in Net Working Capital	(1,239)	171	(11,617)	(6,722)
CAPEX	(25,536)	(34,899)	(29,064)	(11,458)
FCFF	36,290	38,839	33,637	77,613
Terminal Value				723,767
NPV of Future Cash flows				123,838
Less: Net Debt				(28,685)
				152,523
PV of terminal cash flows				460,586
Total Company's Worth				613,110
Beta				1.29
Risk free rate				9.50%
Market risk premium				6.00%
Expected Market Return				15.50%
Cost of equity				17.24%
Expected Lending Rate (6months KIBOR+100bps)				11.50%
Tax Rate				35.00%
Cost of debt				7.48%
Average Equity FY07-10				134,419
Average Debt FY07-10				15,000
WACC				16.26%
Growth Rate				5.00%
Total Company's Worth				613,110
No. of shares outstanding				4,300.93
Fair Value				**143**

Sources: IGI Research

Rs/Share

Table-11 **Sensitivity Analysis: Fair Value per Share**

Terminal Growth Rate	14.0%	15.0%	16.3%	17.0%	18.0%
2.0%	140	129	118	112	104
3.0%	150	137	125	118	110
4.0%	163	148	133	125	116
5.0%	178	160	**143**	134	123
6.0%	198	175	154	144	131
7.0%	222	194	168	156	141
8.0%	256	219	186	170	153

Sources: IGI Research

Sensitivity Analysis

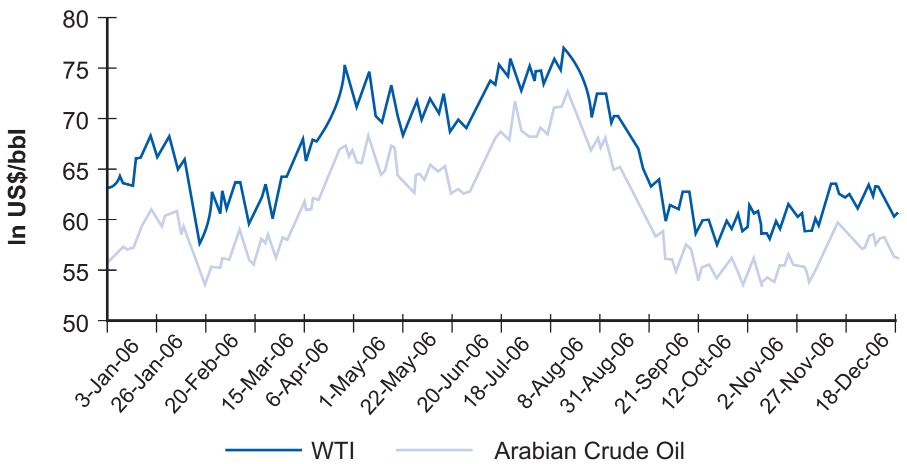
The dilemma of Qadirpur wellhead gas price and uncertainties regarding the global oil prices are key threats to valuations. Considering all other major factors, global oil price movements and any possible upward revision in Qadirpur wellhead gas price have relatively higher impact on the company's fundamentals. We did a sensitivity analysis to enlighten the impact of variations in these two key indicators on the company's bottomline and consequently on the fair value of the stock.

■ Crude Oil Prices

In CY06, Arabian crude oil prices have touched high of US$72.64/bbl…

Throughout CY06, crude oil prices in the international markets remained extremely volatile and witnessed massive fluctuations. Average WTI (Western Texas Intermediate) price for CY06 was US$65.59/bbl. Arabian crude oil prices also fluctuated in line with WTI. On 8th August 2006, Arabian crude oil touched high of US$72.64/bbl (on closing basis), and then took a U-turn to close the year at US$55.97/bbl. Average prices for the year stood at US$60.90/bbl.

Figure-10 **WTI and Arabian Crude Oil Price trend during CY06**



Sources: EIA and IGI Research

During the quarter ended Jan-March CY07, crude oil prices in the international market remained significantly volatile. Western Texas Intermediate (WTI) increased almost 8%QoQ while Arabian crude oil witnessed an increase of 13.3%QoQ. Average prices of WTI and Arabian crude oil stood at US$58.41per barrel and US$54.55 per barrel respectively. Average WTI prices witnessed an increase of 3.61%QoQ, nevertheless declined by 8.53%YoY. Arabian crude oil also depicted a similar trend as it surged 3.09%QoQ while plunged 5.46%YoY. Presently, Arabian crude oil prices are hovering around US$ 60/barrel.

US$ / bbl

Table-12 **Changes in Average Crude Oil Prices**

	Average Price		%Chg	Average Price		%Chg
	Jan-Mar 07	Oct-Dec 06	QoQ	Jan-Mar 07	Jan-Mar 06	YoY
WTI	58.21	60.31	3.61%	58.21	63.64	-8.53%
Arabian Crude	54.55	56.23	3.09%	54.55	57.70	-5.46%

Sources: EIA & OPEC

As per our estimates, a US$1 per barrel variation in the prices of Arabian crude oil has an impact of almost 1% on the company's bottomline and subsequently affects the fair value by the same margin. The following table shows the impact of deviation in crude oil prices from the base case, provided everything else remains intact.

Rs/Share

Table-13 **Sensitivity Analysis: Possible Impact of fluctuations in Arabian Crude Oil prices on OGDC's EPS and FV**

In PKR	(-) $5/bbl	(-) $2.5/bbl	(-) $1/bbl	Base Case	(+) $1/bbl	(+) $2.5/bbl	(+) $5/bbl
EPS FY07	11.38	11.68	11.85	11.97	12.08	12.26	12.55
EPS FY08	12.61	12.98	13.19	13.34	13.48	13.7	14.06
EPS FY09	14.54	14.97	15.23	15.40	15.58	15.84	16.27
EPS FY10	18.69	19.21	19.52	19.73	19.93	20.24	20.76
Fair Value	**135.1**	**138.8**	**141.1**	**142.6**	**144.0**	**146.3**	**150.0**

Sources: IGI Research

Qadirpur Wellhead Qas Price

The dilemma of wellhead gas prices at Qadirpur is still unresolved and any favorable outcome in this regard would have significant impact on the company's earnings and subsequently on the fair value. As per our analysis, 5% upward revision, in the field's wellhead gas prices from the base case scenario, would result into an increase of 1.5-1.65% in the company's bottomline and subsequently increase the stock's fair value by almost the same margin. The following table glaringly shows the impact of deviation in Qadirpur's wellhead gas prices on the company's earnings and fair value.

Rs/Share

Table-14 **Sensitivity Analysis: Impact of possible upward revision in Qadirpur gas prices on OGDC's EPS & FV**

	Base Case	5%	10%	15%	20%	25%	30%
EPS FY08	13.34	13.54	13.76	13.97	14.19	14.40	14.62
EPS FY09	15.40	15.63	15.87	16.11	16.34	16.58	16.82
EPS FY10	19.73	19.96	20.21	20.45	20.70	20.95	21.20
Fair Value	**142.6**	**144.2**	**146**	**147.7**	**149.5**	**151.3**	**153.0**

Sources: IGI Research

Comparative Valuation

Besides OGDCL, Pakistan Petroleum Limited (PPL) and Pakistan Oilfields Limited (POL) are the other two major listed E&P companies. These three listed companies together account for 56.7% of the country's total balance recoverable oil reserves and contributed 73.4% to the country's overall crude oil production in FY06.

E&P is the largest sector listed at the KSE-100 index…

Presently, E&P is the largest listed sector at the KSE-100 index with the sector capitalization of Rs756bn (US$12.45bn) equivalent to 23% of the entire market capitalization and 26% of the KSE-100 index. At present levels the sector trades at prospective price to earnings multiple of 9.9times and is offering dividend yield of 5.4% and RoE of 41.2% to secondary market investors. Comparative Valuation of OGDC can be seen in the table below.

Table-15	OGDCL	PPL	POL
Market Data			
Market Price in Rs	119.60	258.45	327.40
# of shares outstanding in mn	4300.9	685.8	197.1
Market Capitalization in PRs mn	514,391	177,250	64,538
Index Weight in %	17.65%	6.08%	2.21%
Earning Per Share			
EPS FY04(A) in Rs	5.21	9.65	12.66
EPS FY05(A) in Rs	7.67	12.57	19.09
EPS FY06(A) in Rs	10.69	19.54	31.08
EPS FY07(E) in Rs	11.97	25.5	34.0
Valuation Based on Earnings			
3Year CAGR	31.6%	37.3%	41.0%
Trailing PE	10.96	12.56	10.31
Prospective PE	9.99	10.13	9.63
Valuation Based on Payout			
DPS FY04(A) in Rs	4.00	4.5	12.5
DPS FY05(A) in Rs	7.50	5.5	12.5
DPS FY06(A) in Rs	9.00	9.0	15
Dividend Yield (FY07)	7.8%	4.5%	4%
Payout Ratio	84.2%	46.1%	48.3%
Valuation Based on Profitability Margin			
Operating Profit Margin	64.2%	65.54%	56.74%
EBITDA Margin	70.5%	69.90%	58.22%
Net Profit Margin	46.7%	47.51%	41.64%
Valuation Based on Equity Position			
Return on Equity	48.8%	38.4%	36.3%
Book Value per Share	23.60	50.84	85.68
PBV	5.10	4.88	3.77

Sources: IGI Research

In terms of dividend yield, OGDC appears to be the most attractive stock in the sector …

Analyzing key valuation indicators shown in the table above, valuation based on earnings, all three E&P stocks appear to be almost equally attractive, as these stocks are trading at prospective price to earnings multiple at 9.60x-10.20x. Taking into account valuation based on payout, OGDCL appears to be most attractive stock among its peers, as the stock has payout ratio of 84.2% and offers dividend yield of 7.8%, which is the highest in the sector.

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Considering RoE, OGDC appears to be most attractive scrip in the sector …

Keeping in view valuation based on profitability margins, PPL & OGDC appear to be equally attractive while POL looks to be the most expensive in the sector. Considering valuation based on equity position, once again all three stocks appear to be almost equally attractive. OGDCL looks most attractive based on RoE but most expensive in terms of PBV. The opposite is true for POL as the stock offers comparatively lowest RoE and is also trading at lowest PBV.

Regional Comparison: OGDC V/S ONGC

Comparing with ONGC, OGDC appears relatively more attractive on PE multiple…

Comparing OGDC, with its Indian counterpart namely Oil and Natural Gas Corporation Limited (ONGC) we find that OGDC looks relatively attractive on price to earning multiples. ONGC, in its nine months ended December 2006, has posted an EPS of IR60.60 as against IR53.04 posted in the comparable period last year, an increase of 14.25%YoY. At the closing price of April 10, 2007 (that is IR 867.50 per share), the stock currently trades at a prospective price earnings multiple of 11.5x while OGDC is presently trading at PE multiple of 9.99x. Coupled with this, ONGC is offering RoE of 29% while OGDC offers RoE of 48%. Moreover, both these stocks appear to be equally attractive when compared on the basis of EV/EBITDA, as both these stocks trade in the range of 6.0-6.3x. However, we find OGDC relatively more expensive when comparing the two on the basis of P/BV. OGDC trades at P/BV of 5.1times while ONGC trades at P/BV of 3.26times. (Note: IR= Indian Rupee)

In the past five years, both OGDC & ONGC demonstrated phenomenal growth in their earnings…

During the past five years, both these companies have witnessed robust growth in their performance. However, OGDC's earnings depicted relatively better consistency compared to ONGC, which can be seen glaringly in the following graphs. In 2003, ONGC witnessed phenomenal growth in its earnings on year-on-year basis, mainly due to the lower base effect (because of dismal performance depicted in 2002).

Figure-12a **Equity Growth**

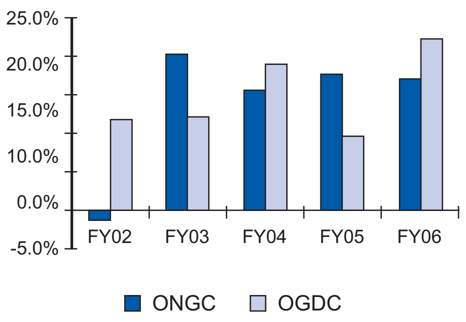


Figure-12b **Sales Growth**

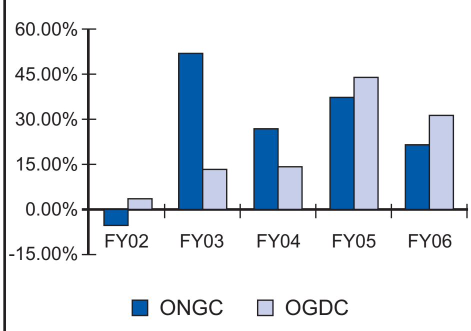


Figure-12c **Earnings Growth**

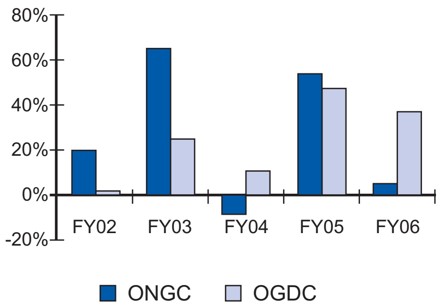
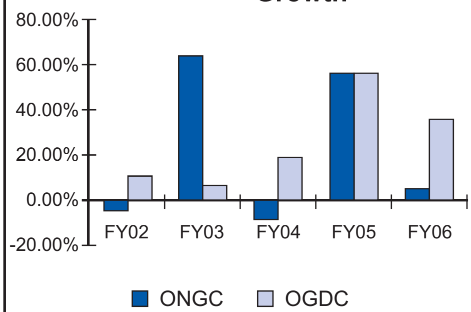


Figure-12d **Operating Profit Growth**



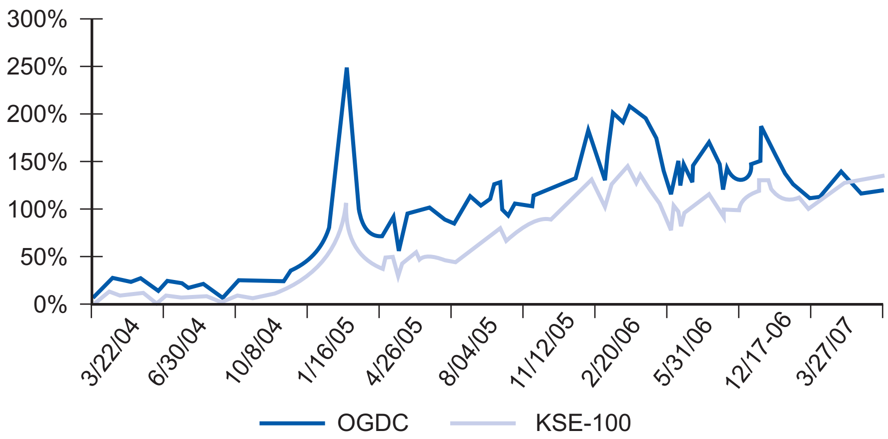
Source: Bloomberg & IGI Research

Stock Performance

One Rupee decline in OGDC's market price results in 17points drop in the KSE-100 index …"

Besides being the largest oil and gas exploration company in Pakistan, OGDCL is also the largest company listed at domestic bourses, in terms of market capitalization. Presently, the company has total market capitalization of US$8.39 bn which is equivalent to 17.63% of the KSE-100 capitalization. As per our estimates at the present index weightage, one rupee per share decline in the stock price of OGDCL leads to almost 17points drop in the KSE-100 index. Because of such a high influence, the company's stock price movement has significant impact on the index's fluctuations. Three year relative performance of OGDC can be seen in the graph below.

Figure-13 **3 Year OGDC Rel Performance**



Sources: Bloomberg and IGI Research

During CY06, the stock offered total return of 12.19% to the secondary market investors (capital gain of 5.51% and dividend yield of 6.69%), however, during the same time period the KSE-100 index yielded a total return 3.80% to investors. Annual return of the stock and KSE-100 index can be seen in the following table.

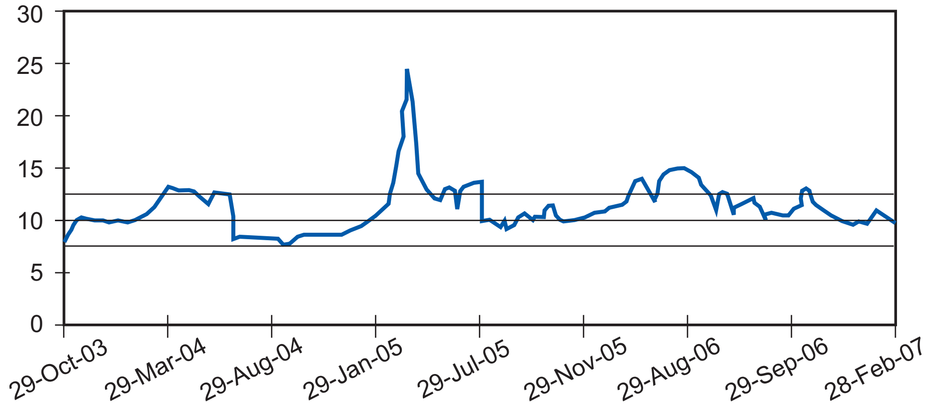
Table-16 **3 Year Stock Return of OGDCL & KSE**

	Capital Gain	Dividend Yield	Total Stock Return	KSE Return	Rel Performance
CY04	44.4%	6.36%	50.77%	39.02%	Out Performed
CY05	45.7%	6.97%	52.65%	53.64%	Under Performed
CY06	5.51%	6.69%	12.19%	3.80%	Out Performed

Sources: IGI Research

Since inception, the stock has usually traded in a PE band of 10x-12x with average prospective PE multiple since inception standing at 11.2x. On 15th March 2005, (on closing basis) the stock traded at an all time high prospective PE multiple of 24.74x. Presently, the stock trades at 12.3% discount from its three year average price to earnings multiple.

Figure-14 **Price to Earnings Performance since Inception**



Sources: Bloomberg & IGI Research

GDR Issue: OGDC going global

Fair Value per GDR	*US$ 23.54*
Market Price per GDR	*US$ 19.35*
Potential Capital gain	*21.0%*
Dividend Yield	*7.8%*
Expected annual return	*28.8%*
10 Ordinary Shares	*1 GDR*
Outstanding GDRs	*40.85m*

In December 2006, the Government of Pakistan issued OGDCL's global depository receipts (GDR) in the London Stock Exchange. Through the book building process, which lasted for 15 days (15th-29th Nov, 2006) the GDR was offered at a strike price of US$18.9/GDR (one GDR=ten ordinary shares). Through this offering, the Government liquidated almost 9.5% of its holdings in the company and offered 408.58 million ordinary shares (40.858millionGDRs) to institutional investors. The offering resulted in to a net foreign exchange inflow of around US$772mn. This foreign exchange inflow would help the GoP to finance the country's burgeoning current account deficit for the ongoing FY07. In addition to this, another benefit of this GDR offering is that after a gap of almost a decade a major Government owned entity has marked its presences in the global market, which could help to entice foreign investors' interest towards local bourses.

By virtue of GDR issue, OGDC has become one of the most liquid trading stocks, which facilitates easy entry and exit coupled with best price discovery to retail and institutional investors.

The Bottomline: An Investment Perspective

The stock offers impressive capital gain coupled with decent dividend yield …"

We view this stock as an aggressive long term growth play. The stock is expected to offer impressive capital gain coupled with decent dividend yield. In our view, OGDC should be an integral part of a prudent investment portfolio.

Table-17

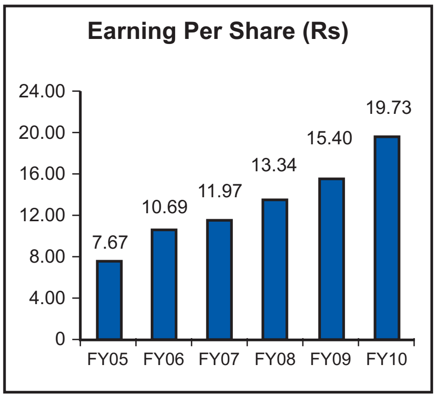
Valuation Highlights

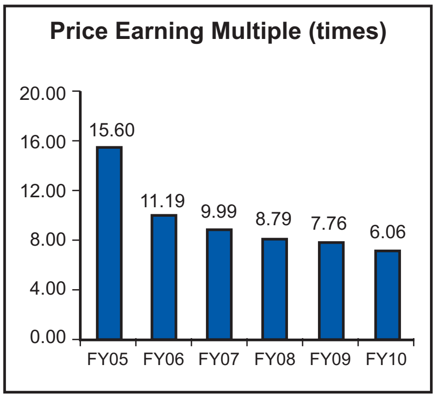
Rs mn

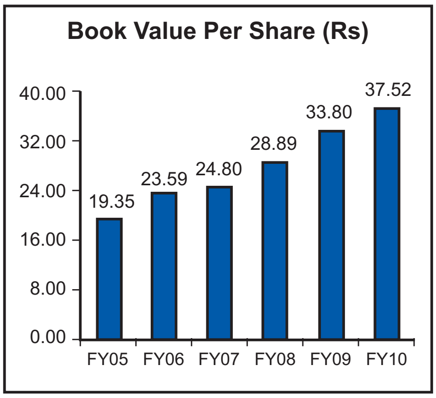
P&L Account-Highlights	FY05A	FY06A	FY07F	FY08F	FY09F	FY10F
Net sales	73,709	96,755	116,709	137,914	158,713	191,734
Royalty	8,109	10,872	12,838	15,171	17,458	21,091
	65,600	85,883	103,871	122,743	141,255	170,643
Operating expenses	12,023	15,046	19,096	22,635	26,823	31,868
Exploration and prospecting expenditure	2,671	3,681	7,661	10,470	10,027	3,953
Transportation charges	760	942	1,413	1,625	1,869	2,149
	50,146	66,215	75,701	88,013	102,536	132,673
General & Admin expenses	823	1,072	1,772	2,073	2,404	2,683
Finance cost	6	10	350	1,050	1,400	1,400
WPPF	2,580	3,469	4,164	4,841	5,639	7,297
	3,409	4,551	6,285	7,964	9,444	11,380
	46,737	61,664	69,416	80,049	93,092	121,293
Other income	2,284	4,248	4,267	2,926	2,944	2,964
Profit before taxation	49,021	65,912	73,683	82,975	96,036	124,257
Provision for taxation	16,052	19,944	22,213	25,616	29,790	39,420
Profit after taxation	**32,969**	**45,968**	**51,470**	**57,359**	**66,247**	**84,837**
Balance Sheet-Highlights						
Share Capital	43,009	43,009	43,009	43,009	43,009	43,009
Equity	**83,210**	**101,465**	**106,681**	**124,257**	**145,354**	**161,382**
Long term loans	0	0	5,000	15,000	20,000	20,000
Taxation	8,948	10,195	12,013	14,416	17,299	20,759
Others	8,887	6,456	9,537	14,843	19,281	21,086
Non Current Liabilities	**17,836**	**16,651**	**26,551**	**44,259**	**56,580**	**61,845**
Trade and other payables	13,533	7,269	10,000	12,074	14,666	17,906
Provision for taxation	-	3,825	8,160	13,283	11,793	11,793
Others	-	-	6,145	17,409	30,503	32,784
Current Liabilities	**13,533**	**11,094**	**24,305**	**42,766**	**56,962**	**62,483**
Total Liabilities	31,369	27,745	50,856	87,025	113,543	124,328
Total Equity & Liabilities	**114,579**	**129,210**	**157,537**	**211,282**	**258,897**	**285,711**
Property, plant and equipment	19,685	20,096	21,188	23,131	24,944	26,527
Development & production assets	21,537	22,651	46,718	81,610	121,199	127,094
Others	6,245	7,814	12,610	12,587	12,550	12,514
Fixed Assets	**47,467**	**50,561**	**80,517**	**117,327**	**158,693**	**166,134**
Stores, spares and loose tools	7,578	13,215	18,603	20,170	27,416	28,724
Trade debts	33	66	116	202	354	619
Stock in trade	18,528	24,501	27,221	32,148	37,007	44,700
Others	40,973	40,867	31,081	41,434	35,427	45,533
Current Assets	**67,112**	**78,649**	**77,020**	**93,954**	**100,204**	**119,576**
Total Assets	**114,579**	**129,210**	**157,537**	**211,282**	**258,897**	**285,711**
Cash Flow Statement-Highlights						
Cash available from operations	42,691	53,200	59,148	68,969	72,774	94,229
Net (increase) in working capital	3,458	11400	(1,239)	171	(11,617)	(6,722)
Total cash from operations	46,149	64,600	57,909	69,140	61,157	87,507
CAPEX	(8,155)	(10,245)	(25,536)	(34,899)	(29,064)	(11,458)
Cashflow from financing activities	(18,615)	(41,444)	(43,623)	(24,447)	(38,683)	(66,765)
Cashflow from investing activities	552	(5,241)	17,108	53	53	53
Total Cash Inflow/(Outflow)	**19,931**	**7,670**	**5,857**	**9,847**	**(6,538)**	**9,336**
Momentum						
Sales Growth YoY	43.61%	31.27%	20.62%	18.17%	15.08%	20.81%
Operating Profit Growth YoY	58.27%	32.04%	14.33%	16.26%	16.50%	29.39%
Earnings Growth YoY	47.09%	39.43%	11.97%	11.44%	15.49%	28.06%
Fixed Assets Growth YoY	10.65%	6.52%	59.25%	45.72%	35.26%	4.69%
Total Assets Growth YoY	19.37%	12.77%	21.92%	34.12%	22.54%	10.36%

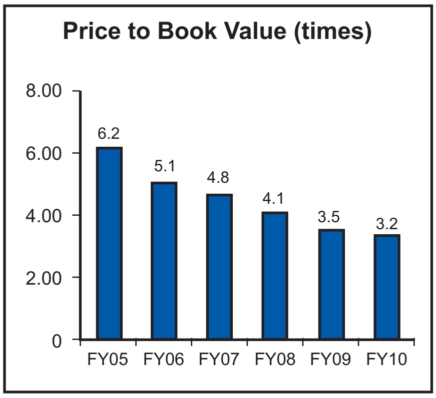
Sources: IGI Research

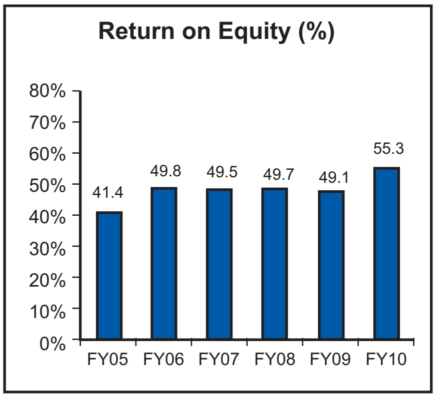
Key Investment Ratios

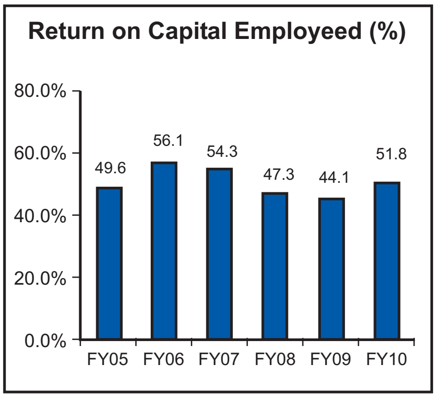


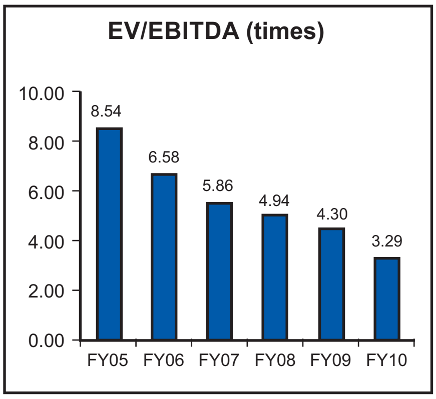


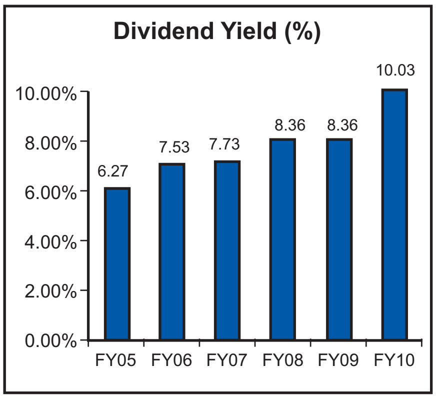


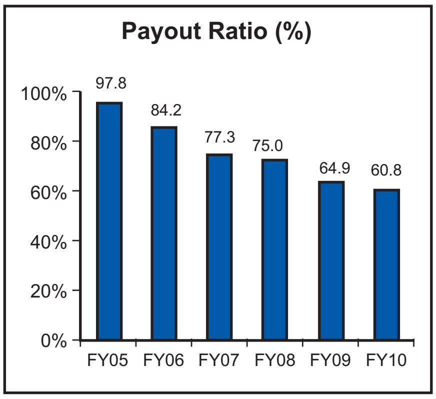


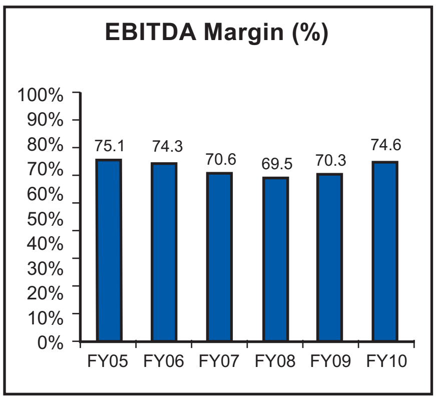


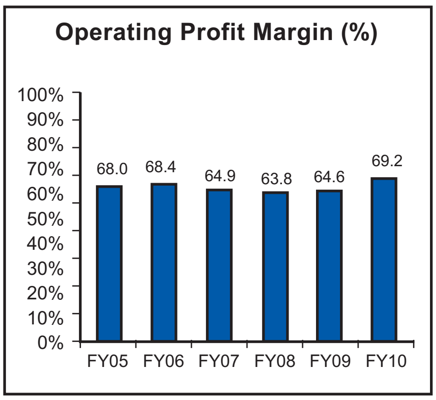


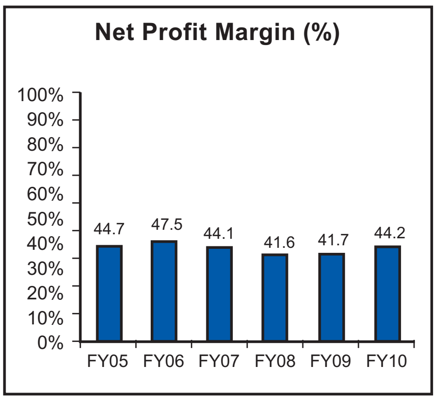












Sources: IGI Research

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