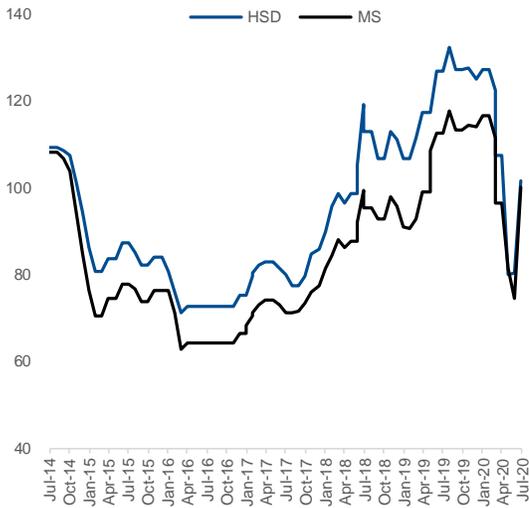


Sector Update

Exhibit: MS and HSD prices (PKR/ltr)



Energy

Fortnightly notification of POL prices based on Platts average approved by ECC; OMCs and refineries to benefit

- ✓ Economic Coordination Committee (ECC) on Tuesday approved Ministry of Energy's proposal for notification of POL prices (MS and HSD) on a fortnightly basis effective from 1st Aug-20,
- ✓ In our view, this will benefit both OMCs and refineries as notification of price on fortnightly basis would reduce the exposure of inventory gains and losses,
- ✓ From refineries standpoint, volatility in refining margins is likely to level out as notification of prices based on average Platts price would ensure steady spreads on POL products for refineries,
- ✓ We maintain a BUY stance on PSO and APL with our Dec-20 target prices of PKR 249/share and PKR 412/share, offering 42% and 29% upside respectively from last close.

POL prices to be notified on fortnightly basis

Economic Coordination Committee (ECC) on Tuesday approved Ministry of Energy's proposal for notification of POL prices (MS and HSD) on a fortnightly basis effective from 1st Aug-20. Currently prices are announced on monthly basis at the start of each month based on average import price of PSO. However, now prices are going to be based on average Platts price. In addition to this, it would warrant alignment of margins for refineries in line with international prices.

Fortnightly notification and average Platts price to reduce volatility in prices

Shifting to fortnightly notification of POL prices based on average Platts would reduce volatility in prices thus allowing OMC's other than PSO to import POL products at prices notified on fortnightly basis which was previously only based on PSO's import price leading to larger difference in import cost. However timing difference between import and payment still remains unaddressed which has been a major reason behind exchange losses for OMCs.

OMCs to benefit in terms of lower volatility in inventory gains/losses...

In our view, this will benefit both OMCs and refineries as notification of price on fortnightly basis would reduce the exposure of inventory gains and losses, whereas, for OMC's other than PSO the current price differential between PSO's import cost (used as base for setting monthly POL prices) and other OMC's import cost would be eliminated. This in turn would be beneficial for HASCOL and SHEL. As import cost of OMC would be translated in to retail prices, we believe issues such as recent fuel shortage crisis are also likely to be mitigated.

... While refining margins would witness less volatility

From refineries standpoint, volatility in refining margins is likely to level out as notification of prices based on average Platts price would ensure steady spreads on POL products for refineries. Currently, refineries were allowed to notify product prices which could not exceed PSO's import cost in the preceding month thus leading to a hit on margins. To note, MS and HSD are high margin products for refineries which generally trade at a spread of USD 5-10/bbl and USD 12-15/bbl respectively.

Analyst

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Exhibit: PSO quarterly inventory gains and losses (PKRbn)

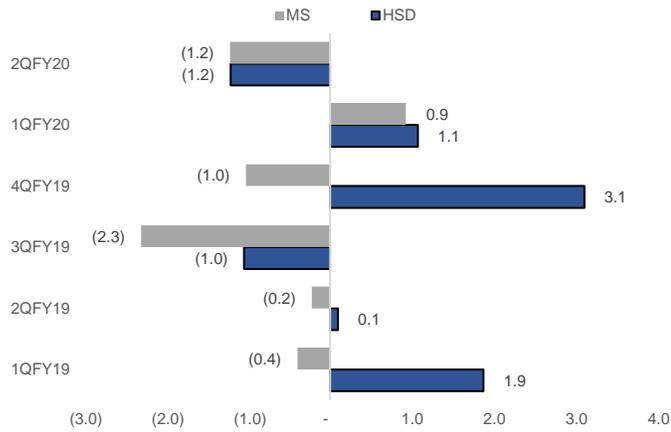
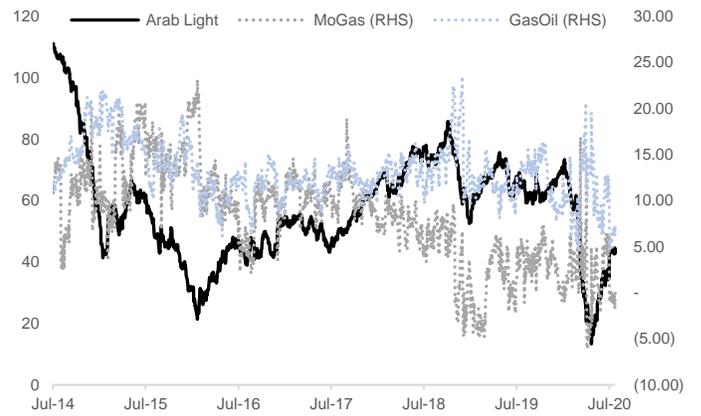


Exhibit: Refining spreads on MS and HSD (USD/bbl)



Recommendation

We maintain a BUY stance on PSO and APL with our Dec-20 target prices of PKR 249/share and PKR 412/share, offering 42% and 29% upside respectively from last close. PSO and APL are currently trading at FY21 P/E of 8.9x and 9.5x respectively.

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Time Horizon: Dec – 2020

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