# Day Break

Wednesday, 10 October 2018

## COMPANY UPDATE

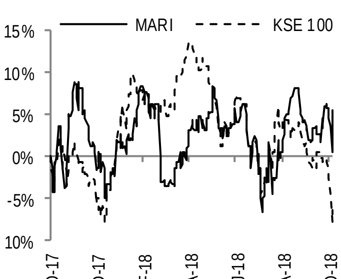
**Mari Petroleum Company Limited**
Oil & Gas Exploration Companies

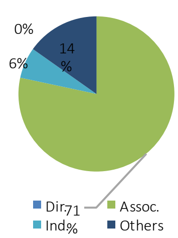
| | | | |
|---|---|---|---|
| **Recommendation** | | | **BUY** |
| Target Price: | | | 1,864.2 |
| Last Closing: | 9-Oct-18 | | 1,409.9 |
| Upside: | | | 32.2 |
| Valuation Methodology: | | Reserve based - Discounted Cash Flow (DCF) | |
| Time Horizon: | | | Dec-18 |
| **Market Data** | | | |
| Bloomberg Tkr. | | | MARI PA |
| Shares (mn) | | | 121.3 |
| Free Float Shares (mn) | | | 22.1 |
| Free Float Shares (%) | | | 18.2% |
| Market Cap (PKRbn \| USDmn) | | 171.0 | 1,330.8 |
| Exchange | | | KSE ALL |
| **Price Info.** | 90D | 06M | 12M |
| Abs. Return | 10.8 | 2.2 | 5.4 |
| Lo | 1,248.1 | 1,248.1 | 1,248.1 |
| Hi | 1,445.4 | 1,449.1 | 1,455.3 |

**Key Company Financials**
Period End: Jun

| PKRbn | FY18A | FY19E | FY20F | FY21F |
|---|---|---|---|---|
| Total Revenue | 40.7 | 61.6 | 72.7 | 72.0 |
| Net Income | 15.4 | 24.6 | 29.8 | 28.9 |
| EPS (PKR) | 126.8 | 203.2 | 246.0 | 238.2 |
| DPS (PKR) | 6.0 | 6.3 | 6.7 | 6.7 |
| Total Assets | 80.9 | 144.2 | 161.4 | 207.5 |
| Total Equity | 40.2 | 53.6 | 82.6 | 110.7 |
| **Key Financial Ratios** | | | | |
| ROE (%) | 38.3 | 46.0 | 36.1 | 26.1 |
| P/E (x) | 11.1 | 6.9 | 5.7 | 5.9 |
| P/B (x) | 29.1 | 4.3 | 3.2 | 2.1 |
| DY (%) | 0.4 | 0.4 | 0.5 | 0.5 |

**Relative Price Performance**




**About the Company**

The Company is a public limited company incorporated in Pakistan in 1984. The principal activity of the company exploration, production and sale of hydrocarbons. The company was listed on all stock exchanges in Pakistan when GoP divested 50% of its stake to Fauji Foundation.

Source: Bloomberg, PSX & IGI Research

**Abdullah Farhan**
Senior Research Analyst
Tel: (+92-21) 111-234-234 Ext.: 912
Abdullah.farhan@igi.com.pk

## Oil & Gas Exploration Companies

# MARI: Macroeconomic down turn in favor with diversification on cards; 'BUY' maintained

- We have revised our earnings for Mari Petroleum Company Limited (MARI) by +10%-16% for FY19/20/21F on the back of a) increased oil price assumption to USD 70/60/55 for FY19/20/21F while keeping long term price assumption at USD 50/bbl, b) total gas production to be enhanced to 775mmcfd with HRL to sustain at 640-650mmcfd till FY23, c) commencement of production Tipu-1 in 1HFY19 and, d) increased flows from Mari field's SML/Lower Guru reservoir
- Moreover, with natural depleting trend from Kalabagh field limiting production levels earlier than anticipated, we have estimated flows at 141bopd and 4.5mmcfd (currently at 120bopd and 4.1mmcfd) with a depletion of 3% there onwards,
- With wellhead gas price to reach 100% from Jan-19 onwards we foresee MARI to post 3yr earnings CAGR of +23% from FY19-21F. Thus, our Dec-18 bonus adjusted target price is revised slightly upwards by +4% to PKR 1,864.2/share.

### Earnings revised to reflect higher oil prices, PKR depreciation and production enhancements

We have revised our earnings for Mari Petroleum Company Limited (MARI) by +10%-16% for FY19/20/21F on the back of a) increased oil price assumption to USD 70/60/55 for FY19/20/21F while keeping long term price assumption at USD 50/bbl, b) total gas production to be enhanced to 775mmcfd with HRL to sustain at 640-650mmcfd till FY23, c) commencement of production Tipu-1 in 1HFY19 with flows expected to be enhanced to 40-75mmcfd from 21.4mmcfd at time of discovery and, d) increased flows from Mari field's SML reservoir. We have also incorporated recent discovery from Bolan East adding nearly 690bopd of oil. Moreover, with natural depleting trend from Kalabagh field limiting production levels earlier than anticipated, we have estimated flows at 141bopd and 4.5mmcfd (currently at 120bopd and 4.1mmcfd) with a depletion of 3% there onwards. We have also incorporated FY18 financial statements and recent hike of 100bps in interest rate in last two months.

With wellhead gas price to reach 100% from Jan-19 onwards we foresee MARI to post 3yr earnings CAGR of +23% from FY19-21F. Thus, our Dec-18 bonus adjusted target price is revised slightly upwards by +4% to PKR 1,864.2/share.

Exhibit:

**Key Financial Highlights**

| | | FY16A | FY17A | FY18A | FY19F | FY20F | FY21F | FY22F |
|---|---|---|---|---|---|---|---|---|
| Oil price | USD/bbl | 40.66 | 48.41 | 62.37 | 70.00 | 60.00 | 55.00 | 50.00 |
| Exchange rate | PKR/USD | 104.30 | 104.77 | 110.01 | 132.15 | 141.29 | 146.11 | 151.76 |
| EPS | PKR | 49.90 | 75.33 | 126.77 | 203.20 | 245.97 | 238.19 | 234.30 |
| DPS | PKR | 5.10 | 5.20 | 5.30 | 6.30 | 6.70 | 6.70 | 6.70 |

*Source: IGI Research*

### MARI capacity enhanced to 900mmcfd, HRL to sustain at 640-650mmcfd

In FY18 financial statements, the management reported that MARI's total gas capacity has been enhanced to 900mmcfd, whereas HRL reserve through drilling of total 19 additional development wells till 2019 would sustain production at 640-650mmcfd till FY23 which was earlier expected to witness depletion from Feb-19 onwards. So far 5 development wells have resulted in gas discoveries in Mari 101-105. As a result we have assumed Mari HRL to sustain at 640-650mmcfd till FY23 and thereafter post 3%-5% depletion in production. However, through drilling in other wells in Mari Development and Production lease, we expected production from MARI field to touch 725mmcfd by FY22 (currently at 697mmcfd).

## Development wells in Mari field to lift production to 725mmcfd by FY22

Mari gas field production has increased by 5.9%YoY to stand at FY18 average of 669mmcfd compared to 632mmcfd in FY17. Current production from Mari field stands at 697mmcfd with a peak of 714mmcfd witnessed in Feb-18. Gas production from Mari field has increased by 2%-5% annually in the last 3 years up until Jun-18 which was due to seven discoveries made (3 exploratory well and 4 appraisal/development wells) in the first phase of strategy to enhance gas flows from Mari Development & Production (D&P) Lease. The appraisal and development well include Bhitai-2, Bhitai-5 and Azadi-1 (cumulatively adding 27mmcfd). The exploratory wells included Tipu-1, Shahbaz-1 and Shaheen-1 which form part of the Mari field SML/SUL reservoir and is granted higher price incentive under PP12. These exploratory wells are estimated to cumulatively contribute nearly 45mmcfd. This has led to an increase of 70-80mmcfd of gas from Mari field.

With enhancement of production from other wells, we expect Mari HRL to drop to 88-89% from current 90% based on estimated revenue generated through incremental production of PKR 10.5bn as production is estimated to clock in at 775mmcfd by FY22. HRL contribute nearly 87% to total gas production of MARI. Total incremental production during FY18 from MARI HRL was 27,797mmcf.

## Gas production to increase by +4%YoY in FY19

With inclusion of appraisal/development wells and exploratory wells, we expect production from Mari field to sustain at 700mmcfd for FY19. On average we expect natural depletion on other fields at the rate of 5%-7% from FY18 onwards, thus leading to total gas production of 734mmcfd for FY19.

## Oil production to drop by 6% in FY19, however estimated to grow by +21%YoY in FY20

Due to natural depletion at Kalabagh, Halini, Halini Deep and Ghauri (contributing nearly 82% of total production) facing natural depletion at the rate of 16% on average, is likely to lead in production decline of 6%YoY in FY19. However, post commencement of production from Bolan East in FY19 we expect production to increase by +21%YoY to 1,659bopd.

Exhibit:

**Gas production to remain steady with new discoveries in Mari Lower Guru/SML reserves (mmcfd)**

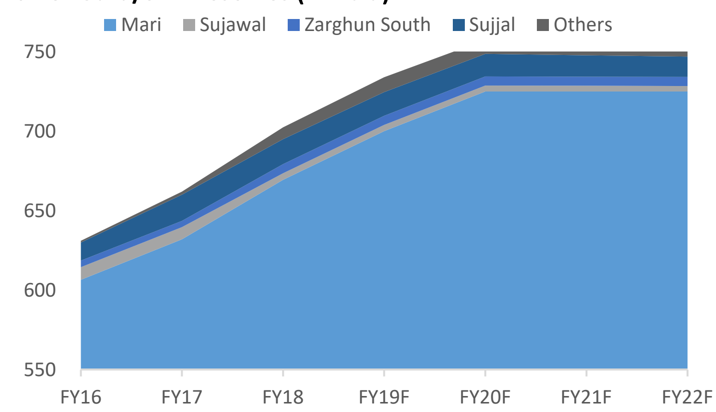
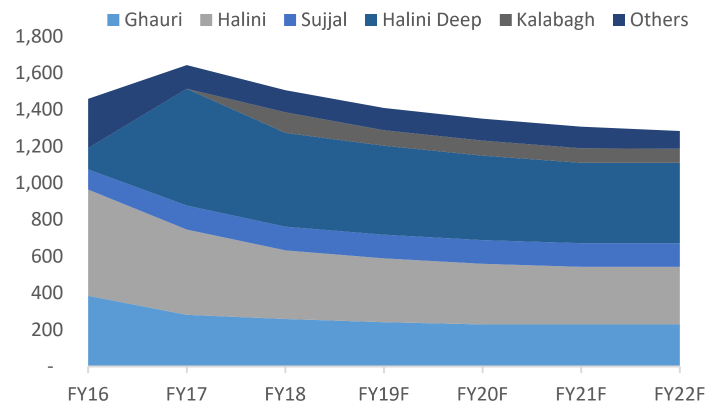



Exhibit:

**Oil production to drop despite addition of Bolan East (bopd)**




*Source: IGI Research, PPIS, Company Financial, PSX*

## 8-10 wells planned for drilling in FY19

The Company drilled 6 exploratory wells, 2 appraisal and 2 development wells in FY18. Shaheen-2 has been carried forward to FY19. The Management of the Company has enhanced the drilling budget for FY19 to USD 371mn from 249mn in FY18. As a result of this MARI was able to add 259bcf of gas reserves in FY18 with production potential enhanced by 80 mmcfd. With a success ratio of 70% in FY18, reserve replacement ratio stood at 43% in FY18 and the Company has targeted a reserve replacement ratio of 100% in FY19. The Company has also increased the target to drilling of 8-10 wells per year from 2-3 wells per annum previously.

The Company plans to drill 8-10 number of wells in FY19. Shaheen-2 (Mari D&P lease), Surghar (Karak Block), Tipu-2 (Mari D&P lease), Miraj-1 (Ghauri Block) and first exploratory well in Bannu West Block have been planned for drilling in FY19 so far.

Exhibit:

**Highest ever drilling in FY18 with focus on other wells beside Mari…**

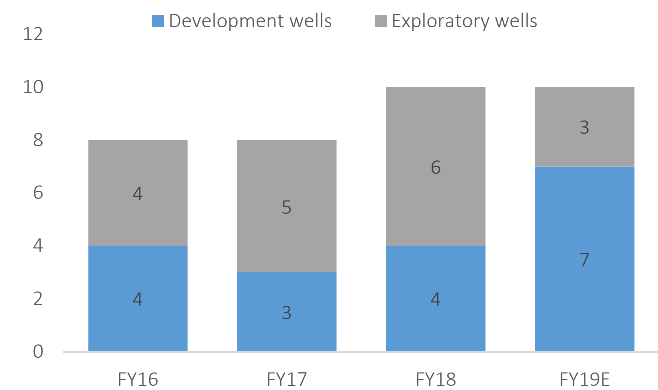
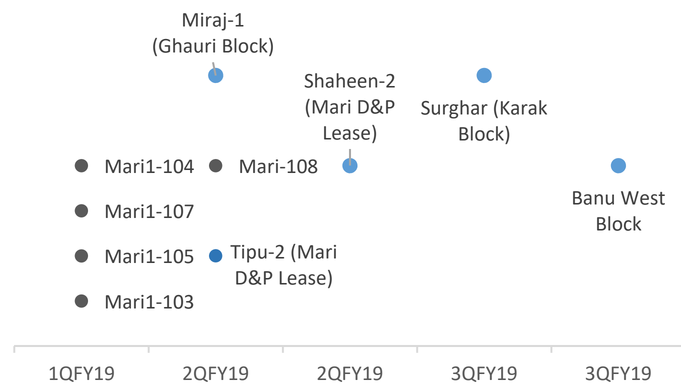



Exhibit:

**Aggressive drilling trend likely to continue in FY19 with focus on HRL X project**




*Source: IGI Research, PPIS, Company Financial, PSX*

## Bolan east and Tipu to add to oil & gas production from FY19 onwards…

In a recent discovery PPL operator of Bolan East discovered oil reserves where MARI has 60% working along with PPL. We have assumed 690bopd of oil flows under Moro/Mughal Kot formation, however under Chiltan formation the well tested for 810bopd. We estimate Bolan East to contribute PKR 0.9/share in earnings on annual basis. However, we highlight that further development in the well on Chiltan formation could result in higher flows.

Similarly, we have estimated 21mmcfd of gas flows from Tipu field which is expected to start production by Mar-19 as reported by management. However, under lower Guru Formation Tipu tested for flows of 15.5mmcfd. As MARI has signed MOU with Pak Arab fertilizers for supply of 40mmcfd of gas, the Company had planned to drill Tipu-2 in Sep-18 in order to meet the daily production levels.

## …however natural depletion in Kalabagh remains a concern

Kalabagh has witnessed natural depletion since commencement of production in Jun-17 and production has remained well below the tested flows of 500bopd. As a result, we have revised down our production forecast for Kalabagh field to 4.5mmcfd of gas and 141bopd of oil for FY19 with a natural depletion of 3% going forward. At these levels of flow, we estimate Kalabagh field to contribute nearly PKR 2.3/share or 1.1% of FY19 earnings. With every 5% drop in oil and gas flows from Kalabagh field, earnings are expected to contract by 0.1% or PKR 0.12/share.

Exhibit:

**Bolan East to add 690bopd to oil production from FY19 onwards (bopd)**

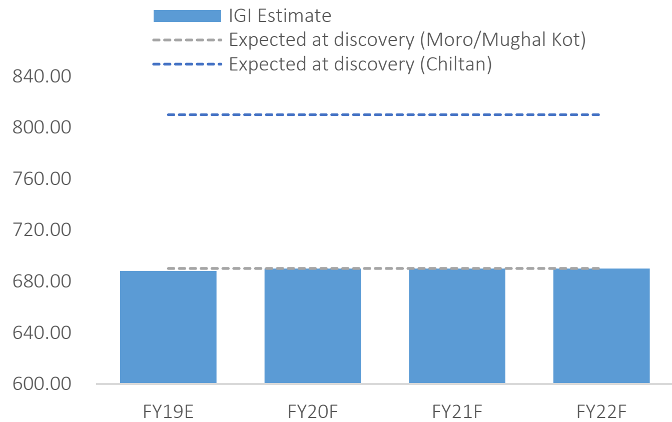
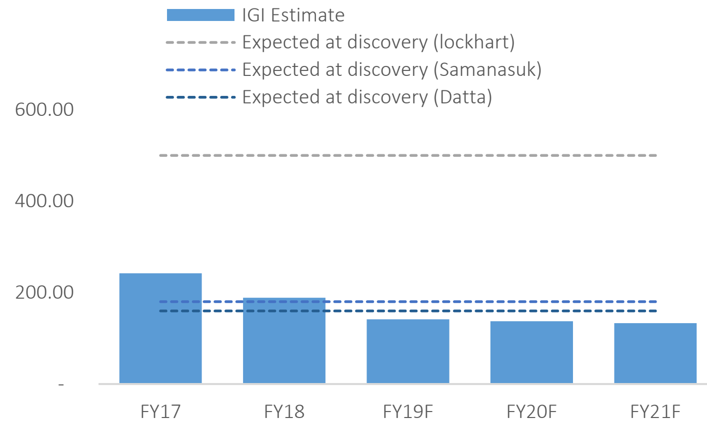



Exhibit:

**Kalabagh oil production to face natural depletion however further development may sustain flows (bopd)**




*Source: IGI Research, PPIS, Company Financial, PSX*

## Acquisition of concessions from Pakistan Petroleum Limited (PPL)

MARI under its strategy to expand exploration acreage, has acquired additional working interest in concessions from JV partners and is in the process of acquiring the rest. MARI has been assigned 30% working interest in Ghari block by PPL taking total stake for MARI to 65%. As oil production contributes ~3% of total revenues, we estimate negligible impact of increased stake in Ghauri block on MARI's earnings. Other acquired stakes include 25% working interest in Bela West block from PPL and a farm in & farm out basis agreement under which PPL will acquire 35% working interest in Sujawal block while MARI will take over 24% stake in Kotri block. MARI will also acquire a 13.3%, 30%, 95% and 20% working interest in Kohat Block, Kalchas, Block-28 and Banu West respectively from Tullow. MARI will also transfer 35% working interest to PPL in Sujawal block which in our view is likely to shred PKR 0.85/share of MARI earnings in FY19 or 0.4% in FY19 and erode 0.2%-0.3% on recurring basis till FY23 until reserves deplete.

Exhibit:

**Working Interest in Concessions Assigned to MARI**

| | Ghauri (30%) | Bela West (25%) | Sujawal (35%) | Kotri (24%) | Kohat (13.3%) | Banu West (20%) | Block-28 (95%) | Kalchas (30%) |
|---|---|---|---|---|---|---|---|---|
| Owned by | PPL | PPL | MARI | PPL | Tullow | Tullow | Tullow | Tullow |
| Assigned to | MARI | MARI | PPL | MARI | MARI | MARI | MARI | MARI |

*Source: IGI Research*

## Diversification into power production, food grade liquid carbon dioxide production and investment in mid-stream or downstream petroleum sector

MARI in its financial statements reported that the Company is in the advanced stages of diversifying in to low BTU power plant which is expected to yield return at the rate of 15-20% annually. The management has revised down the capacity of proposed power plant from 280MW to 180MW in view of availability from lower Guru-B reservoirs. To note the lower Guru-B reservoir has heating value range of 450-462 mmbtu/mmcf which is lower than the current heating value of HRL/SML reserves providing gas to fertilizer sector. Assuming 180MW power plant with an estimated cost of USD 180-200mn, we estimate annualized earnings accretion of PKR 27-29/share with anticipated value addition of PKR 147.1/share. The Company had planned to complete the feasibility study by Sep-18.

The company has also expressed interest in investing in mid/down-stream petroleum sector which is the refinery/ oil pipelines / oil & gas marketing sector. This in our view is a positive step forward as Pakistan is currently in need of deep conversion refineries to reduce reliance on imports of POL products with current refineries operating inefficiently and below international standards. However, currently oil & gas marketing sectors due to rise in competition and expected slow-down in economy may not be as easy to penetrate despite high ROEs.

MARI also plans to diversify in to commercial production of food quality liquid carbon dioxide for sale to beverage industry. The management has targeted for commercial operations by summer 2019. The Company has engaged an engineering consultancy firm to undertake Front End Engineering Study (FEED) which will provide MARI will submission of deliverables to allow the Company to proceed with hiring of EPC contractor.

**Target price downgraded to PKR 1,864.2/share offering +32% upside; 'BUY' call maintained**

We still maintain MARI as our top pick in IGI E&P universe with our revised Dec-18 target price of PKR 1,864.2/share offering +32% upside from last close. MARI is currently trading at FY19E P/E of 6.9x and trades at lowest EV/BoE of USD 1.53/BoE among its peers. We base our investment case on 3Yr earnings CAGR of +23% during FY19-21F on the back of a) total gas production to reach 775mmcfd by FY22 with HRL to sustain at 640-650mmcfd, b) unwinding of discount for Mari field which will gradually decrease every six months to reach 100% of gas price in Jan-19 and, c) higher gas price incentive under PP12 for Mari HRL field for incremental production over and above benchmark of 525mmcfd.

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| Recommendation | Rating System |
|---|---|
| Buy | If target price on aforementioned security(ies) is more than 10%, from its last closing price(s) |
| Hold | If target price on aforementioned security(ies) is in between -10% and 10%, from its last closing price(s) |
| Sell | If target price on aforementioned security(ies) is less than -10%, from its last closing price(s) |

**Time Horizon:** Dec – 2018

**Valuation Methodology:** The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):
(Reserve Based DCF Valuation)

Risk: Investment in securities are subject to economic risk, market risk, interest rate risks, currency risks, and credit risks, political and geopolitical risks. The performance of company (ies) covered herein might unfavorably be affected by multiple factors including, business, economic, and political conditions. Hence, there is no assurance or guarantee that estimates, recommendation, opinion, etc. given about the security (ies)/company (ies) in the report will be achieved.

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IGI Finex Securities Limited
**Research Analyst(s)**
Research Identity Number: BRP009

# Contact Details


Research Team

| | | | |
|---|---|---|---|
| Saad Khan | Head of Research | Tel: (+92-21) 111-234-234 Ext: 810 | saad.khan@igi.com.pk |
| Abdullah Farhan | Senior Analyst | Tel: (+92-21) 111-234-234 Ext: 912 | abdullah.farhan@igi.com.pk |
| Suleman Ashraf | Research Analyst | Tel: (+92-21) 111-234-234 Ext: 957 | suleman.ashraf@igi.com.pk |
| Muhammad Saad | Research Analyst | Tel: (+92-21) 111-234-234 Ext: 816 | muhammad.saad@igi.com.pk |
| Umesh Solanki | Database Manager | Tel: (+92-21) 111-234-234 Ext: 974 | umesh.solanki@igi.com.pk |

Equity Sales

| | | | |
|---|---|---|---|
| Faisal Jawed Khan | Head of Equities | Tel: (+92-21) 35301779 | faisal.jawed@igi.com.pk |
| Zaeem Haider Khan | Regional Head (North) | Tel: (+92-42) 35777863-70 | zaeem.haider@igi.com.pk |
| Muhammad Naveed | Regional Manager (Islamabad & Upper North) | Tel: (+92-51) 2604861-62 | muhammad.naveed@igi.com.pk |
| Ejaz Rana | Regional Manager (Faisalabad) | Tel: (+92-41) 2540843-45 | ejaz.rana@igi.com.pk |
| Asif Saleem | Branch Manager (RY Khan) | Tel: (+92-68) 5871652-56 | asif.saleem@igi.com.pk |
| Mehtab Ali | Branch Manager (Multan) | Tel: (+92-61) 4512003 | mahtab.ali@igi.com.pk |
| Zeeshan Kayani | Branch Manager (Abbottabad) | Tel: (+92-992) 408243-44 | zeeshan.kayani@igi.com.pk |
| Ihsan Mohammad | Branch Manager (Peshawar) | Tel: (92-91) 5253035 | ihsan.mohammad@igi.com.pk |

IGI Finex Securities Limited
Trading Rights Entitlement Certificate (TREC) Holder of
Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited

Head Office
Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780
Website: www.igisecurities.com.pk

Stock Exchange Office
Room # 134, 3rd Floor, PSX Building,
Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2 ,
Fax: (+92-21) 32429607

| | |
|---|---|
| **Lahore Office**<br>Shop # G-009, Ground Floor,<br>Packages Mall<br>Tel: (+92-42) 35777863-70, 35876075-76<br>Fax: (+92-42) 35763542 | **Islamabad Office**<br>Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,<br>Block- B, Jinnah Avenue, Blue Area<br>Tel: (+92-51) 2604861-2, 2604864, 2273439<br>Fax: (+92-51) 2273861 |
| **Faisalabad Office**<br>Room #: 515-516, 5th Floor, State Life<br>Building, 2- Liaqat Road<br>Tel: (+92-41) 2540843-45<br>Fax: (+92-41) 2540815 | **Rahim Yar Khan Office**<br>Plot # 12, Basement of Khalid Market,<br>Model Town, Town Hall Road<br>Tel: (+92-68) 5871653-6, 5871652<br>Fax: (+92-68) 5871651 |
| **Multan Office**<br>Mezzanine Floor, Abdali Tower,<br>Abdali Road<br>Tel: (92-992) 408243 - 44 | **Abbottabad Office**<br>Ground Floor, Al Fatah Shoppinig Center ,<br>Opp. Radio Station, Mansehra Road<br>Tel: (+92-99) 2408243 - 44 |
| **Peshawar Office**<br>2nd Floor, The Mall Tower,<br>35 The Mall Peshawar Cantt.<br>Tel: (92-91) 5253035, 5278448 | **Sialkot Office**<br>Suite No. 10 & 11, 1st Floor, Soni Square,<br>Mubarik Pura<br>Tel: (+92-52) 3258437, 3258762 |


IGI Finex Securities Limited
**Research Analyst(s)**
Research Identity Number: BRP009