Day Break

Tuesday, 25 July 2017

IGI Securities
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COMPANY UPDATE

OIL & GAS DEVELOPMENT COMPANY LIMITED
OIL & GAS EXPLORATION COMPANIES

Recommendation		BUY
Target Price:		195.8
Last Closing:	24-Jul-17	150.1
Upside:		30.4
Valuation Methodology:		Reserve based - Discounted Cash Flow (DCF)
Time Horizon:		Dec-17

Market Data

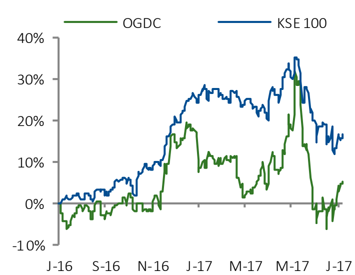
Bloomberg Tkr.		OGDC PA
Shares (mn)		4,300.9
Free Float Shares (mn)		645.1
Free Float Shares (%)		15.0%
Market Cap (PKRbn | USDmn)	645.7	6,129.4
Exchange		KSE 100

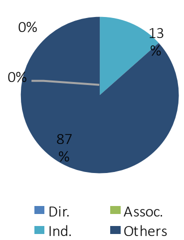
Price Info.	90D	180D	365D
Abs. Return	(5.8)	(4.7)	4.9
Lo	133.7	133.7	133.7
Hi	188.7	188.7	188.7

Key Company Financials
Period End: Jun

PKRbn	FY16A	FY17E	FY18F	FY19F
Total Revenue	162.9	186.2	230.7	228.3
Net Income	59.97	68.5	89.2	86.8
EPS (PKR)	13.9	15.9	20.7	20.2
DPS (PKR)	5.2	5.5	7.0	6.5
Total Assets	589.6	646.5	709.6	764.9
Total Equity	478.6	527.5	586.1	640.4
Key Financial Ratios				
ROE (%)	12.5	13.0	15.2	13.6
P/E (x)	10.8	9.4	7.3	7.4
P/B (x)	1.3	1.2	1.1	1.0
DY (%)	3.5	3.7	4.7	4.3

Relative Price Performance & Shareholding





About the Company

The Company was incorporated on October 23, 1997 and is engaged in the exploration and development of oil and gas resources, including production and sale of oil and gas and related activities. Its GDS are listed on the London Stock Exchange.

Source: Bloomberg, KSE 100 & IGI Research

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Oil & Gas – Exploration Companies

OGDC: Fundamentals Overshadowed by Lower Oil Prices; BUY

- Foreign outflow post inclusion of Pakistan in MSCI EM from Jun-17 onwards combined with 5% decline in oil prices post-OPEC meeting held on 25th May-17, the stocked plunged nearly 21% to stand at PKR 150.1/share. Nevertheless, we believe given company's sound fundamentals based on a) solid earnings growth of +34% in FY18F, b) higher success ratio and c) newer discoveries in pipeline; OGDC is trading at an attractive FY18 forward P/E multiple of 7.3x
- OGDC in a notice sent to PSX on 21st Jul-17 announced that the company has received the cash amount in full against the maturity of PKR 53.4bn PIBs. The company's management has not yet communicated as to what these cash flows will be utilized for
- Due to lack of clarity on where these proceeds will be utilized we have not changed our assumption of reinvestment in PIBs and await official announcement from the management. We maintain our "BUY" call on OGDC with our Dec-17 target price of PKR 196/share, offering +30% upside from its last closing.

Recent slump in share price post inclusion in MSCI…

To recall, pre-announcement of Pakistan inclusion in MSCI Emerging Market (EM) starting Jun-17, the stock rallied nearly +22% in May-17 touching a high of PKR 188.7/share during the period. However, foreign outflow post inclusion of Pakistan in MSCI EM from Jun-17 onwards combined with 5% decline in oil prices post-OPEC meeting held on 25th May-17, the stocked plunged nearly 21% to stand at PKR 150.1/share. Nevertheless, we believe given company's sound fundamentals based on a) solid earnings growth of +34% in FY18F, b) higher success ratio and c) newer discoveries in pipeline; OGDC is trading at an attractive FY18 forward P/E multiple of 7.3x. We recommend a buy call on OGDC.

Strong fundamentals makes OGDC attractive in terms of valuation upside despite lower oil price

Company focus on aggressive exploration activities, along with old and new discoveries coming online and development projects such as KPD-TAY and Uch-II are expected to provide +34% growth in earnings in FY18F. For FY17 alone we estimate +14%YoY rise in earnings on the back +18%YoY recovery in oil price and new discoveries coming online such as Mardankhel, Dars, Dars West and Deep, Pasakhi East and Deep West, Shah, Thora/Thora Deep and Unar cumulatively adding 38.6mmcfd and 1,487bopd. Our long term price assumption remain at USD 50/bbl from FY18F onwards, while any global reforms to balance the oil supply glut should provide further upside to our valuation.

Aggressive drilling focused towards Appraisal/Development well

OGDC has spudded 9 exploratory and 13 appraisal/development in FY17 against plan of 16 exploratory and 12 appraisal/development wells. As a result the company has successfully discovered oil and gas reserves from 5 exploratory wells and while 2 appraisal/development wells with a success ratio of 31% (highest among E&P sector) along with three development projects namely Uch-II, KPD-TAY and Nashpa-Mela project. The company has discovered 4 appraisal/developments well in FY17 from joint venture in Tal block.

Exhibit:

EPS and Target Price Sensitivity to Oil Prices

Scenarios	EPS (PKR) FY18	FY19	FY20	TP (PKR) - Dec'17
Bear @ USD/bbl. 45	19.8	19.2	18.3	190.4
Base@ USD/bbl. 50	20.7	20.2	19.3	195.5
Bull 1@ USD/bbl. 55	21.7	21.1	20.1	200.4
Bull 2@ USD/bbl. 60	22.6	22.0	21.0	205.3
Bull 3@ USD/bbl. 65	23.5	23.0	21.9	210.1

Source: IGI Research

New Discoveries to add PKR 6.1/share in FY18F

We expect new discoveries coming online to add PKR 6.1/share which includes 114mmcfd of gas and 5,395bopd of oil/condensate. Further, production is expected to come online from Uch-II, KPD-TAY and Nashpa-Mela project cumulatively adding 235mmcfd of gas, 5,120 of bopd of oil and 750mtpd of LPG.

Maturity of PIBs in Jul-17; Cash received for the total amount

OGDC in a notice sent to PSX on 21st Jul-17 announced that the company has received the cash amount in full against the maturity of PKR 53.4bn PIBs (face value plus interest) carrying a mark-up rate of 11.5%. To recall these PIBs were issued in Jul-2012 (PKR 50.8bn) for 5 years by GoP to settle overdue payments from oil refineries and gas companies (matured on 19th Jul-17). Given current debt obligations and poor fiscal position of GoP we had previously assumed roll over of PIBs at a lower mark-up of 7.0%. As a result other income was expected to come down to PKR 14.5bn in FY18F from PKR 15.7bn estimated in FY17E.

The company's management has not yet communicated as to what these cash flows will be utilized for. However, we highlight a number of possibilities that could arise.

However, we highlight different possibilities of utilization of proceeds from maturity of PIBs including;

Scenario – 1: Reinvests in PIBs (Our base case)
Scenario – 2: The company pays off partial amount as dividend and invests other to acquire concessions globally or a local firm (company might opt for acquiring OMVs assets which is up for sale) and,
Scenario – 3: Company pays off partial amount as dividend and induces the rest in its working capital

For our base case, lack of clarity on utilization of proceeds we have simply reinvested the proceeds in PIBs at current yields. However, we do not rule out the possibility of incremental dividend at this stage.

Exhibit

Scenario – 1: Reinvestment in PIBs

Cash Received: PKR 53.40 or PKR 12.42/share

	Dividend Payout	Incremental Dividend PKR/share	Reinvested PKR/share	FY18F earnings	FY18F earnings change (%)
Base case	0%	-	12.42	20.73	-
Case 1	30%	3.75	8.67	20.58	(0.15)
Case 1	50%	6.25	6.17	20.46	(0.28)
Case 3	70%	8.50	3.92	20.34	(0.40)

**Reinvestment in PIBs assumed at 7%*

Recommendation

We maintain our **"BUY"** call on OGDC with our Dec-17 target price of PKR 196/share, offering +30% upside from its last closing. The company is currently trading at a FY18F P/E of 7.3x and offers a dividend yield of 4.7%.

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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 priceon 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 - 2017

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, credit risks, political and geopolitical risks. The performance of company(ies) covered herein mightunfavorably 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.

Basic Definitions and Terminologies used: Target Price: A price target is the projected price level of a financial security stated by an investment analyst or advisor. It represents a security's price that, if achieved, results in a trader recognizing the best possible outcome for his investment. **Market Cap.:** Market capitalization is calculated by multiplying a company's shares outstanding by current trading price. **ROE:** Return on equity is the amount of net income returned as a percentage of shareholders' equity. **P/E**: Price to Earnings ratio of a company's share price to its per-share earnings. **P/B**: Price to Book ratio used to compare a stock's market value to its book value. **DY**: The dividend yield is dividend per share, divided by the price per share.

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