

Day Break

Monday, 28 May 2018

COMPANY UPDATE

Pakistan Oilfields Limited

Oil & Gas Exploration Companies

| | | | |
|-------------------------|--|--|--|
| Recommendation | NEUTRAL | | |
| Target Price: | 610 | | |
| Last Closing: 25-May-18 | 662 | | |
| Upside: | -8% | | |
| Valuation Methodology: | Reserve based - Discounted Cash Flow (DCF) | | |
| Time Horizon: | Dec-18 | | |

Market Data

| | | | |
|----------------------------|---------|---------|-------|
| Bloomberg Tkr. | POL PA | | |
| Shares (mn) | 236.5 | | |
| Free Float Shares (mn) | 108.3 | | |
| Free Float Shares (%) | 45.8% | | |
| Market Cap (PKRbn USDmn) | 156.6 | 1,355.6 | |
| Exchange | KSE 100 | | |
| Price Info. | 90D | 06M | 12M |
| Abs. Return | 13.4 | 8.6 | 28.2 |
| Lo | 594.7 | 551.8 | 429.8 |
| Hi | 707.3 | 707.3 | 707.3 |

Key Company Financials

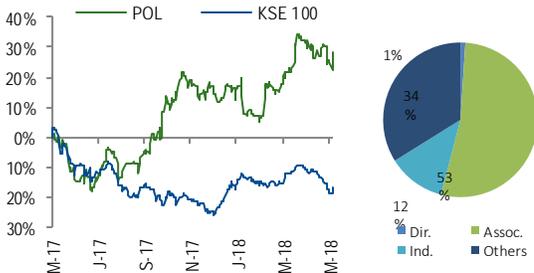
Period End: Jun

| PKRbn | FY17A | FY18E | FY19F | FY20F |
|---------------|-------|-------|-------|-------|
| Total Revenue | 27.3 | 31.4 | 42.5 | 39.8 |
| Net Income | 9.7 | 11.0 | 16.5 | 15.2 |
| EPS (PKR) | 40.9 | 46.7 | 69.9 | 64.3 |
| DPS (PKR) | 40.0 | 45.0 | 62.5 | 57.5 |
| Total Assets | 57.7 | 62.7 | 75.3 | 74.7 |
| Total Equity | 31.5 | 31.9 | 33.7 | 35.3 |

Key Financial Ratios

| | | | | |
|---------|------|------|------|------|
| ROE (%) | 30.7 | 34.6 | 49.2 | 43.1 |
| P/E (x) | 16.2 | 14.2 | 9.5 | 10.3 |
| P/B (x) | 11.6 | 5.0 | 4.9 | 4.7 |
| DY (%) | 6.0 | 6.8 | 9.4 | 8.7 |

Relative Price Performance



About the Company

The Company is incorporated in Pakistan as a public limited company. The Company is principally engaged in exploration, drilling and production of crude oil and gas. The Company is a subsidiary of the Attock Oil Company Limited, UK and its ultimate parent is Bay View International Group, S.A.

Source: Bloomberg, PSX & IGI Research

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Oil & Gas Exploration Companies

POL: Higher oil prices and expectation of new discoveries mask over production concerns; maintain 'HOLD'

- We have revised upwards our earnings for Pakistan Oilfields Limited (POL) by +6.0%/+3.9% for FY19/20F on the back of increased oil price assumption to USD 65/60/55 for FY19/20/21F while keeping long term price assumption at USD 50/bbl. However, despite increase of +13.1%/+13.5%/+7.5% in FY19/20/21F due to hike in oil price forecast, our overall earnings estimates have been revised up by only +6.0%/+3.9% for FY19/20F while slightly shredding out earnings forecast by 1.4% for FY21.
- However, our target price is revised downwards by 2% to PKR 610/share after incorporating net impact on increased oil price and lower production along with 50bps increase in policy rate.,
- We still maintain a 'HOLD' call on POL with our revised Dec-18 target price of PKR 610/share offering 8% downside from last close. The Company is currently trading at FY18E/19F P/E of 14.2x/9.5x and offers the highest dividend yield of 6.8% among its peers.

Oil price assumption revised upward to USD 65, 60 and 55/bbl for FY19, FY20 and FY21

Oil prices have witnessed a hike of nearly ~56% to USD 71.57/ bbl in FY18TD, a level last observed in Dec-14, on the back of a) increased geo-political tensions, b) deeper production cuts by Saudi Arabia ahead of Aramco IPO and persistent compliance by OPEC members, c) decline in production by Venezuela and, d) imposition of sanctions on Iran by US. However, after recent comments by world's largest and 3rd largest oil producer Russia and Saudi Arabia (increase their output by 1mn bopd cumulatively to compensate for decline in production from Venezuela and likely curb in exports from Iran post imposition of sanctions and hinting towards an early exit from agreement between OPEC and Non-OPEC members), oil prices have fallen by nearly 3% since 22nd May-18. Based on this change in supply and demand dynamics of oil, we have increased our oil price assumption to USD 65/60/55 per bbl for FY19/20/21F while keeping our long term price intact at USD50/bbl. This alone has led to earnings accretion of +13.1%/+13.5%/+7.5% in FY19/20/21F.

Earnings revised to reflect higher oil prices and lower production flows; 'HOLD' call intact

We have revised upwards our earnings for Pakistan Oilfields Limited (POL) by +6.0%/+3.9% for FY19/20F on the back of increased oil price assumption to USD 65/60/55 for FY19/20/21F while keeping long term price assumption at USD 50/bbl. However, despite increase of +13.1%/+13.5%/+7.5% in FY19/20/21F due to hike in oil price forecast, our overall earnings estimates have been revised up by only +6.0%/+3.9% for FY19/20F while slightly shredding out earnings forecast by 1.4% for FY21 on account of a) lower than expected flows from Jhandial which is currently averaging 883bopd till May-18 post production commencement and, b) drop in production from Tal block and other fields amid abrupt closure of FO based power plants in Oct-17. However, our target price is revised downwards by 2% to PKR 610/share after incorporating net impact on increased oil price and lower production along with 50bps increase in policy rate.

Exhibit:

Key Financial Highlights

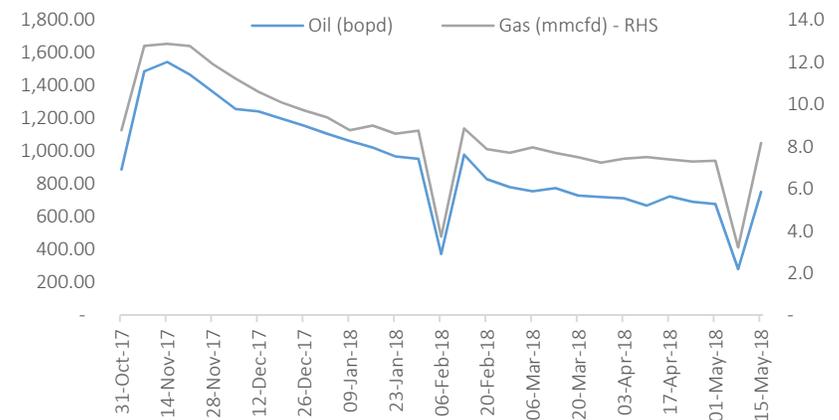
| | | FY16A | FY17A | FY18F | FY19F | FY20F | FY21F | FY22F |
|-----------|---------|--------|--------|--------|--------|--------|--------|--------|
| Oil price | USD/bbl | 40.66 | 48.41 | 60.00 | 65.00 | 60.00 | 55.00 | 50.00 |
| PKR/USD | | 104.30 | 104.82 | 108.90 | 115.91 | 120.52 | 124.14 | 127.86 |
| EPS | PKR | 30.58 | 40.92 | 46.69 | 69.94 | 64.31 | 56.47 | 37.15 |
| DPS | PKR | 35.00 | 40.00 | 45.00 | 62.50 | 57.50 | 50.00 | 32.50 |

Source: IGI Research

Flows from Jhandial continues to remain below par since inception

As witnessed by production data published by Pakistan Petroleum Information Services (PPIS), flows from Jhandial have been on a decline since inception following the precedent of some major discoveries in recent times including Mardankhel, which has witnessed a revision of 65%/66% in oil/gas reserves. Average oil and gas production from Jhandial till 15th May-18 since commencement of production in Oct-17 stands at 883bopd and 8.2mmcf/d respectively, as against range of 1,630-2,520bopd for oil and 16.5-21mmcf/d for gas reported by the management at initial testing. For enhancing flows from Jhandial, we highlight further development/appraisal wells would need to be drilled to sustain or improve production from the field. As a result, we have revised down our production estimates for Jhandial to 1,100 bopd for oil and 10 mmcf/d for gas as against our previous forecast of 2,160bopd for oil and 19 mmcf/d for gas. Based on this, we expect downward revision in production forecast from Jhandial alone will lead to earnings attrition of 9.2%/10.3%/10.8% in FY18E/19/20F.

Exhibit:

Oil & gas production from Jhandial since commencement

Source: IGI Research, PPIS, Company Financial, PSX

Flows from Tal block and other fields dropped as FO based plants were closed down

Oil production from Tal block has declined by 20% in 10MFY18 to 17,372bopd while gas production has increased by +10% to 324mmcf/d respectively, due to commencement of production from Makori Deep, Tolanj and Tolanj West cumulatively adding 1,628bopd and 17mmcf/d in 10MFY18. Decline in oil production is primarily led by closure of FO based power plants in Oct-17 as new LNG and Coal based power plants commenced operations. As a result we have revised down our production estimate for Tal block, Pariwali, Pindori and Ratana by on average 5%-10% for FY18 onwards.

Further upside to emanate from exclusion of windfall levy on supplemental agreement granted to concession...

To recall, POL in its 2QFY18 financial result reverted price incentive offered to Tal block under Supplemental Agreement (SA) granted by GoP post imposition of windfall levy on 27th Dec-17 on oil for converted blocks under SA. As a result of this, we estimate POL to witness earnings attrition of 12%-13% on recurring basis and PKR 7.05/share for the retrospective amount of the incentive booked since Jul-15 to Dec-17. The Petition filed in Islamabad High Court (IHC) against the imposition of windfall levy resulted in stay order by the court and next hearing was scheduled on 24th May-18. Until a decision is reached, according to the court order, as POL had already reverted the incentive back to old pricing under Petroleum Policy 1997 (PP97), POL will continue to record its revenue from Tal block under PP97 price. Thus if court's ruling terms in favor of the Company and incentive is allowed under PP12 without imposition of windfall levy applied retrospectively, we estimate POL to witness earnings accretion of 12-14% on recurring basis with a PKR 60-70/share (or +10%) value addition to our Dec-18 target price of PKR 610/share.

...and new discoveries expected from current drilling in Tal block, Joya Mair and Khaur North

Recent drilling report published by PPIS shows that currently there are 2 new exploratory wells under drilling by MOL in Tal block namely Tolanj East-01 and Mamikhel Deep-01 while Joya Mair Deep-01 and Kahur North-01 which is operated by POL is also under drilling. Tolanj East-01 is currently under testing phase and has reached a depth of 4,982M (meters) against target of 5,557M, whereas Mamikhel Deep-01 is still under drilling with a depth of 3,996M completed against target of 5,229M. However, Joya Mair Deep-01 has almost reached its target depth of 2,713M and is currently under process which was spudded back in Oct-17.

Consequently, if there is a discovery announced from either Joya Mair or Khaur North to the extent of 2,000bopd cumulatively we estimate this to have an annualized earnings impact of PKR 10.8/share at oil price of USD 65/bbl. A 600bopd discovery from Tal block would have an EPS impact of PKR 0.7/share due to only 21.05% working interest in the concession. However, gas discoveries from any new discovery would not have significant impact as price incentive on new discovery under PP12 has been forgone by the company post imposition of windfall levy and until a decision is announced by the IHC, the old pricing regime of PP97 for Tal block and PP01 for Ikhlas block will prevail which offer nearly 60-70% lower wellhead gas price.

Exhibit:
Current and Target depth of fields under drilling

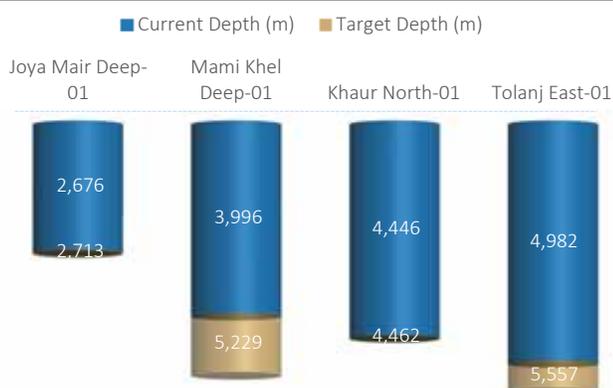


Exhibit:
Current Drilling activity

| Field | Block | Stake | Status |
|-------------------|-----------|--------|----------------------|
| Joya Mair Deep-01 | Joya Mair | 100.0% | Testing |
| Khaur North-01 | Khaur | 100.0% | POOH in progress |
| Tolanj East-01 | Tal Block | 21.1% | Testing |
| Mami Khel Deep-01 | Tal Block | 21.1% | Drilling in progress |

Source: IGI Research, PPIS

9MFY18 result review

POL reported financial results for 3QFY18 with earnings clocking in at PKR 3.11bn (EPS PKR 13.13) as compared to PKR 2.81bn (EPS PKR 11.88) in the same period last year, up +11%YoY. We attribute this to a) exchange gains of PKR 391mn owing to 5% PKR depreciation in Mar-18, b) 24%YoY rise in oil prices and, c) lower effective tax rate of 17% compared to 24% in the same period last year. However, earnings growth was limited due to a) +2.1xYoY rise in royalty expense to PKR 1.36bn compared to PKR 0.67bn in the same period last year, b) +48%YoY increase in amortization of D&D cost in the absence of revision in estimates of decommissioning cost last year and, c) +2.8xYoY incline in finance cost to PKR 0.54bn owing to exchange loss of PKR 393mn. This brings 9MFY18 earnings to PKR 7.87bn (EPS PKR 33.26) up by +5%YoY compared to PKR 7.47bn (EPS PKR 31.56) in the same period last year. Total cash dividend for 9MFY18 stands at PKR 17.5/share.

Target price slightly revised to PKR 610/share offering 8% downside; 'HOLD' call maintained

We still maintain a 'HOLD' call on POL with our revised Dec-18 target price of PKR 610/share offering 8% downside from last close. The Company is currently trading at FY18E/19F P/E of 14.2x/9.5x and offers the highest dividend yield of 6.8% among its peers.

Exhibit:

POL EPS sensitivity to changes in oil price

| Scenarios | Oil Assumption (USD/bbl) | | | EPS (PKR) | | | Target Price (PKR) - Dec'18 |
|-----------|--------------------------|------|------|-----------|------|------|-----------------------------|
| | FY19 | FY20 | FY21 | FY19 | FY20 | FY21 | |
| Bear 1 | 55.0 | 50.0 | 45.0 | 60.7 | 55.5 | 47.7 | 558.5 |
| Bear 2 | 60.0 | 55.0 | 50.0 | 65.3 | 59.9 | 52.2 | 584.4 |
| Base | 65.0 | 60.0 | 55.0 | 69.9 | 64.3 | 56.5 | 610.0 |
| Bull 1 | 70.0 | 65.0 | 60.0 | 74.6 | 68.7 | 60.8 | 635.1 |
| Bull 2 | 75.0 | 70.0 | 65.0 | 79.1 | 73.1 | 65.1 | 659.9 |

Source: IGI Research

Important Disclaimer and Disclosures

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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)

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