Day Break

Thursday, 16 July 2020

IGI Securities

COMPANY UPDATE

Pakistan Oilfields Limited

Oil & Gas Exploration Companies

Recommendation		**BUY**
Target Price:	Dec/20	489.9
Last Closing:	15-Jul-20	388.9
Upside (%):		26.0
Valuation Methodology:		Reserve based - Discounted Cash Flow (DCF)
Time Horizon:		6M

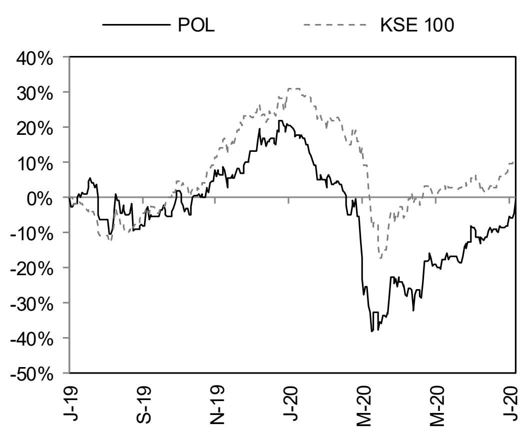
Market Data			
Bloomberg Tkr.			POL PA
Shares (mn)			283.9
Free Float Shares (mn)			129.8
Free Float Shares (%)			45.7%
Market Cap (PKRbn | USDmn)		110.4	715.3
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	32.5	(17.1)	(0.7)
Lo	264.0	241.1	241.1
Hi	385.5	465.0	473.4

Key Company Financials

Period End: Jun

PKRbn	**2019a**	**2020e**	**2021f**	**2022f**
Total Revenue	44.0	40.4	39.9	41.9
Net Income	16.9	16.3	14.8	15.9
EPS (PKR)	59.4	57.4	52.2	55.8
DPS (PKR)	50.0	40.0	45.0	45.0
Total Assets	81.5	83.4	85.4	88.7
Total Equity	38.1	43.0	45.1	48.1
Key Financial Ratios				
ROE (%)	35.4	47.6	40.2	33.6
P/E (x)	6.5	6.8	7.5	7.0
P/B (x)	3.4	2.9	2.6	2.5
DY (%)	12.9	10.3	11.6	11.6

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Oil & Gas Exploration Companies

POL: High Dividend Yield Play; However New Reserve Addition Remains Impetus to Earnings

- ✓ We have tweaked our earnings estimate and target price for Pakistan Oilfields Limited (POL) by 16-25% for FY20/22F after incorporating 9mFy20 financial reports. We have also incorporated recent discovery in Mamikhel South-01 and drop in interest rates, resulting in our revised target price for Dec-20 of PKR 490/share offering an upside of 26% from last close.
- ✓ We base our liking for the scrip on a) healthy cash generation with no cash tied to circular debt, b) high cash pay-out leading to decent dividend yield and c) recent discovery in Tal Block. Key triggers may include favourable decision on Tal block and development of reserves (Jhandial, Joyamair and Pindori) will provide an uplift to POL's earnings
- ✓ From market standpoint this will come as surprise relief, as it lacked material triggers. However once over, we think all eyes would be on corporate earnings performance in the next two quarters.

Earnings and investment case revised post 3q financial results

We have tweaked our earnings estimate and target price for Pakistan Oilfields Limited (POL) by 16-25% for FY20/22F after incorporating 9MFY20 financial reports. We have also incorporated recent discovery in Mamikhel South-01 and drop in interest rates, resulting in our revised target price for Dec-20 of PKR 490/share offering an upside of +26% from last close.

Healthy cash generation, immunity to circular debt and consistent pay-out to ensure high dividends

We base our liking for the scrip on a) healthy cash generation with no cash tied to circular debt, b) high cash pay-out leading to decent dividend yield and c) recent discovery in Tal Block. Key triggers may include favourable decision on Tal block and development of reserves (Jhandial, Joyamair and Pindori) will provide an uplift to POL's earnings.

However downside risks include higher sensitivity to volatility in oil prices, heavily reliant on Tal block with lack of focus on new reserve addition and depletion of reserves in the next 3-4 years to pose serious risk to earnings sustainability.

Exhibit: POL Key Financial Highlights

		FY17A	FY18A	FY19A	FY20E	FY21F	FY22F
EPS	PKR	34.1	40.1	59.4	57.4	52.2	55.9
DPS	PKR	40.0	42.5	50.0	40.0	45.0	45.0
Key Assumptions:							
Oil price	USD/bbl	48.4	62.4	69.4	53	40	40
Exchange rate	PKR/USD	104.8	110	136.3	158.5	172.2	179.9

Source: IGI Research

Best dividend play in E&Ps universe

1# Cash generation remains healthy with no exposure to circular debt

POL has remained relatively immune to cash constraints relating to circular debt compared to PPL and OGDC where trade debts as of Mar-20 only stood at PKR 30/share compared to PKR 73.2/109.9 per share for OGDC/PPL. Thus total cash as of Mar-20 stood at PKR 164/share. As a result, POL stands well poised to invest in further blocks to enhance its reserve base. In our view POL is likely to utilize the cash for development of its mature fields such as Balkassar, Jhandial, Pindori and Khaur.

2# …leading to consistent dividend pay-out and higher dividend yield

As a result of higher cash generation, POL has maintained a higher cash payout which on annual basis has stood above 80% in the last few years. Thus POL remains a high dividend yield stock with FY20/21 dividend yield of 10.3%/11.6% and thus remains as a preferred dividend yield stock.

Exhibit: POL Receivable and payable cash position

Working capital has remained manageable with healthy cash generation

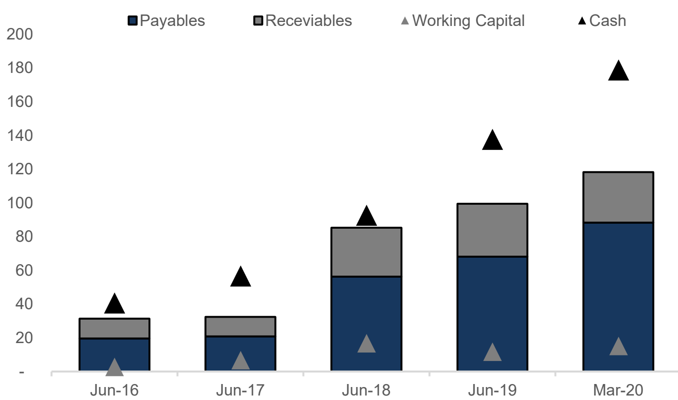
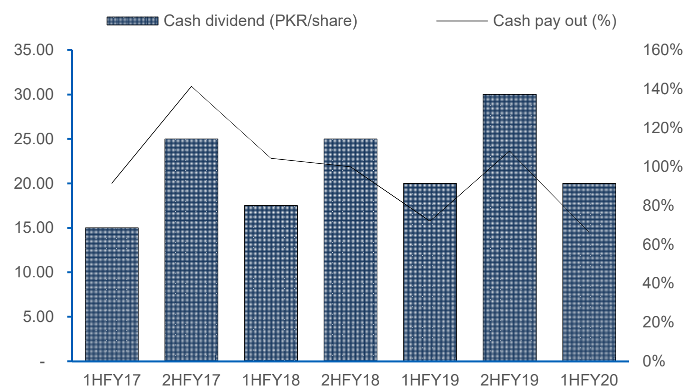


Exhibit: POL historic cash pay-out

POL has maintained a healthy cash pay-out of over 80% despite drop in oil price



3# Discovery of hydrocarbons in Tal Block (Mamikhel South-01)

MOL has recently announced discovery of hydrocarbons in Mamikhel South-01 in Tal Block where POL holds 21.05% working interest. The size of the discovery at initial testing stood at 3,240bopd and 16.12mmcfd from which in our view production is likely to start in a few months' time. We expect this discovery to contribute PKR 3.6/share to POL's earnings in FY21 on annualized basis. The actual production may differ from the flows tested initially however considering the pressure at wellhead we estimate flows to be close initial expectation. However sustainability of flows would only be ascertained once production starts.

Exhibit: Jhandial, Pindori and Khaur weekly oil production (bopd)
Discoveries in Jhandial, Pindori and Khaur are yet to yield any benefits to production enhancements

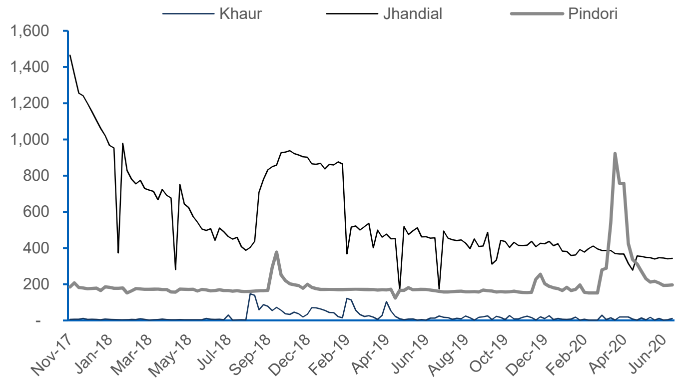
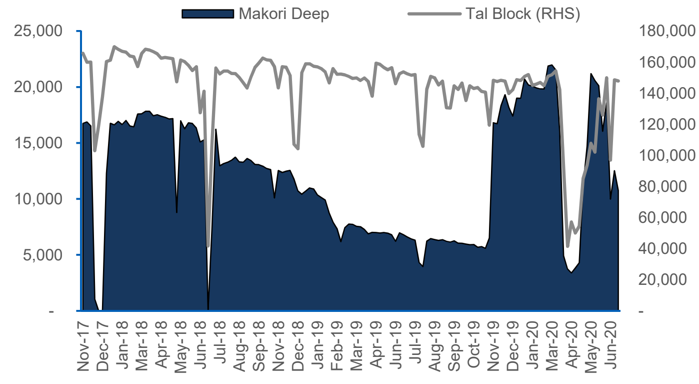


Exhibit: Makori Deep and Tal Block weekly oil production (bopd)
POL has maintained a healthy cash pay-out of over 80% despite drop in oil price



Key Risks

On the downside flows from Jhandial, Khaur and Pindori disappoint while Makori Deep has supported production

Flows from Jhandial have been disappointing since commencement of production considering the heavy reserve base 23.4mnbbls and 0.3tcf. Similarly recent discoveries in Khaur and Pindori have failed to reap any benefits in terms of substantial rise in production where Khaur North was expected to produce 502bopd whereas Pindori was expected to produce between 655-1,103bopd. However actual production has remained below expectation. Nevertheless, Makori Deep has witnessed rise in production post discovery in development well Makori Deep-02 in Aug-19. Despite lockdowns effecting Tal Block production Makori Deep production average ~2,500bopd in May-20 despite lockdown effecting production

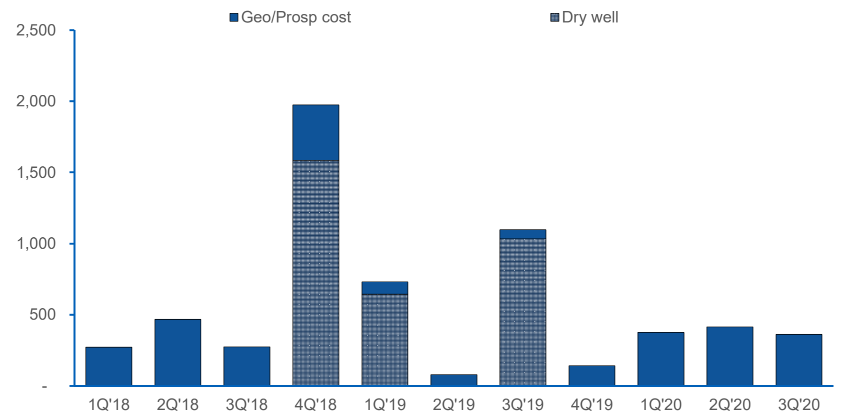
Tal block depletion cause of concern for POL's reserve replacement in future

Tal blocks reserve life stands at 3-5yrs for oil while 5-6yrs for gas. As a result POL will likely witness substantial drop in earnings during Fy24-26 where current 5yr earnings CAGR stands at negative 12%. Thus development of mature fields and substantial reserves at Jhandial remain impetus to earnings sustainability for POL in the next few years.

Most of the drilling planned focused in JV blocks with average stake below 30%

The drilling plan has been focused towards JV blocks which is owned by JV partners such as Tal block (where MOL is operator and POL holds 21.05% stake), Hisal Block (where PPL is operator and POL holds 25% stake), Margalla Block (where MOL is operator and POL holds 30% stake) and Gurgalot Block (where OGDC is operator and POL holds 20% stake). POL has planned drilling in two Company operated block which is Ikhlas block and D.G Khan Block where POL holds 80% and 70% stake respectively. However, with lower drilling in operated blocks, POL has managed to keep dry well cost under control whereas high potential block has yielded crucial production sustainability. The impact from JV blocks such as Makori Deep-2 (Tal block) would have diluted impact owing to lower stake. In our view, development of existing reserves at Pindori, Jhandial and Khaur would enable POL to enhance production flows and reduce reliance on production from Tal Block. To note POL had initiated work on Jhandial-2 but due to Covid-19 the completion has been stalled.

Exhibit: POL quarterly dry well cost and prospecting expense (PKRbn)
With no dry well cost in Fy20, post has managed to up lift prospecting cost while keeping exploration cost at bay



Source: IGI Research, Company Accounts

Recommendation

Considering healthy cash generation and higher dividend yield we prefer POL as dividend yield stock as stability in oil prices have subsided risk of higher sensitivity to oil prices. Recent discovery in Tal Block is also likely to keep POL in limelight however in the long term risk of substantial depletion in reserves likely to erode earnings significantly still looms. Thus we maintain a BUY stance on POL with our Dec-20 target price of PKR 490/share (after incorporating recent interest rate cut) offering 27% upside from last close. POL is currently trading at FY20/21 P/E of 6.8/7.5x and offers FY20/21 dividend yield of 10.3%/11.6%.

Exhibit: Best dividend play in E&P universe

	P/E (x)			DPS (PKR)			D/y (%)		
	2019	2020	2021	2019	2020	2021	2019	2020	2021
POL	6.5	6.8	7.5	50.0	40.0	45.0	12.9	10.3	11.6
OGDC	4.2	4.8	5.0	11.0	5.3	7.0	9.6	4.6	6.1
PPL	4.3	6.2	6.3	2.0	-	3.0	2.0	-	3.1
MARI	7.1	5.9	6.4	6.0	6.1	6.0	0.5	0.5	0.5

Source: IGI Research, Company Accounts

3q Financial Result

POL reported EPS of PKR 18.95 during 3QFY20, up by +64%YoY

POL announced its financial results for with earnings clocking in at PKR 5.38bn (EPS: PKR 18.95) as compared to PKR 3.29bn (EPS: PKR 11.58) in the same period last year, up by +64%YoY. We attribute growth in earnings during 3QFY20 to a) 11%YoY PKR depreciation despite 15%YoY drop in oil prices, b) lower exploration cost amid no dry well expense and, c) higher other income amid exchange gains. Effective tax rate dropped substantially to 19.6% during 3QFY20 compared to 30.4% (2QFY20: 26.0%) reported in the corresponding period last year, bringing total effective tax rate for 9MFY20 to 25.2% compared to 33.5% in the same period last year. Other income was up due to hefty exchange gains on investments while finance cost was higher due to exchange losses and unwinding of discounts on provision for decommissioning cost.

On quarterly basis, earnings were up by +18%QoQ during 3QFY20. This brings total profitability for 9MFY20 to PKR 13.95bn (EPS PKR 49.13) up by +25%YoY compared to PKR 11.18bn (EPS PKR 39.37) in the same period last year.

Exhibit: Financial Highlights

PKRmn	3QFY20	3QFY19	y/y	2QFY20	q/q	9MFY20	9MFY19	y/y
Net Sales	10,737	10,682	1%	11,461	-6%	32,450	32,891	-1%
Operating Costs	2,660	2,822	-6%	2,798	-5%	7,709	8,326	-7%
Royalty	1,080	1,087	-1%	1,221	-12%	3,420	3,331	3%
Amortization of D&D Cost	653	1,014	-36%	732	-11%	1,899	2,817	-33%
Gross Profit	6,267	5,683	10%	6,637	-6%	19,199	18,185	6%
Exploration Costs	362	1,097	-67%	415	-13%	1,152	1,907	-40%
Finance Cost	1,240	315	293%	309	301%	1,688	2,064	-18%
Other Income	2,523	849	197%	707	257%	3,698	3,975	-7%
PBT	6,690	4,722	42%	6,160	9%	18,643	16,819	11%
PAT	5,379	3,287	64%	4,560	18%	13,947	11,176	25%
EPS (PKR)	18.95	11.58		16.07		49.13	39.37	
DPS (PKR)	-	-		20.00		20.00	20.00	

Source: IGI Research and Company Financials

No of Shares: 283.86mn