

Day Break

Wednesday, 16 March 2016

Company Update

Pak Petroleum Ltd.

Oil & Gas Exploration Companies

Recommendation	BUY
Target Price	147.1
Last Closing	120.0
Upside	23%

Market Data

Bloomberg Tkr.	PPL PA
Shares (mn)	1,971.7
Market Cap (PKRbn USDmn)	236.6 2,261.6
Exchange	KSE 100

Price Info.	90D	180D	365D
Abs. Return	10.1	(2.2)	(24.9)
Low	101.1	101.1	101.1
High	125.2	138.6	185.0

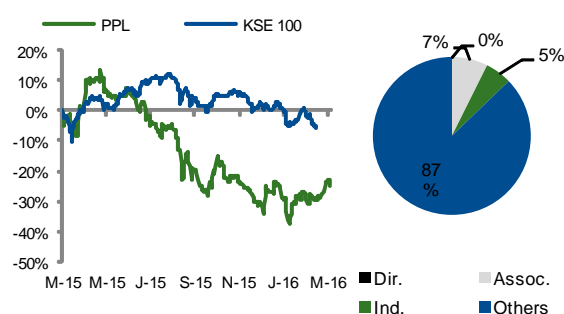
Key Company Financials

PKRbn	FY15A	FY16E	FY17F	FY18F
Total Revenue	104.4	71.9	77.9	82.8
Net Income	34.3	23.1	25.7	26.8
EPS (PKR)	17.4	11.7	13.0	13.6
DPS (PKR)	8.5	5.8	6.5	6.8
Total Assets	247.7	247.3	263.4	277.5
Total Equity	192.0	203.8	216.9	230.6

Key Financial Ratios

ROE (%)	18%	11%	12%	12%
P/E (x)	6.9	10.2	9.2	8.8
P/B (x)	1.2	1.2	1.1	1.0
DY (%)	7.1	4.8	5.4	5.6

Relative Price Performance & Shareholding



About the Company

The Company was incorporated in Pakistan in 1950 with the main objectives of conducting exploration, prospecting, development and production of oil and natural gas resources.

Source: Bloomberg, KSE 100 & IGI Research

Analyst

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Oil & Gas Exploration

PPL: Impairment Cost Diluted Earnings in 2QFY16

- Pakistan Petroleum Limited (PPL) reported reduction in earnings by 30%YoY to PKR 5.9bn (EPS PKR 2.98) in 2QFY16 as compared to PKR 8.5bn (EPS PKR 4.29) in the same period last year. Along with the result, the company announced a cash dividend of PKR 2.25/share for 2QFY16.
- Oil revenues contracted by 42%YoY to PKR 6.4bn in 2QFY16 owing to 46%YoY slump in benchmark oil price to USD 40/bbl (Arab Light) and 1%YoY decline in oil production. Gas revenues witnessed a minor dip of 11%YoY to PKR 13.3bn in 2QFY16 owing to decline in prices where realized price for gas stood at PKR 201.8/mmcf.
- We currently have a strong “BUY” call on PPL with our Dec-16 TP of PKR 147/share, offering +23% upside from its last closing of PKR 120/share. The company is currently trading at a FY16E P/E of 10.2x and offers a dividend yield of 4.8%.

Earnings Tumbled; Down by 30%YoY to PKR 2.98/share in 2QFY16

Pakistan Petroleum Limited (PPL) reported reduction in earnings by 30%YoY to PKR 5.9bn (EPS PKR 2.98) in 2QFY16 as compared to PKR 8.5bn (EPS PKR 4.29) in the same period last year. Earnings petered out owing to a) 46%YoY fall in oil prices, b) impairment loss of PKR 2.2bn (PKR 1.12/share) on long term investment in PPL Europe Limited and, c) higher field expenditure owing to inflated dry well costs.

Profitability plummeted by 47%YoY to PKR 11.8bn (EPS PKR 5.96) for 1HFY16. Along with result, company announced a cash dividend of PKR 2.25/share for 2QFY16.

Exhibit: PPL Production

	2QFY16	2QFY15	YoY	1HFY16	1HFY15	YoY
Oil (bbl)	1,372,285	1,387,838	-1%	2,601,013	2,757,986	-6%
Gas (mmcf)	67,745	63,841	6%	138,471	132,892	4%
LPG (Tons)	18,023	14,268	26%	30,531	26,521	15%

Source: IGI Research and Company Financials

Nosedived Price taking its toll on Revenues

Oil revenues contracted by 42%YoY to PKR 6.4bn in 2QFY16 owing

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to 46%YoY slump in benchmark oil price to USD 40/bbl (Arab Light) and 1%YoY decline in oil production. Nashpa, Adhi and Makori East, according to our estimates contributed around 80% in total oil production during 2QFY16 (81% during 1HFY16). Realized price for oil stood at USD 44.63/bbl during 2QFY16.

Gas revenues witnessed a minor dip of 11%YoY to PKR 13.3bn in 2QFY16 owing to decline in prices where realized price for gas stood at PKR 201.8/mmcf (PKR 240.6/mmcf during 2QFY15). According to our estimates, Sui and Kandhkot contributed around 71% in the total gas production in quarter/half year. LPG revenues increased by +6%YoY owing to +26%YoY incline in production backed by incremental production from Tal block and Adhi.

Exhibit: PPL Revenues

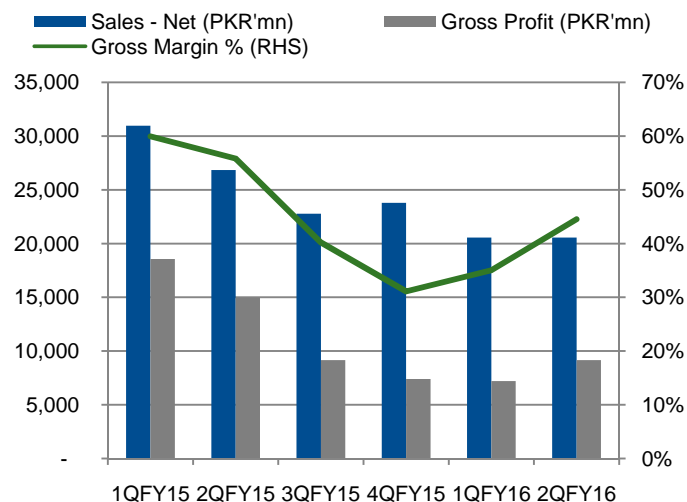
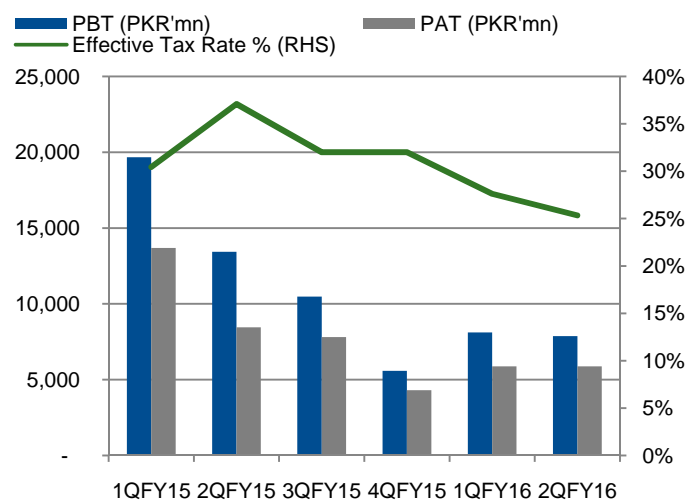
PKR'mn	2QFY16	2QFY15	YoY	1HFY16	1HFY15	YoY
Oil	6,423	11,036	-42%	12,933	25,207	-49%
Gas	13,309	14,955	-11%	26,772	30,952	-14%
LPG	832	943	-12%	1,413	1,743	-19%

Exhibit: Realized Price

	2QFY16	2QFY15	YoY
Oil (USD/bbl)	44.63	78.06	-43%
Gas (PKR/mmcf)	201.78	240.59	-16%

Source: IGI Research and Company Financials

Note* Net sales estimated based on actual gross sales reported in company's financials

Exhibit: Gross Margins Picking up on monthly basis but trimming down annually**Exhibit: Effective Tax Rate on the downturn since inception of plunge in oil prices from 2QFY15 onwards**

Source: IGI Research, Company's Financials

Impairment and Dry Well Cost Further Diluted the Earnings

PPL booked impairment of PKR 2.2bn during 2QFY16 on investment in PPL Europe Limited owing to decline in oil prices, as compared to PKR 2.5bn in the corresponding period. Company incurred PKR 9.0bn field expenditure in 2QFY16 owing to dry well cost on Nooriabad X-1 (Jungshahi), Jhim X-1 (Jati), Duljan East (Gambat) and Misribhambro X-1 (South West Miano II). As a consequence, exploration cost jumped by 49%YoY to PKR 6.7bn during 1HFY16.

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Key Concerns for PPL; Sui Mining Lease Extension and Uncapped Wellhead Gas Prices

According to management, production lease for Sui mining expired on 31st May-15 after which the company was granted extension of 1 year, which is due to expire on 31st May-16. Company expects renewal of the lease, however without renewal, it can cause ~52% decline in overall gas production. Moreover, almost 80% of the company's production falls under uncapped wellhead gas price, exposing it to higher risk of lower revenues particularly when oil prices are at their lowest. Whereas, commencement of production from Mardankhel and Nashpa fields in FY17 would provide some resistance to falling profitability.

Exhibit: EPS and Target Price Sensitivity to Oil Prices

Scenarios	Oil Assumption (USD/bbl)			EPS (PKR)			Target Price (PKR) - Dec16
	FY16	FY17	FY18	FY16	FY17	FY18	
Bear	30.0	35.0	45.0	10.2	11.9	12.5	137.9
Base	35.0	40.0	50.0	11.7	13.0	13.6	147.1
Bull	40.0	45.0	55.0	12.4	14.1	14.7	155.3

Source: IGI Research

Recommendation

We currently have a strong **"BUY"** call on PPL with our Dec-16 TP of PKR 147/share, offering +23% upside from its last closing of PKR 120/share. The company is currently trading at a FY16E P/E of 10.2x and offers a dividend yield of +4.8%.

Exhibit: Financial Highlights

PKRmn	2QFY16	2QFY15	YoY	1HFY16	1HFY15	YoY
Net Sales	20,565	26,844	-23%	41,118	57,811	-29%
Field Expenditure	9,012	8,726	3%	19,974	17,440	15%
Royalty	2,393	3,134	-24%	4,784	6,820	-30%
Gross Profit	9,161	14,983	-39%	16,361	33,551	-51%
Other Income	1,497	1,751	-15%	3,011	4,031	-25%
Oth. Operating Expense	2,617	3,164	-17%	3,049	4,199	-27%
Finance Cost	164	139	18%	328	277	18%
PBT	7,876	13,432	-41%	15,995	33,106	-52%
PAT	5,881	8,451	-30%	11,758	22,139	-47%
EPS (PKR)	2.98	4.29		5.96	11.23	
DPS (PKR)	2.25	4.50		2.25	4.50	
Key Ratios						
Gross Margins	45%	56%		40%	58%	
Field Exp / Net Sales	44%	33%		49%	30%	
Net Margins	29%	31%		29%	38%	

Source: IGI Research and Company Financials

Analyst Certification

The analyst[^] hereby certify that the views about the company/companies and the security/securities discussed in this report are accurately expressed and that he/she has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report. The analyst is principally responsible for the preparation of this research report and that he/she or his/her close family/relative does not own 1% or more of a class of common equity securities of the following company/companies covered in this report.

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

Valuation Methodology

The analyst[^] has used following valuation methodology to arrive at the target price of the said security (ies):

- Asset Based Valuation

Time Horizon

- Dec-16

Risk

- Changes in State Bank of Pakistan Policy Rate
- Changes in USD/PKR
- Change in Oil price

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