

# Day Break

Monday, 10 July 2017

## COMPANY UPDATE

### PAKISTAN PETROLEUM LIMITED OIL & GAS EXPLORATION COMPANIES

<b>Recommendation</b>	<b>BUY</b>
Target Price:	229.7
Last Closing: 7-Jul-17	163.1
Upside:	40.9
Valuation Methodology:	Reserve based - Discounted Cash Flow (DCF)
Time Horizon:	Dec-17

#### Market Data

Bloomberg Tkr.	PPL PA
Shares (mn)	1,971.7
Free Float Shares (mn)	481.3
Free Float Shares (%)	24.4%
Market Cap (PKRbn   USDmn)	321.5   3,034.7
Exchange	KSE 100
<b>Price Info.</b>	90D 180D 365D
Abs. Return	(1.4) (18.7) (0.7)
Lo	143.7 143.7 143.7
Hi	186.5 192.9 193.3

#### Key Company Financials

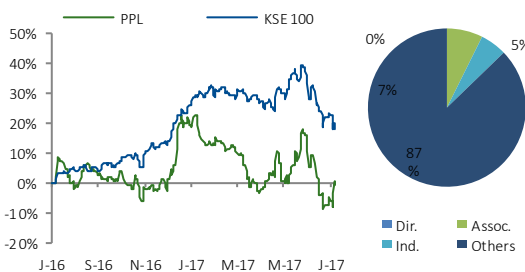
Period End: Jun

PKRbn	FY16A	FY17E	FY18F	FY19F
Total Revenue	80.2	90.8	132.4	129.6
Net Income	17.24	26.8	42.4	40.5
EPS (PKR)	8.7	13.6	21.5	20.5
DPS (PKR)	5.8	6.5	9.5	9.0
Total Assets	272.5	277.1	306.3	327.2
Total Equity	192.6	207.6	231.4	254.0

#### Key Financial Ratios

ROE (%)	8.9	12.9	18.3	15.9
P/E (x)	18.6	12.0	7.6	7.9
P/B (x)	1.7	1.5	1.4	1.3
DY (%)	3.5	4.0	5.8	5.5

#### 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

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## Oil & Gas – Exploration Companies

### PPL: Revised Wellhead Price for Sui Field to Lift Earnings by 25% in FY18

- According to notice issued on Pakistan Stock Exchange (PSX) by Pakistan Petroleum Limited's (PPL), the company's largest gas producing asset, Sui has been granted 10 year lease extension which expired on 31st May-15. Under the arrangement, Sui field will now be priced under Petroleum Policy 2012 (PP12) at a discount of 55%.
- Sui field has been converted to Development & Production Lease from previous Exploration Lease. Apart from conversion of pricing mechanism to PP12, other key arrangements include imposition of additional royalty of 10% to be collected from Sui field by Baluchistan Government.
- We maintain our "BUY" call on PPL with our revised Dec-17 target price of PKR 230/share (up by +14%), offering +41% upside from its last closing. The company is currently trading at a FY18F P/E of 7.6x and offers a dividend yield of 5.8%.

#### Sui Lease Extended; New Terms of the Contract

According to notice issued on Pakistan Stock Exchange (PSX) by Pakistan Petroleum Limited's (PPL), the company's largest gas producing asset, Sui has been granted 10 year lease extension which expired on 31st May-15. The new agreement will be effective from Jun-15 (retrospectively). One of the key highlights of the lease contract is linking of wellhead gas price for Sui field with Petroleum Policy 2012 (PP12).

Based on new pricing policy, we have revised our earnings estimate for FY18F/FY19F by +25%/+27%. We have increased our earnings forecast by nearly 30% to 82% from FY19F onwards. As a result we have lifted our Dec-17 target price for PPL by +14% to PKR 230/share, offering +41% upside from its last closing.

#### Sui wellhead price determined at 55% of price under PP12

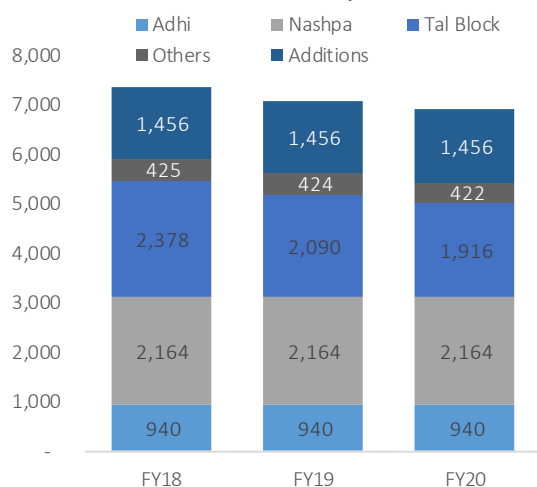
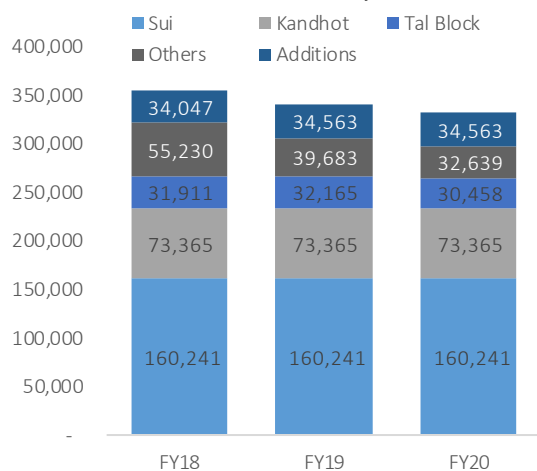
Under the arrangement, Sui field will now be priced under Petroleum Policy 2012 (PP12) at a discount of 55%. Sui field contributes around 53% of company's total gas production. With this revised pricing mechanism, we expect revenue contribution of Sui field to increase to 56% in FY18 from 42% in FY17. Based on our estimate, we expect 80% uptick (USD 4.96/mmbtu under PP12) in gas price for Sui field at oil price assumption of USD 50/bbl in FY18F.

#### New wellhead price effective from 1-Jun-15

Moreover, the revised wellhead price for Sui field will be effective from 1st Jun-15 as the old Gas Price Agreement (GPA) expired on 31st May-15. However, the company was granted provisional extension of 1 year to 31st May-16 and then was extended by 6 months to 30th Nov-16, then 31st May-17 and was currently operating under 6 months extension till 30th Nov-17. We estimate retrospective earnings impact of PKR 5.95/share (after tax) starting from Jun-15. Although due to uncertainty in timing of cash amount of retrospective payment to be received, we have not incorporated the accumulated amount in our earnings. However, if the said amount is received in FY18 it will elevate our earnings by +35% (or PKR 5.95/share) and target price by PKR 9.25/share or 4% to PKR 239/share.

**Exhibit: Revised Earnings**

PKR/share	FY18	FY19	FY20	TP
Old EPS	17.22	16.12	15.62	202.4
Sui Addition	3.6	3.7	3.9	26.2
Kandhkot Addition	0.7	0.7	0.7	1.2
<b>Revised EPS</b>	<b>21.5</b>	<b>20.5</b>	<b>20.2</b>	<b>229.7</b>

**Exhibit: Oil Production over next 3 years - 000'bbls****Exhibit: Gas Production over next 3 years - mmcf****Conversion from Exploration to Development & Production Lease**

Sui field has been converted to Development & Production Lease from previous Exploration Lease. As a result PPL will have to spend PKR 20bn on exploration of new reservoirs of oil and gas over the 10-year period of lease term.

**Additional royalty - A bad card**

Apart from conversion of pricing mechanism to PP12, other key arrangements include imposition of additional royalty of 10% to be collected from Sui field by Baluchistan Government. This additional royalty according to our estimate will have an earnings impact of PKR 1.5/share in FY18. Baluchistan government expects to raise PKR 74bn in royalty from Sui field over the 10-year period of lease term.

**Increased flows from Kandhkot to further corroborate earnings growth**

Recently PPL has increased its production flows from Kandhkot field to 230 mmcf (up by +28%) as reported in news. Kandhkot contributed nearly 17% of total gas production in FY17 (12% of total revenue). However, post enhancement in production we expect production contribution to increase to 21% while revenue contribution is expected to remain at 12% owing to increase in gas price for Sui field. Increased flows from Kandhkot field is estimated to add PKR 0.69/share and PKR 0.71/share in FY18 and FY19, respectively.

**Aggressive exploration to be more focused towards development wells**

PPL spudded 12 exploratory and 11 development wells in FY16, resulting in six discoveries in company operated fields while four in partner operated. The company planned to spud 13 exploratory and 9 development wells in FY17 out of which 6 exploratory and 10 development wells have been spudded so far with 3 discoveries in company operated blocks and 4 discoveries in joint ventures. Whereas PPL has incurred 3 dry well cost up until Feb-17. Similarly, we expect company to continue aggressive exploration with more focus on development wells.

**New discoveries to further drive earnings in FY18**

New discoveries in Gambat South and Dhok Sultan with a cumulative expected oil and gas production of 771bopd and 104mmcf, respectively is yet to commence production. As a result of delayed production start, we have moved our estimated production commencement date to 1QFY18 and 2QFY18, respectively. Whereby, we expect upcoming production from new discoveries to add PKR 5.54/share and PKR 5.83/share to company's earnings in FY18F and FY19F, respectively.

**Recommendation**

We maintain our "BUY" call on PPL with our revised Dec-17 target price of PKR 230/share (up by +13%), offering +41% upside from its last closing. The company is currently trading at a FY18F P/E of 7.6x and offers a dividend yield of 5.8%.

Exhibit:

**EPS and Target Price Sensitivity to Oil Prices**

Scenarios	Oil Assumption (USD/bbl)			EPS (PKR)			Target Price (PKR) -
	FY18	FY19	FY20	FY18	FY19	FY20	Dec17
Bear 2	40.0	40.0	40.0	17.8	16.8	16.5	208.2
Bear 1	45.0	45.0	45.0	19.6	18.7	18.4	219.0
Base	50.0	50.0	50.0	21.5	20.5	20.2	229.7
Bull 1	55.0	55.0	55.0	23.1	22.1	21.8	238.4
Bull 2	60.0	60.0	60.0	24.6	23.7	23.4	247.1

Source: IGI Research

No of Shares: 1971.7 mn

Source: Company Financials, PSX, IGI Research

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Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
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**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)

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