

Day Break

Thursday, 21 March 2019

COMPANY UPDATE

Pakistan Oilfields Limited

Oil & Gas Exploration Companies

| Recommendation | | NEUTRAL |
|------------------------|--|---------|
| Target Price: | 31-Dec-19 | 477.9 |
| Last Closing: | 20-Mar-19 | 437.7 |
| Upside: | | 9.2 |
| Valuation Methodology: | Reserve based - Discounted Cash Flow (DCF) | |
| Time Horizon: | | 9M |

Market Data

| | | | |
|----------------------------|---------|--------|-------|
| Bloomberg Tkr. | POL PA | | |
| Shares (mn) | 283.9 | | |
| Free Float Shares (mn) | 130.0 | | |
| Free Float Shares (%) | 45.8% | | |
| Market Cap (PKRbn USDmn) | 124.2 | 890.1 | |
| Exchange | KSE ALL | | |
| Price Info. | 90D | 06M | 12M |
| Abs. Return | 1.6 | (11.2) | (6.0) |
| Lo | 415.2 | 415.2 | 415.2 |
| Hi | 482.7 | 558.3 | 589.5 |

Key Company Financials

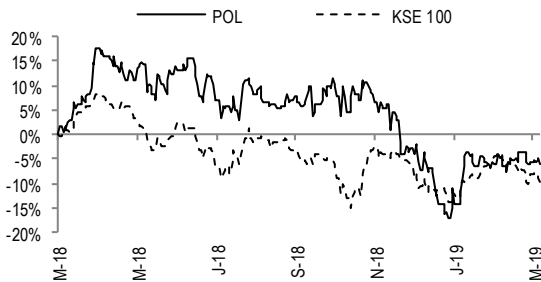
Period End: Jun

| PKRbn | FY18A | FY19E | FY20F | FY21F |
|---------------|-------|-------|-------|-------|
| Total Revenue | 31.9 | 46.1 | 45.4 | 40.9 |
| Net Income | 11.4 | 16.1 | 16.8 | 15.8 |
| EPS (PKR) | 40.1 | 56.7 | 59.3 | 55.5 |
| DPS (PKR) | 42.5 | 45.0 | 47.5 | 45.0 |
| Total Assets | 58 | 70 | 78 | 80 |
| Total Equity | 33 | 37 | 40 | 43 |

Key Financial Ratios

| | | | | |
|---------|------|------|------|------|
| ROE (%) | 34.7 | 44.0 | 42.2 | 36.7 |
| P/E (x) | 10.9 | 7.7 | 7.4 | 7.9 |
| P/B (x) | 7.3 | 3.8 | 3.4 | 3.1 |
| DY (%) | 9.7 | 10.3 | 10.9 | 10.3 |

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: Production upside limited amid concerns of recoverability of reserves; downgrade to 'Hold'

- We have revised down our earnings estimate and target price for Pakistan Oilfields Limited (POL) by 8%/3%/4% for FY19/20/21F after incorporating 1HFY19 financial reports.
- We have revised our investment case based on a) Lower than expected oil flows from Khaur North and Jhandial, b) High reserve base in Joyamair and Pindori yet to be translated in production growth, c) Tal block depletion cause of concern for POL's reserve replacement in future and, d) Most of the drilling planned focused in JV blocks with average stake below 30% and,
- However favorable decision on Tal block and development of reserves (Jhandial, Joyamair and Pindori) will provide an uplift to POL's earnings. As a result, we have revised down our target price to PKR 477.88/share (down by 15.8%), thus downgrading to 'Hold' call on the scrip.
- We have revised down stance for POL to 'Hold' with our Dec-19 target price of PKR 477.88/share offering +9% upside from last close. The Company is currently trading at FY19/20 P/E of 7.7x/7.4x and offers a dividend yield of 10.3%.

Earnings and Target price revised down on lower production; downgrade to 'HOLD'

We have revised down our earnings estimate and target price for Pakistan Oilfields Limited (POL) by 8%/3%/4% for FY19/20/21F after incorporating 1HFY19 financial reports. We have revised our investment case based on

- Lower than expected oil flows from Khaur North and Jhandial,
- High reserve base in Joyamair and Pindori yet to be translated in production growth,
- Tal block depletion cause of concern for POL's reserve replacement in future,
- Most of the drilling planned focused in JV blocks with average stake below 30% and,
- Lower dividend income from APL and NRL amid drop in profitability for APL and NRL.

However favorable decision on Tal block and development of reserves (Jhandial, Joyamair and Pindori) will provide an uplift to POL's earnings. As a result, we have revised down our target price to PKR 477.88/share (down by 15.8%), thus downgrading to 'Hold' call on the scrip.

Exhibit:

POL Earnings estimates

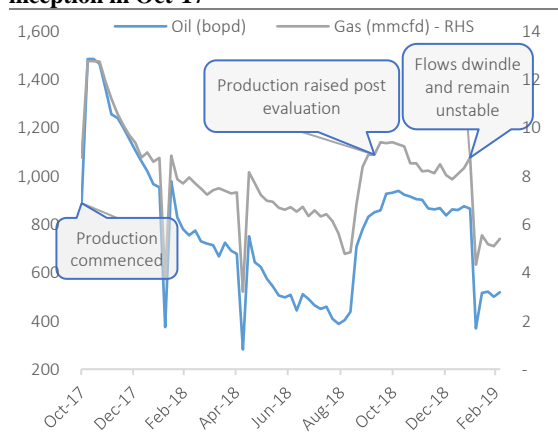
| PKR/share | FY16 | FY17 | FY18 | FY19E | FY20F | FY21F |
|-------------------|-------|-------|-------|-------|-------|-------|
| EPS | 25.48 | 34.10 | 40.10 | 61.68 | 61.44 | 58.10 |
| EPS (revised) | 25.48 | 34.10 | 40.10 | 56.68 | 59.31 | 55.52 |
| Change % | 0% | 0% | 0% | -8% | -3% | -4% |
| DPS | 35.00 | 40.00 | 42.50 | 45.00 | 47.50 | 45.00 |
| P/E (x) | 17.18 | 12.84 | 10.91 | 7.10 | 7.12 | 7.53 |
| P/E (x) (revised) | 17.18 | 12.84 | 10.91 | 7.72 | 7.38 | 7.88 |
| D/Yld. (%) | 8% | 9% | 10% | 10% | 11% | 10% |

Source: Company accounts, IGI Research

Khaur North under evaluation however discovery size yet to materialize

POL discovered oil & gas reserves in Khaur North in Jul-18 which lies in Khaur Lease operated by POL with a working interest of 100%, where Company reported estimated flows of 502bopd and 1.4mmcf/d respectively. Khaur North was connected to production line in 1QFY19 however cumulative flows from Khaur Block have averaged around 60bopd in 1HFY19. The well is currently under evaluation with work done on different development options for work over to achieve optimum production flows. However, until it materializes and sustainability of production flows can be determined, we have revised down our production estimate for Khaur Block to 80bopd for FY19 and onwards. As a result our profitability has been revised down by PKR 1.57/share and PKR 2.39/share for FY19 and FY20 respectively.

Exhibit:
Weekly Jhandial Oil & Gas Production since inception in Oct-17



Source: PPIS, IGI Research

Jhandial flows increased post evaluation but still remain unstable

During 1QFY19, POL undertook evaluation of Jhandial field and post appraisal the Company was able to increase flows from Jhandial to nearly 900bopd from 400-500bopd. Conversely, flows from Jhandial have again slipped down to 500-550bopd post Jan-19 onwards. Although Jhandial holds significant oil and gas reserves, but our reservation emanates from lower recoverability of those reserves as oil and gas flows have remained on declining trend. Thus we maintain our conservative stance on flows from Jhandial as no new development/appraisal well has been planned so far. Well proposal for Jhandial-2 is under evaluation. We keep our assumption for flows from Jhandial intact at 800bopd and 8mmcf. At current production level of 500-550bopd and 5.4mmcf with oil price assumption of USD 70/bbl and exchange rate of PKR 140/USD, we estimate Jhandial to contribute nearly PKR 3.19/share to POL's earnings with every 100bopd/1mmcf increase in oil/gas flows to add PKR 0.39/share to Company's profitability.

Pindori-10 development well under drilling as POL pace up to recover huge reserve base

POL has recently initiated drilling in Pindori-10 to enhance flows from the well which holds substantial reserve base of 2.11mnbbbl of oil and 6.2bcf of gas which were revised upward in Jun-18. Similarly, Joyamair reserves were also revised upwards which now holds 13.3mnbbbls of oil reserves. However, recent discovery in Joyamair Deep only yielded 26bopd of oil and irrecoverable costs were expensed out. Furthermore, development well in Pariwali lease was unsuccessful.

This brings total reserve life of POL, including reserve and production ratio of Jhandial, to 14.3yrs whereas excluding Jhandial, Pindori and Joyamair comes at 5.8yrs. The Reserve Replacement Ratio (RRR) stood at +8.3x in FY18, however excluding Jhandial, Joyamair and Pindori reserves the total RRR stood at net depletion of 0.6x.

We await further clarity on the matter on development of these reserves of Joyamair, Pindori and Jhandial from the management. If these wells are developed to enhance oil & gas flows, only then can we witness a reflection of these reserves in POL's earnings. As of now, we remain conservative on recoverability of these reserves and development of these wells would also require additional capex as well.

Exhibit:

Major Oil & Gas fields and key concerns

| Well | Block | Stake | Reserve Size FY18 (oil I gas) | Current Production (bopd I mmcf) | Discovery (bopd I mmcf) | Analyst Comments | Impact | EPS Contribution FY19 | Impact FY20 | Impact FY21 |
|------------------|------------------|-------|-------------------------------|----------------------------------|-------------------------|---|----------|-----------------------|-------------|-------------|
| Khaur North | Khaur | 100% | 0.07mnbbbl I | 22bopd I 0.16mmcf | 502bopd I 1.4mmcf | - Flows remain below expectation while Khaur North under evaluation - Flows might increase post evaluation but may not sustain | Negative | 0.35 | 0.50 | 0.50 |
| Jhandial | Ikhlas | 80% | 23.76mnbbbl I 289.98bcf | 519bopd I 5.4mmcf | 2520bopd I 21mmcf | - High reserve base yet to be translated in production - Flows improved to 850bopd post evaluation but still unstable | Negative | 6.15 | 7.04 | 7.17 |
| Joyamair Deep | Joyamair | 100% | 13.3mnbbbl I 2.11mnbbbl I | 42bopd I 170bopd I | 26bopd | - Discovery size of 26bopd below expectation despite huge reserve base - Flows remain on lower side despite high reserve size | Negative | 0.24 | 0.25 | 0.25 |
| Pindori | Pindori | 35% | 6.21bcf | 0.57mmcf I 309bopd I | - | - Natural depletion in field while development under process | n/a | 0.41 | 0.42 | 0.43 |
| Balkassar | Balkassar | 100% | 2.76mnbbbl I | 0.03mmcf | - | - Installation of plant has been stopped as decision yet to be finalized | Negative | - | - | - |
| Jhal Magsi South | Jhal Magsi South | 24% | 0.5mnbbbl I 36.78bcf | - | 11mmcf | - Seismic planning in process to explore full potential | n/a | 0.08 | 0.09 | 0.08 |
| Turkwal | Turkwal | 67% | 0.35bcf | 0.04mmcf | - | - Production has reached potential but reserve size uncertainty | Negative | 5.14 | 5.57 | 5.74 |
| Mardankhel | Tal Block | 21% | 6.2mnbbbl I 132bcf | 4355bopd I 46.9mmcf | - | - Reserve life of 3.5yrs left with no substantial replacement | Negative | 39.17 | 42.85 | 43.81 |
| - | Tal Block | 21% | 31.24mnbbbl I 551bcf | 21685bopd I 46.9mmcf | - | - | - | - | - | - |

Source: IGI Research, PPIS

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

Oil production from Tal block increase by +4% YoY in FY18 on the back on commencement of production from Makori Deep, Tolanj and Tolanj West cumulatively adding 0.8mn bbls. However, in FY19TD production from Tal block has dropped with only Maramzai and Mardankhel witnessing increase in production as new discoveries have been connected to production line. Furthermore, Mardankhel reserves have been revised down significantly to 6.2mn bbls of oil and 132bcf of gas. As a result of this total reserve life of Tal block now stands at 3.5yrs. Tal block contribute nearly 65% of total oil production and 77% of total gas production, thus due to depletion of Tal block reserves POL's 5yr earnings CAGR stands negative at 6%. This further consolidates our stance that POL heavily relies on Tal block for its oil and gas revenues and depleting reserve base holds serious concerns for POL's reserve replacement in the next 5-7 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. 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 Joyamair would enable POL to enhance production flows and reduce reliance on production from Tal Block. The drilling plan of six wells for FY19 included 2 exploratory wells and rest development/appraisal wells.

Oil price volatility and delays in Tal block decision remain key concerns

Oil prices have remained volatile since Oct-18 after touching high of USD 86/bbl with prices falling by nearly ~40% till Dec-18 to USD 52/bbl and then recovering back by almost 28% since Jan-19. The uncertain outlook for oil prices have kept investors at bay as POL stands to benefit most from increase in oil price and vice versa due to higher revenue contribution from oil production. Furthermore, with investors eyeing upside potential in OGDC and PPL through expected discovery in Kekra-1 (offshore Indus –G block), POL's performance has remained laggard with negative return of 22% in FY19TD. Moreover, case regarding imposition of windfall levy on oil which is applicable retrospectively and on blocks which were awarded price incentive under Supplemental Agreement (SA) which includes Tal block has been pending and further delay or decision against petition filed would bode negative for POL.

Recommendation

We have revised down stance for POL to 'Hold' with our Dec-19 target price of PKR 477.88/share offering +9% upside from last close. We have also increased our risk free rate by 25bps accounting for rate hike in Jan-2019. The Company is currently trading at FY19/20 P/E of 7.7x/7.4x and offers a dividend yield of 10.3%.

Exhibit:

EPS and Target Price sensitivity to change in oil prices

| Scenarios | Oil Assumption (USD/bbl) | | | EPS (PKR) | | | Target Price (PKR) – Dec'19 |
|-----------|--------------------------|------|------|-----------|------|------|--------------------------------|
| | FY19 | FY20 | FY21 | FY19 | FY20 | FY21 | |
| Bear | 65.0 | 55.0 | 50.0 | 53.2 | 55.0 | 51.0 | 453.70 |
| Base * | 70.0 | 60.0 | 55.0 | 56.7 | 59.3 | 55.5 | 477.88 |
| Bull 1 | 75.0 | 65.0 | 60.0 | 60.1 | 63.6 | 60.1 | 501.38 |
| Bull 2 | 80.0 | 70.0 | 65.0 | 63.5 | 67.9 | 64.6 | 524.80 |
| Bull 3 | 85.0 | 75.0 | 70.0 | 66.9 | 72.1 | 69.2 | 548.08 |

Source: IGI Research

* FY21 onwards at USD 50/bbl

Oil price volatility and delays in Tal block decision remain key concerns

POL announced its financial results for 2QFY19 with earnings clocking in at PKR 4.02bn (EPS: PKR 14.17) as compared to PKR 2.23bn (EPS: PKR 7.85) in the same period last year, up +81%YoY. We attribute this substantial growth in earnings during 2QFY19 to a) one off reversal booked last year of PKR 3bn relating to price incentive offered on 3 fields in Tal block, b) +15% YoY rise in oil prices and PKR depreciation and, c) lower exploration cost in the absence of dry well cost. However, earnings growth was limited by higher effective tax rate of 42% during 2QFY19 compared to 12% 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 are up by +4%QoQ during 2QFY19. This brings total profitability for 1HFY19 to PKR 7.89bn up by +66% YoY.

Exhibit:

POL Financial Highlights

| PKRmn | 2QFY19 | 2QFY18 | YoY | 1HFY19 | 1HFY18 | YoY |
|--------------------------|--------|--------|------|--------|--------|------|
| Net Sales | 11,639 | 6,000 | 94% | 22,209 | 13,240 | 68% |
| Operating Costs | 2,726 | 2,155 | 26% | 5,504 | 4,129 | 33% |
| Royalty | 1,160 | 428 | 171% | 2,245 | 1,091 | 106% |
| Amortization of D&D Cost | 1,029 | 978 | 5% | 1,803 | 1,490 | 21% |
| Gross Profit | 6,646 | 2,361 | 181% | 12,502 | 6,384 | 96% |
| Exploration Costs | 79 | 468 | -83% | 810 | 740 | 9% |
| Finance Cost | 1,347 | 487 | 177% | 1,749 | 675 | 159% |
| Other Income | 2,286 | 1,316 | 74% | 3,127 | 1,565 | 100% |
| PBT | 6,962 | 2,522 | 176% | 12,096 | 6,050 | 100% |
| PAT | 4,022 | 2,227 | 81% | 7,889 | 4,761 | 66% |
| EPS (PKR) | 14.17 | 7.85 | | 27.79 | 16.77 | |
| DPS (PKR) | 20.00 | 17.50 | | 20.00 | 17.50 | |

Source: IGI Research and Company Financials

No of Shares: 283.86mn

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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 – 2019

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

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Research Identity Number: BRP009

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