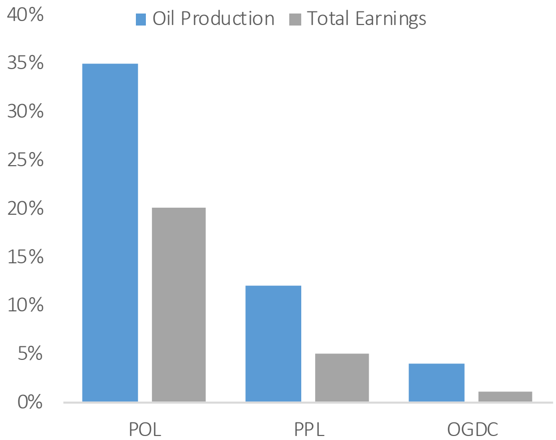
Day Break

Thursday, 25 January 2018

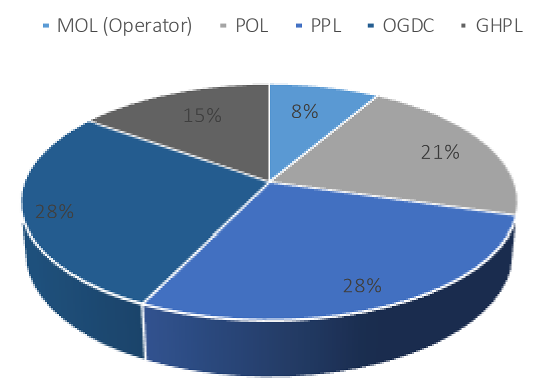
IGI Securities
SERVING YOU SINCE 1994

Sector Update

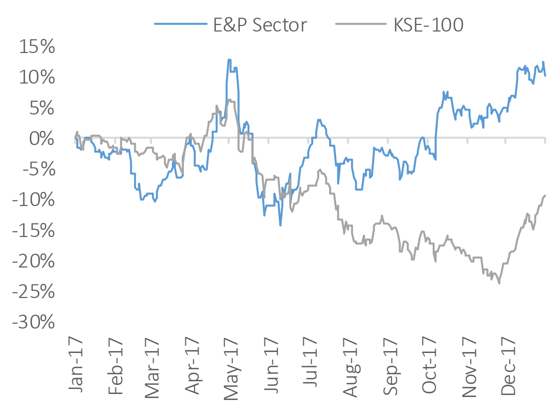
OGDC, PPL and POL new oil discoveries on PP12



Working Partners in Tal Block



E&P Sector Relative Performance to KSE 100



Source: Bloomberg, PSX & IGI Research

Analyst

Abdullah Farhan
abdullah.farhan@igi.com.pk
Tel: (+92-21) 111-234-234 Ext.: 912

Oil & Gas Exploration Companies

Imposition of windfall levy on oil; POL most affected while OGDC and PPL to bear minimum burn

- As per notice issued by Pakistan Oilfield Limited (POL) on Pakistan Stock Exchange (PSX), the Ministry of Energy (Petroleum Division) has amended Petroleum Policy 2012 (PP12) and has imposed windfall levy on oil/condensate.
- We believe working partners in Tal block (OGDC, PPL, POL, MOL and GHPL) will challenge the decision in court and hold reasonable basis to challenge the decision.
- Considering if OGDC and PPL opt to reverse the revenue earned from price incentive on Tal block like POL until resolution of the matter, we estimate minimal impact on earnings for OGDC (2%-3%) and PPL (5%-6%) while POL would be most affected by 12%-13% downside.
- Having said that we await completion of 90days time period allowed by GoP to finalize the SA, and thus have not yet revised our investment case for OGDC, PPL and POL. It is pertinent to mention here that MARI would remain unaffected at this point in time

Amendments in Petroleum Policy and imposition of windfall levy on oil

As per notice issued by Pakistan Oilfield Limited (POL) on Pakistan Stock Exchange (PSX), the Ministry of Energy (Petroleum Division) has amended Petroleum Policy 2012 (PP12) and has imposed windfall levy on oil/condensate. Under the said notification the ministry has guided the signed Supplemental Agreements (SA) already executed for conversion from PP 1994 and 1997 shall be amended within 90 days starting 27th Dec-17, falling which the Oil & Gas Exploration companies holding working interest will not be eligible for gas price incentive. If the Supplemental Agreement is finalized, windfall levy will be effective retrospectively in order to avail gas price incentive.

The impact of Tal block reversal may not be as widespread

We believe working partners in Tal block (OGDC, PPL, POL, MOL and GHPL) will challenge the decision in court and hold reasonable basis to challenge the decision. Considering if OGDC and PPL opt to reverse prices back to PP97 for Tal block like POL until resolution of the matter, we estimate minimal impact on earnings for OGDC (2%-3%) and PPL (5%-6%) while POL would be most affected by 12%-13% downside.

A brief background on Supplemental Agreements signed previously

To recall, back in 2015, the government of Pakistan (GoP) awarded conversion to different concessions to PP12 (including TAL Block) under the supplemental agreements. As a result of these concessions awarded newer discoveries which were to be priced under PP12 wellhead gas price mechanism, allowing for roughly ~50-70% higher prices. For Tal Block which falls under PP01, wellhead gas prices for Maramzai/Mamikhel/Makori East were further awarded conversion to PP07 and PP09. This entitled working partners in Tal block to retrospectively receive higher gas price incentive since Nov-07.

Company wise OGDC, PPL, POL and GHPL hold 27.8%, 27.8%, 21% and 15% stake respectively in Tal block while MOL operator of Tal block holds 8.42% working interest. The retrospective amount from Nov-07 to Jun-15 in respect of revision in wellhead price for Tal block as stated by respective management of companies stood at PKR 3.9bn each for OGDC and PPL while PKR 2.9bn for POL.

Two fold impact on E&Ps

We have subdivided the implication of the decision to impose windfall levy in to two aspects which are as follows:

a) **Tal block and retrospective impact:** Exclusively for Tal block the price incentive was applicable since Nov-07 for revision in wellhead gas price for Maramzai, Mamikhel and Makori East to PP07/PP09, while PP12 price was offered for any new discoveries post 2015. As per the notice now the windfall levy will also be applicable retrospectively, and that the SA needs to be finalized within 90 days else the price incentive will be forgone and Tal block will revert back to wellhead prices under PP97 (capped at USD 36/bbl), which is almost ~64% lower than PP12.

b) **Windfall levy on oil/condensate:** Petroleum concessions converted to PP12 will now be charged windfall levy on oil/condensate production. This will also apply to old blocks which were granted PP12 price incentive for newer discoveries.

What this means for local E&Ps

Considering the impact of this on Tal block, the amount stated by POL for retrospective amount up until Dec-17 of windfall levy stands at PKR 13,687mn while revenue amount stands at PKR 6,404mn. Taking 21.05% stake for POL in Tal block, the aggregate amount of windfall levy till Dec-17 comes at PKR 30,419mn while total retrospective revenue is foreseen at PKR 65,013mn (based on our estimates). As a result we believe OGDC, PPL and POL to realize a net expense of PKR 2.23/share/ PKR 4.87/share and PKR 30.79/share, respectively.

Exhibit:

Retrospective amount of windfall levy and revenue from Tal block

	Stake (%)	Income* (PKRmn)	Windfall (PKRmn)	Net (PKRmn)	No. of Shares	PKR/Share
POL	21.1%	6,404.0	13,687.0	-7,283.0	236.6	-30.8
PPL	27.8%	8,445.0	18,050.0	-9,604.0	1,971.7	-4.9
OGDC	27.8%	8,445.0	18,050.0	-9,604.0	4,300.9	-2.2
MOL	8.4%	2,562.0	5,475.0	-2,913.0		
GHPL	15.0%	4,563.0	9,752.0	-5,189.0		
Total	**100.0%**	**30,419.0**	**65,013.0**	**-34,594.0**		

*Source: IGI Research, PSX, *This includes the retrospective amount from Nov-07 till Jun-15 and from Jul-15 to Dec-17*

Company wise impact of reversal of Tal block; OGDC and PPL likely to follow

Assuming this, we believe E&P companies would opt to forego the price incentive for Tal block and wellhead price for Tal block would revert back to PP97. As POL in its 2QFY18 result reported a reversal of price incentive realized since Jul-15 of PKR 3,011mn and effectively reverted prices back to PP01 price for Tal block. Based on this, we believe OGDC and PPL will likely follow the lead and reverse the price incentive.

POL to be most affected amongst our coverage companies

POL holds nearly 21.05% stake in Tal block while Tal block contributes nearly 63%/74% to oil/gas production and 89% of total revenue (81% after reversion in price). We expect POL to witness earning compression of 12%-13% as a result of reversion of wellhead gas price to PP01. Besides Tal block, Ikhlas block was also granted conversion to PP12 from which recent discovery of Jhandial will be subjected to windfall levy on oil/condensate. *(To view our 2QFY18 result preview on POL click here)*

PPL to be least affected on other blocks converted to PP12

PPL holds nearly 27.76% stake in Tal block while Tal block contributes nearly 40%/11% to oil/gas production and 19% of total revenue (14% after reversion in price). We expect PPL's earning to shed by 5%-6% as a result of reversion of wellhead gas price to PP01. As PPL has already booked retrospective amount during 1QFY18 we believe the reversal amount of PKR 3.92bn in respect of Tal block would be entire PKR 8.45bn having earnings impact of PKR 3.01/share. However, beside Tal block, PPL has discovered major portion of gas compared to oil from blocks converted to PP12 such as Gambat South. If implemented, PPL does not currently hold significant portion of oil from converted blocks and according to PP12 is already paying windfall levy on gas production.

OGDC to be least affected by Tal block while portion of new oil discoveries remain insignificant to total production

OGDC holds nearly 27.76% stake in Tal block while Tal block contributes nearly 13%/7% to oil/gas production and 14% of total revenue (10% after reversion in price). We expect OGDC's earning to depress by 2%-3% as a result of reversion of wellhead gas price to PP01. We believe similar to POL, OGDC is yet to book the retrospective amount thus the latter may only reverse amount of PKR 4.25bn (PKR 0.69/share) during 2QFY18. As new discoveries of oil from converted blocks only account for 4% of total oil production and contributes only 1% to total earnings, the imposition of windfall levy would have minimal impact on OGDC.

Exhibit:

Earnings impact of reversal of Tal block to PP01

PKR/share	Change in FY18 EPS	% Change	Change in FY19 EPS	% Change
POL	7.66	11.9%	8.80	12.6%
PPL	1.17	5.1%	1.33	5.5%
OGDC	0.48	2.4%	0.55	2.8%

Source: IGI Research, PSX

Future oil discoveries from converted blocks will result in lower value addition

If the decision is implemented, we believe the earnings impact of new oil discoveries will be reduced owing to windfall levy hence result in lower value addition. However, if offering of new concessions is implemented we estimate this would compensate for the loss of revenues in windfall levy on oil production to a certain extend.

Concerns and likely stance of the respective companies' management

As per POL; the company's management believes that the SA signed under Conversion package offered higher gas price and windfall levy on oil/condensate was not applicable. In addition the management argues that if GoP amends any policy, it does not have the authority to apply the law retrospectively. Based on this, the management of the company will be challenging the decision in court of law and as such PPL and OGDC are likely to follow suit.

Although we believe the respective companies' have solid grounds to challenge the decision in court but the resolution of the said matter could take some time. In meantime likewise of POL, OGDC and PPL are likely to reverse the gas price incentive on Tal block on prudent basis, which on the outlook would lead to a loss of income for these companies.

Recommendation

Having said that we await completion of 90 days time period allowed by GoP to finalize the SA, and thus have not yet revised our investment case for OGDC, PPL and POL. It is pertinent to mention here that MARI would remain unaffected at this point in time as gas production and revenue contributes nearly 98% and 95% to total production and revenue, respectively. However, based on this we recommend a cautious stance on POL while keeping our BUY stance intact on PPL, OGDC and MARI, respectively.

Important Disclaimer and Disclosures

Research Analyst(s) Certification: The Research Analyst(s) hereby certify that the views about the company/companies and the security/securities discussed in this report accurately reflect his or her or their personal views 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(s) 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.

Disclaimer: The information and opinions contained herein are prepared by IGI Finex Securities Limited and is for information purposes only. Whilst every effort has been made to ensure that all the information (including any recommendations or opinions expressed) contained in this document (the information) is not misleading or unreliable, IGI Finex Securities Limited makes no representation as to the accuracy or completeness of the information. Neither, IGI Finex Securities Limited nor any director, officer or employee of IGI Finex Securities Limited shall in any manner be liable or responsible for any loss that may be occasioned as consequence of a party relying on the information. This document takes no account of the investment objectives, financial situation and particular needs of investors, who shall seek further professional advice before making any investment decision. This document and the information may not be reproduced, distributed or published by any recipient for any purpose. This report is not directed or intended for distribution to, or use by any person or entity not a client of IGI Finex Securities Limited, else directed for distribution.

Rating system: IGI Finex Securities employs three tier ratings system, depending upon expected total return (return is defined as capital gain exclusive of tax) of the security in stated time period, as follows:

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)

Risk: Investment in securities are subject to economic risk, market risk, interest rate risks, currency risks, credit risks, political and geopolitical risks. The performance of company(ies) covered herein mightunfavorably 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.

Basic Definitions and Terminologies used: Target Price: A price target is the projected price level of a financial security stated by an investment analyst or advisor. It represents a security's price that, if achieved, results in a trader recognizing the best possible outcome for his investment. **Market Cap.:** Market capitalization is calculated by multiplying a company's shares outstanding by current trading price. **ROE:** Return on equity is the amount of net income returned as a percentage of shareholders' equity. **P/E:** Price to Earnings ratio of a company's share price to its per-share earnings. **P/B:** Price to Book ratio used to compare a stock's market value to its book value. **DY:** The dividend yield is dividend per share, divided by the price per share.

IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009

Contact Details

Research Team

Saad Khan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 810	saad.khan@igi.com.pk
Abdullah Farhan	Senior Analyst	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Syed Daniyal Adil	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 973	daniyal.adil@igi.com.pk
Suleman Ashraf	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 957	suleman.ashraf@igi.com.pk
Muhammad Saad	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 816	muhammad.saad@igi.com.pk
Tanweer Kabeer	Research/Fund Select	Tel: (+92-21) 111-234-234 Ext: 966	tanweer.kabeer@igi.com.pk
Umesh Solanki	Database Manager	Tel: (+92-21) 111-234-234 Ext: 974	umesh.solanki@igi.com.pk

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 35777863-70	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Ejaz Rana	Regional Manager (Faisalabad)	Tel: (+92-41) 2540843-45	ejaz.rana@igi.com.pk
Asif Saleem	Branch Manager (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Branch Manager (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk
Zeeshan Kayani	Branch Manager (Abbottabad)	Tel: (+92-992) 408243-44	zeeshan.kayani@igi.com.pk
Ihsan Mohammad	Branch Manager (Peshawar)	Tel: (92-91) 5253035	ihsan.mohammad@igi.com.pk

IGI Finex Securities Limited
Trading Rights Entitlement Certificate (TREC) Holder of
Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited

Head Office
Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780
Website: www.igisecurities.com.pk

Stock Exchange Office
Room # 719, 7th Floor, PSX Building, Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2 , Fax: (+92-21) 32429607

Lahore Office
5-F.C.C. Ground Floor, Syed Maratib Ali Road,
Gulberg II, Lahore
Tel: (+92-42) 35777863-70, 35876075-76
Fax: (+92-42) 35763542

Islamabad Office
Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza,
Block- B, Jinnah Avenue, Blue Area, Islamabad
Tel: (+92-51) 2604861-2, 2604864, 2273439
Fax: (+92-51) 2273861

Faisalabad Office
Room #: 515-516, 5th Floor, State Life
Building, 2- Liaqat Road, Faisalabad
Tel: (+92-41) 2540843-45
Fax: (+92-41) 2540815

Rahim Yar Khan Office
Plot # 12, Basement of Khalid Market,
Model Town, Town Hall Road, Rahim Yar Khan
Tel: (+92-68) 5871653-6, 5871652
Fax: (+92-68) 5871651

Multan Office
Mezzanine Floor, Abdali Tower,
Abdali Road, Multan
Tel: (92-992) 408243 - 44

Abbottabad Office
Ground Floor, Al Fatah Shoppinig Center , Opp. Rad
Station, Mansehra Road, Abbottabad
Tel: (+92-99) 2408243 - 44

Peshawar Office
2nd Floor, The Mall Tower,
35 The Mall Peshawar Cantt.
Tel: (92-91) 5253035, 5278448

Sialkot Office
Suite No. 10 & 11, 1st Floor, Soni Square,
Mubarik Pura, Sialkot.
Tel: (+92-52) 3258437, 3258762