Alfa Adhi Securities
REN # REP-004

AKSEER RESEARCH
REN # REP-400R

Pakistan Petroleum Limited (PPL):
Weighed down by circular debt

October 14, 2021

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Prices as of 14th October, 2021

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Reiterate 'BUY' with PT of PKR 179/share

- We revise our earnings estimates upward for Pakistan Petroleum Limited (PPL) after incorporating FY21 financial accounts, PKR devaluation and recent uptrend in international oil prices. Our new EPS forecast for FY22/23 now comes at PKR 24.4/25.6, compared to previous estimates of PKR 22.0/23.3 (up 11%/9.8%).
- We have also rolled forward our PT to June-22, which comes at PKR 179, offering an upside of 141%, along with a dividend yield of 6.7%.
- We like PPL on the basis of:
  - Base case oil price change from USD 50/bbl to USD 70/bbl and expected PKR devaluation against USD accreting to the revenue.
  - Incremental production from Margand discovery to boost earnings from FY25 onwards (EPS impact of PKR 10/share). We expect PPL's gas production to reach 900mmcfd in FY27 compared to 757mmcfd during FY21.
  - Commencement of production from past discoveries including Hatim, Zafir in Gambat South block and Mamikhel South in TAL block.
  - Trading at a steep discount of 66% to its historical P/BV and 23% below industry's P/BV of 0.68x. We believe that underlying cashflow issues due to circular debt have already been priced in. Any positive development on circular debt will be an upside trigger for the company.
- The key downside risk to our investment call are 1) Mounting overdue receivables due to circular debt, 2) Development and commencement of production from Margand discovery takes longer than expectation.
- We reiterate 'BUY' on PPL. The stock is trading at FY22 PE and P/BV of 3.0x and 0.5x, respectively.

Key Data	
PSX Ticker	PPL
Bloomberg Ticker	PPL:PA
Reuters Ticker	PPL:KA
Target Price (PKR)	179
Current Price (PKR)	74
Upside/(Downside) (%)	141%
Dividend Yield (%)	6.7%
Total Return (%)	148%
12-month High (PKR)	104
12-month Low (PKR)	77
Outstanding Shares (mn)	2,721
Market Cap (PKR mn)	202,224
Year End	June

Key Ratios	FY19A	FY20A	FY21A	FY22E	FY23F	FY24F
EPS	21.9	18.2	19.2	24.4	25.6	22.9
EPS Growth	30%	-17%	6%	27%	5%	-11%
DPS	1.7	1.0	3.5	5.0	7.5	7.0
PER	3.4	4.1	3.9	3.0	2.9	3.2
Div. Yield	2.2%	1.3%	4.7%	6.7%	10.1%	9.4%
EV/EBITDA	1.1	1.5	1.3	0.7	0.2	0.1
P/BV	0.7	0.6	0.5	0.5	0.4	0.4
ROE	22.1%	15.4%	14.3%	16.0%	15.0%	12.2%

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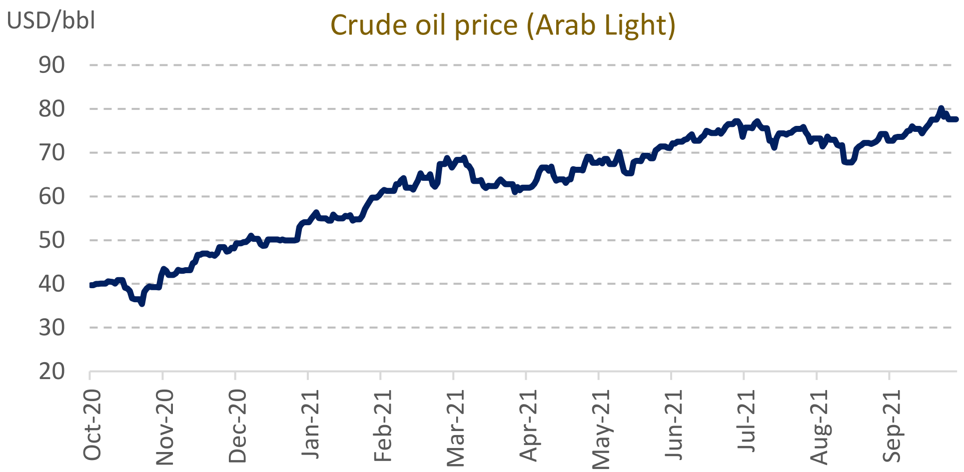
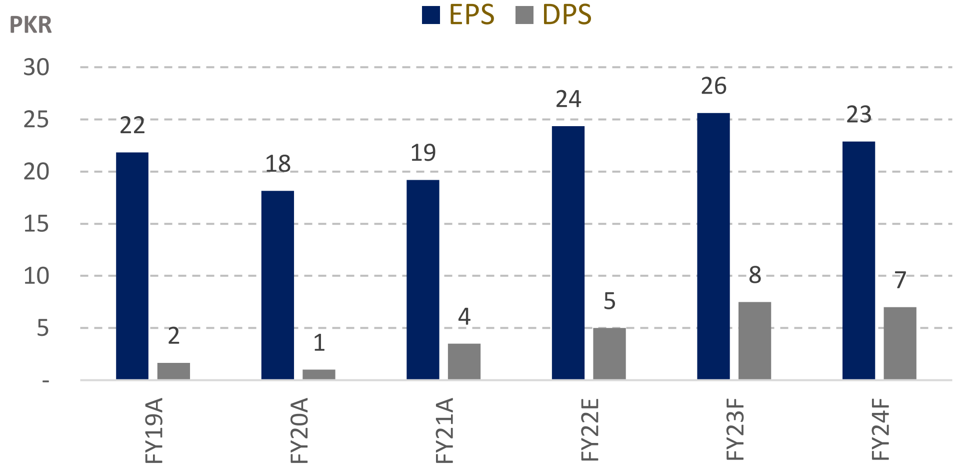
Earnings to grow at CAGR of 14% during FY25-FY27

- **Earnings revised up by 11%/9.8%**
  - We have revised upward our earnings estimates for PPL owing to recent rally in international crude oil prices and PKR devaluation versus the Greenback. We now expect Arab Light oil price to average USD 70/barrel in FY22, USD 60/barrel in FY23 and USD 55/barrel in FY24 and beyond (earlier assumption USD 50/barrel).
  - Similarly, We expect exchange rate to average at PKR 168/USD in FY22 (previously PKR 163/USD).
  - Resultantly, our FY22/23 earnings are expected to clock in at PKR 24.4/25.6, compared to previous estimates of PKR 22.0/23.3 (up 11%/9.8%).
- **Margand to add significant value**
  - Although during the initial testing, the well flowed 10.7mmcfd of gas and 132bpd of oil, it has a potential to flow at a higher rates. According to the company, the discovered column of gas indicates reserve size of 1.0 trillion cubic feet (tcf), which will be substantiated further based on appraisal wells.
  - We expect delays in commencement of production from this discovery due to difficult terrain and lack of infrastructure.
  - We have taken 200mmcfd of production from Margand, commencing from FY25, while peak flows will be achieved by FY27.
  - Resultantly, PPL's earnings are expected to grow at a CAGR of 14% during FY25-FY27.



Source: Investing & Akseer Research

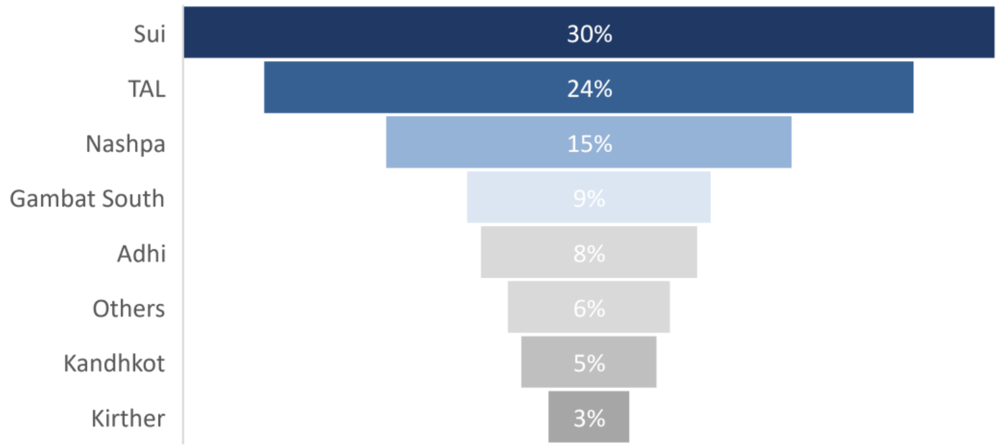


Source: Company Accounts & Akseer Research

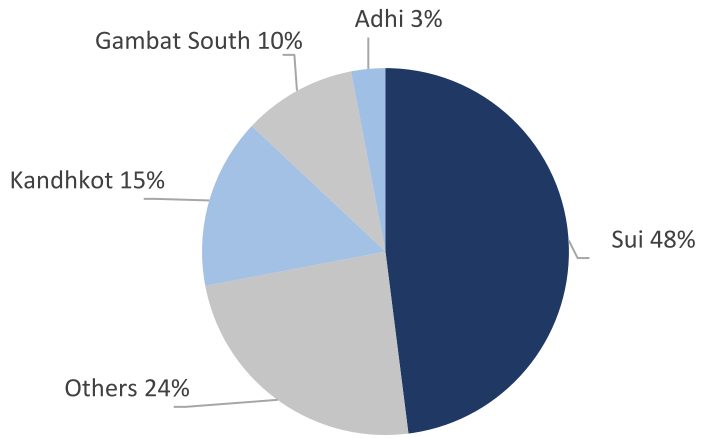
Incremental production to ramp up flows

- **Gambat South and Margand block update**
  - Exploratory well Qasar X-1 is in drilling phase, whereas, Gambat South GPF IV-phase 2 has been commissioned in Jan-21, enhancing the gas production by 35mmcfd. Furthermore, the company has planned Gambat South GPF IV compression project in FY22.
  - In TAL block, commencement of production from Mamikhel South is expected as soon as the government approves its. Just to recall, the field was expected to come online in March-21. During the initial testing, well yielded 3,240bpd of oil and 16.12mmcfd of gas.
  - In Margand block, post well studies have been completed and the acquisition of 2D seismic data is in progress over Iskalku lead.
- **Development underway to reduce natural decline in Sui gas field**
  - During FY21, PPL drilled 2 development wells in Sui, recovering ~6 mmcfd of gas production. In addition, 6 mmcfd production was recovered as a result of optimization activity of SML pipeline network. PPL, during the year, has managed to reduce Sui field's natural decline to 2.6% from 4.2% in FY20. On average Sui field's gas production has declined 4% each year during the last 10 years.
- **Offshore block 5 in Abu Dhabi**
  - Recently, PPL led consortium, including OGDC, MARI and GHPL, has been awarded offshore block 5 in Abu Dhabi. The consortium will invest USD 400mn in next 5 years through an SPV namely Pakistan International Oil Limited. No further update on the project from the management.

Field wise revenue contribution in FY21



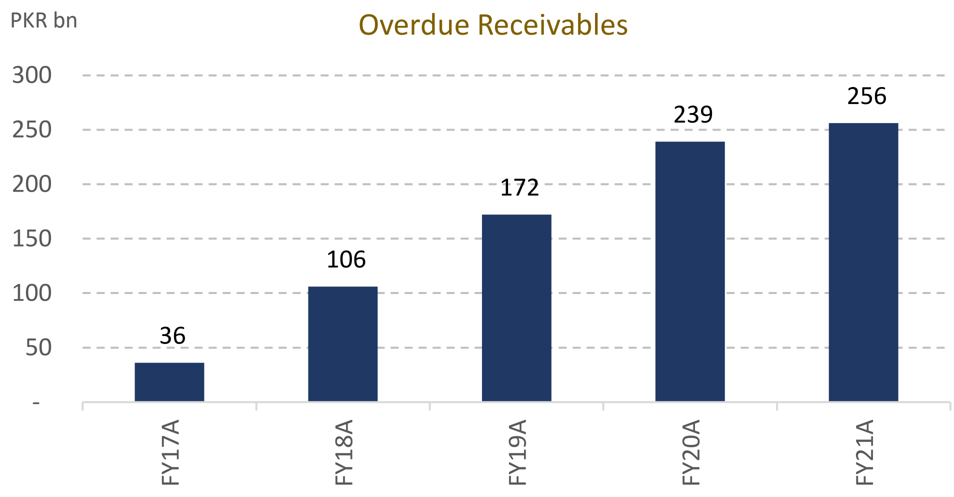
Gas revenue contribution in FY21

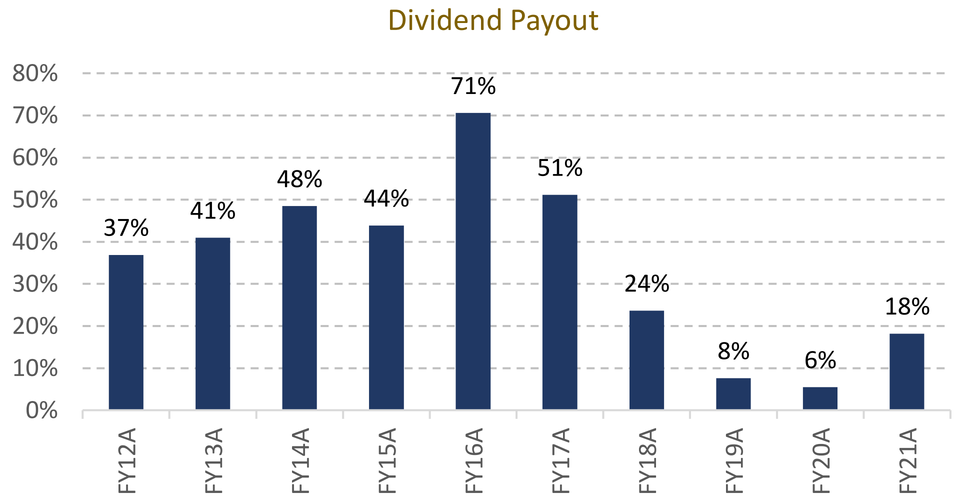


Source: Company Accounts & Akseer Research

Burgeoning circular debt restricting growth, affecting dividend payout

- **Overdue receivables up PKR 17bn during FY21**
  - PPL's overdue receivables further rose by PKR 17bn YoY to PKR 256bn (~PKR 95/share) by end of FY21 because of non receipt of gas sales. Besides, the difference between consumer gas prices and the cost of gas, has also led to the rapid surge in circular debt recently.
  - We believe that increase in consumer gas prices is inevitable in order to arrest the pileup of gas sector circular debt.
  - The management has shared various proposals with the government to address this issue. One of the proposals include linking statutory payments with cash receipts. If implemented, these proposals will reverse the increasing trend in gas related circular debt.
- **Average dividend payout at 14% since FY17**
  - Due to the mounting circular debt issue, PPL's capacity to pay dividends has deteriorated since FY17. The average dividend payout has remained 14% during the last 4 years. In FY21, PPL's payout ratio slightly improved to 18%.
  - We believe that resolution of circular debt will ease the cashflow issue, resulting in higher dividend payouts going forward.
  - We have assumed 30% payout in our investment horizon.





Source: Company Accounts & Akseer Research

Earnings sensitivity (FY22)

	Oil Price USD/bbl						
Exchange rate PKR/USD		**50**	**60**	**70**	**80**	**90**	**100**
	150	18.82	20.66	22.45	24.09	25.73	27.37
	160	19.69	21.61	23.50	25.22	26.94	28.66
	168	20.40	22.39	**24.37**	26.15	27.94	29.72
	170	20.56	22.56	24.54	26.34	28.15	29.95
	180	21.42	23.52	25.58	27.47	29.35	31.24
	190	22.29	24.47	26.62	28.60	30.56	32.53

Source: Company Accounts & Akseer Research

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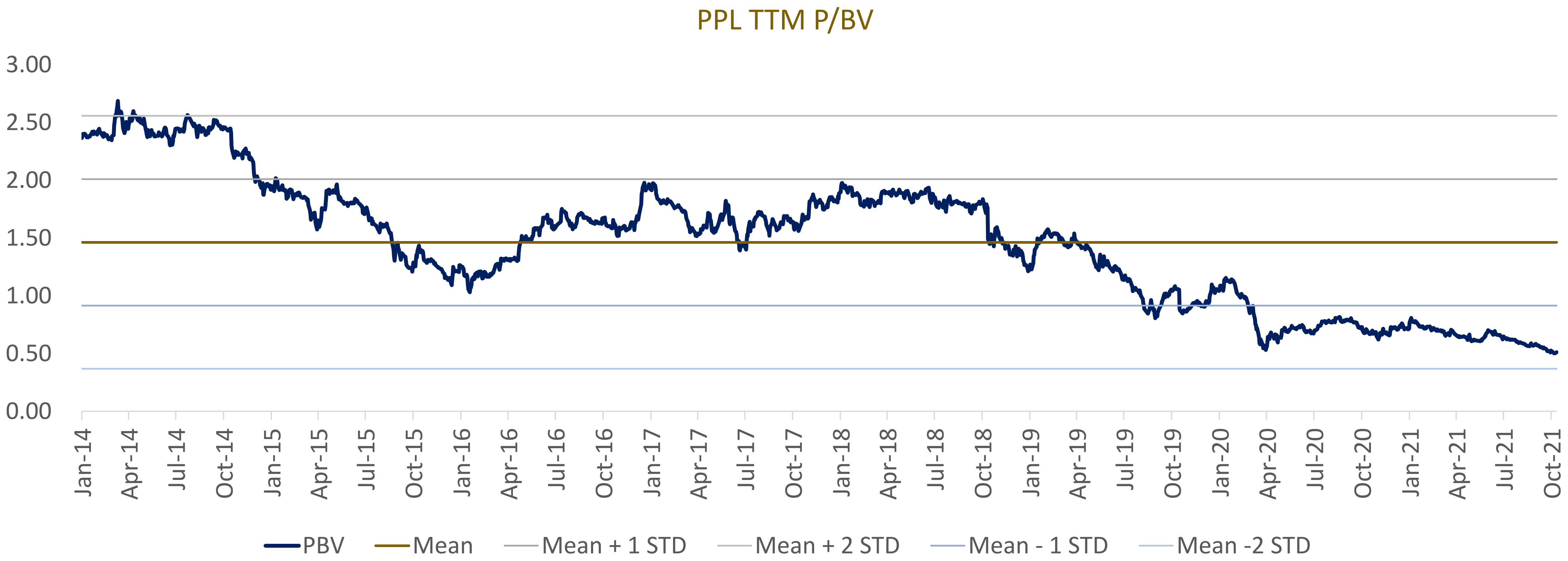
Trading at an attractive multiples; marred by the non resolution of the circular debt issue



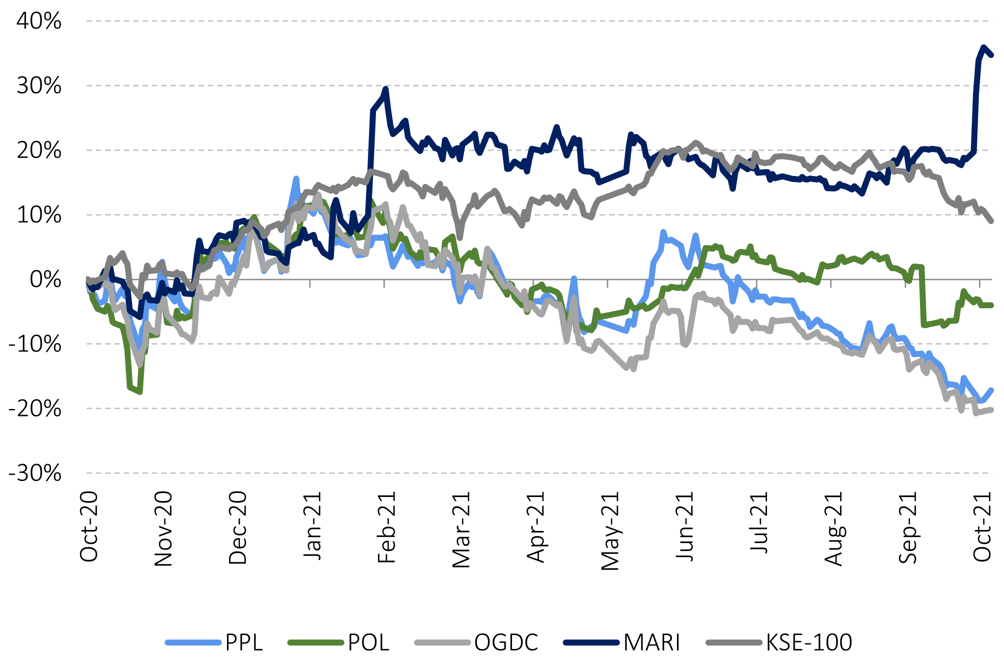
- Currently, PPL is trading at trailing P/BV of 0.5x which is at a whopping 66% discount to its mean P/BV of 1.46x during the last 8 years.
- PPL is also trading at discount of 23% to E&P sectors' P/BV of 0.68x.

Source: Company Accounts & Akseer Research

Risk - Return Profile

- **Valuation Basis**
  - Our PT for Pakistan Petroleum Limited (PPL) has been computed using the reserve-based Free cash flow to equity (FCFE) method. We have used a risk free rate of 11%, beta of 1.0 & market risk premium of 6% to arrive at cost of equity of 17%.
- **Investment Thesis**
  - Our investment case on PPL is based on:
    1) Incremental production from new discoveries,
    2) Rebound in international crude oil prices, and
    3) Likely PKR devaluation against the USD.
- **Risks**
  - Key risks to our investment thesis are
    1) Volatility in oil prices,
    2) Appreciation in PKR against USD,
    3) Delay in connection of discoveries,
    4) Increase in overdue receivables due to circular debt, and
    5) lower than estimated life of main reserves.

Relative Price Performance



Source: PSX & Akseer Research

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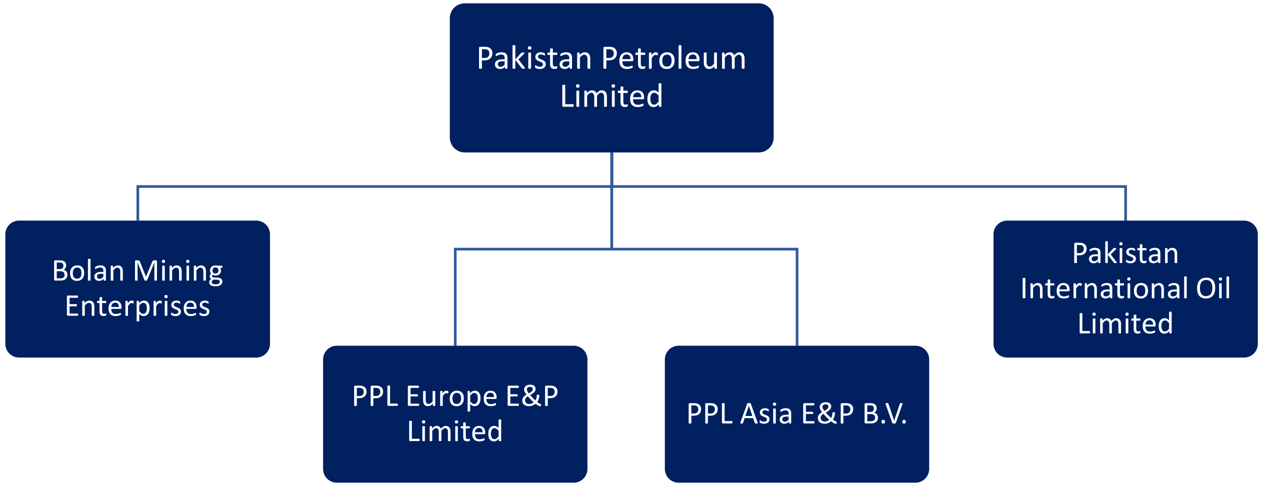
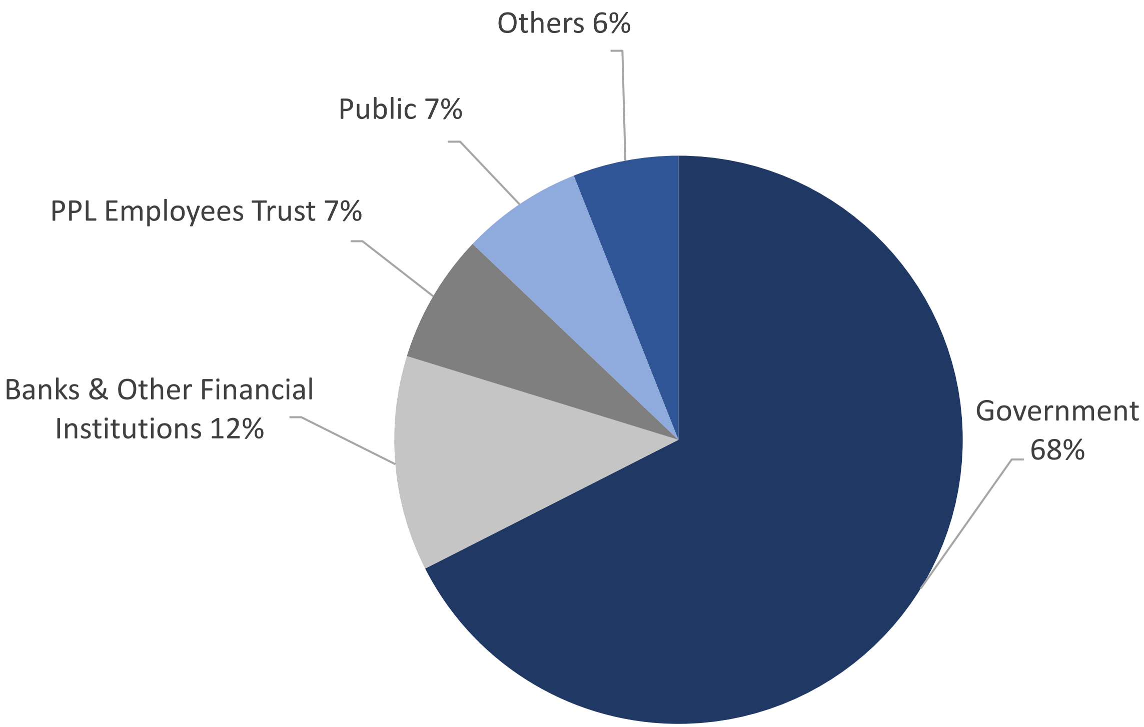
Company Overview

- **Company Description**
  - Pakistan Petroleum Limited, together with its subsidiaries, engages in the exploration, prospecting, development, and production of oil and natural gas resources in Pakistan, Iraq, and Yemen. It produces natural gas, crude oil, natural gas liquids (NGLs), and liquefied petroleum gas (LPG). The company operates several producing fields located in Sui, Kandhkot, Adhi, Mazarani, Chachar, Adam, Adam West, and Kinza regions.
- **Associated Companies**



Shareholding Pattern



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Financial Highlights

Income Statement (PKR mn)	FY19A	FY20A	FY21A	FY22E	FY23F	FY24F
Net Sales	164,366	157,999	149,279	177,003	184,703	167,045
Operating Costs	(40,280)	(43,082)	(40,776)	(42,068)	(43,272)	(40,839)
Royalty	(24,375)	(23,842)	(22,228)	(26,874)	(27,545)	(25,093)
Exploration Costs	(27,207)	(17,952)	(10,634)	(9,943)	(11,736)	(12,227)
Admin Cost	(2,405)	(3,086)	(3,786)	(3,975)	(4,174)	(4,382)
EBITDA	**99,623**	**92,092**	**87,832**	**108,674**	**113,228**	**102,411**
Financial Charges	(777)	(1,113)	(1,147)	(866)	(890)	(916)
Other charges	(7,164)	(5,866)	(7,043)	(8,855)	(9,333)	(8,286)
Other Income	15,679	6,583	4,080	4,551	6,238	7,930
Profit Before Tax	**77,837**	**69,643**	**68,438**	**88,972**	**93,990**	**83,232**
Taxation	(18,377)	(20,218)	(16,155)	(22,663)	(24,242)	(20,946)
Net Profit	**59,459**	**49,425**	**52,283**	**66,310**	**69,748**	**62,287**
Ratios						
EPS	21.85	18.16	19.21	24.37	25.63	22.89
DPS	1.67	1.00	3.50	5.00	7.50	7.00
Payout Ratio	8%	6%	18%	21%	29%	31%

Source: Company Accounts & Akseer Research

Financial Highlights

Balance Sheet (PKR mn)	FY19A	FY20A	FY21A	FY22E	FY23F	FY24F
Trade debts	198,425	264,220	282,671	305,511	318,802	288,323
Other working capital assets	64,742	64,340	98,216	100,505	105,328	109,761
Cash	8,562	6,525	4,751	35,938	80,077	111,054
Current assets	**271,729**	**335,084**	**385,639**	**441,954**	**504,207**	**509,139**
PPE	161,073	159,915	147,403	141,064	140,567	140,090
Other non current assets	608	431	4,466	4,679	4,854	5,053
Total assets	**433,409**	**495,430**	**537,508**	**587,697**	**649,628**	**654,282**
Creditors	62,617	69,091	67,212	63,391	74,096	33,566
Provisions	7,163	15,278	20,611	20,611	20,611	20,611
Other liabilities	360	320	522	0	0	1
Current liabilities	**70,140**	**84,689**	**88,345**	**84,002**	**94,707**	**54,177**
Deferred Taxation	37,134	36,525	29,830	30,725	31,647	32,596
Other liabilities	27,931	30,908	30,401	31,334	32,297	33,291
Total liabilities	**135,205**	**152,121**	**148,576**	**146,061**	**158,651**	**120,065**
Reserves	275,529	316,098	361,722	414,427	463,767	507,007
Shareholders' equity	298,204	343,308	388,932	441,637	490,977	534,217
Total equity and liabilities	**433,410**	**495,430**	**537,508**	**587,697**	**649,628**	**654,282**
Ratios						
BVPS	131.51	126.17	142.94	162.31	180.44	196.33
ROCE	20.50%	14.66%	13.59%	16.34%	16.97%	14.72%
ROA	14.80%	10.64%	10.12%	11.79%	11.27%	9.55%
ROE	22.08%	15.41%	14.28%	15.97%	14.96%	12.15%

Source: Company Accounts & Akseer Research

Financial Highlights

Cashflow Statement (PKR mn)	FY19A	FY20A	FY21A	FY22E	FY23F	FY24F
Net Income	59,459	49,425	52,283	66,310	69,748	62,287
Depreciation	20,835	21,167	18,097	18,750	18,306	18,243
Amortisation of E&D	173	169	149	85	41	20
Working capital	(18,736)	(50,202)	(26,189)	(23,596)	(1,163)	(7,947)
CFO	**61,732**	**20,559**	**44,341**	**61,550**	**86,932**	**72,603**
Interest	777	1,113	1,147	866	890	916
Capex	(26,554)	(20,010)	(5,585)	(12,412)	(17,808)	(17,766)
Additions	(234)	(27)	(22)	23	11	5
FCFF	**35,722**	**1,635**	**39,881**	**50,027**	**70,026**	**55,757**
Interest	(777)	(1,113)	(1,147)	(866)	(890)	(916)
Net borrowing	0	0	0	0	0	0
FCFE	**34,944**	**523**	**38,734**	**49,161**	**69,135**	**54,842**
Change in equity	(1,705)	(4,321)	(6,659)	(13,605)	(20,407)	(19,047)
Net Cashflow	33,240	(3,798)	32,075	35,556	48,728	35,795
Beginning Cash	8,252	8,563	6,525	4,751	35,938	80,077
Ending Cash	**8,563**	**6,525**	**4,751**	**35,938**	**80,077**	**111,054**

Source: Company Accounts & Akseer Research

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To arrive at our 12-months Price Target, the JV uses different valuation methods which include: 1). DCF methodology, 2). Relative valuation methodology, and 3). Asset-based valuation methodology.

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JV employs a three-tier ratings system to rate a stock, as mentioned below, which is based upon the level of expected return for a specific stock. The rating is based on the following with time horizon of 12-months.

Rating	Expected Total Return
Buy	Greater than or equal to +15%
Hold	Between -5% and +15%
Sell	Less than or equal to -5%

Ratings are updated to account for any development impacting the economy/sector/company, changes in analysts’ assumptions or a combination of these factors.

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