

PAKISTAN
OMCsMARKET
VISTA

With changes abound, big remains beautiful

We assume a bullish outlook for domestic OMCs with an investment thesis premised on i) favorable policy developments entailing national storage benchmarks, assured annual margin revision, increased barriers to entry; and ii) improved liquidity vis-à-vis potential clearance of circular debt. Broader economic stability has positive spillovers for catalyzing a turnaround in OMC volumes where progress is already being witnessed, with overall and retail fuel volumes increasing by 11.1%YoY and 11.0%YoY, respectively in 5MFY21. In line with historical trends, MS is expected to lead growth, with 10/10%YoY increase for FY21/22 while low-base is expected to result in a 6%YoY growth in HSD for FY21. On the later segment, influx of grey product dealt a serious blow to local HSD sales in FY19/20, however GoP efforts to shore up border controls is expected to stabilize HSD demand (slated to grow by 6/4%YoY for FY22/23). PSO (TP: Pkr293.1/sh, 41.3% upside) is our top pick where medium term developments include clearance of circular debt and shift in cash profile of cash flows due to increased share of retail fuels while focus on improving storage infrastructure will result in company sustaining the recently gained market share, moving forward. Moreover, recently released inquiry commission report also calls for firming up regulatory oversight of the sector and any progress in that regard will be beneficial for PSO, in our opinion. At the other end of the spectrum, APL (TP:Pkr434.3/sh, 29.7% upside; D/Y: 8.0%) has inherent 'anti-bodies' against sector headwinds with a strong balance sheet, high cash flow generation (Pkr4.1bn avg. OCF for FY21-24) and progress on storage capability to improve market share.

New policy to significantly improve sector dynamics: Government is in the process of finalizing a re-vamped petroleum sector policy to address longstanding demands of the sector and improve product availability. An expected policy concession is likely to be in the form of region based minimum storage requirement to be shifted towards national basis. Though players have obtained a stay order against OGRA's order of minimum region wise storage requirement, the aforesaid change will be significantly beneficial for our OMC universe where APL will be allowed to expand country wide given national compliance. To recall, APL was only allowed to expand in Punjab and Sindh given regional compliance requirement. Even though PSO (only allowed to expand in Sindh) will continue to be non-compliant on national basis, a shift in policy can decrease CAPEX requirement for the company (from 238k tons on regional basis to 181k tons on national basis). With OMC margin revision facing a delay currently (previously delayed by 5 months in FY20), automatic annual revisions will provide much needed certainty. Another important proposal is to increase the minimum investment required to establish an OMC which will significantly increase barriers to entry, in our view; again a positive for existing players.

OMC volumes to witness a turnaround: OMC volumes witnessed a dull FY20 where influx of grey product, low economic activity and COVID-19 related restrictions weighed heavily, resulting in a decline of 10.4%YoY while decline in retail fuel volumes stood at 4.8%YoY. Currently, as economic activity gains pace, OMC volumes are also expected to turn the page with MS/HSD slated to grow by 10/6%YoY for FY21. With low per capita usage (0.13/0.1 liters per capita of MS/HSD usage per day against 0.23/0.2 liters for APAC/India) and low motorization acting as long term growth propellers, additional impetus to local volumes is expected to be provided by a concurrent upcycle in automobile sales. From a relatively low base, ~6% volumetric growth is expected for HSD where influx of grey product remains a significant risk (our estimates show Pakistan witnessed influx of 1.8/2.5mn tons of grey product in FY19/20). Govt. has initiated efforts to improve border controls which are expected to provide support to HSD demand in long term (expected to grow by 6/4% in FY22/23). Early success of these efforts can result in significant upside as evident by HSD sales increasing by 24%YoY during Jul'20-Aug'20 with strict border control however as soon as restrictions were eased, HSD volumes declined by 14/8% YoY/MoM for Sep'20.

PSO emerges as top pick: We highlight PSO (TP: Pkr293.1/sh, 41.3% upside) as our top pick where medium term catalysts include clearance of circular debt as GoP looks to enter into agreements with IPPs tied to immediate clearance. Improved liquidity post clearance of 94% of

Shahrukh Saleem
shahrukh.saleem@akdsecurities.net
111-253-111 Ext:637

OMC Universe Valuations

	TP	Price	Upside	D/Y	Stance
PSO	293.1	207.4	41.3%	6.0%	Buy
APL	434.3	331.1	29.7%	8.0%	Buy

Source: PSX & AKD Research

PSO: Valuation Glance

Key metrics	FY19	FY20	FY21F	FY22F
EPS	22.5	-13.8	30.8	33.4
DPS	8.3	0.0	12.5	13.5
BVPS	253.9	240.8	271.6	292.4
PER (x)	9.2	-15.1	6.7	6.2
Dividend Yield	4.0%	0.0%	6.0%	6.5%
P/BVS(x)	0.817	0.9	0.8	0.7
Earnings Growth	-31.5%	NA	NA	8.4%
ROE	8.9%	-5.7%	11.3%	11.4%
ROA	3.6%	-3.0%	5.3%	5.2%

Source: Company Reports & AKD Research

APL: Valuation Glance

Key metrics	FY19	FY20	FY21F	FY22F
EPS	39.8	10.1	37.9	39.4
DPS	20.0	9.0	26.5	31.5
BVPS	190.2	185.3	214.2	227.1
P/E	8.3	32.7	8.7	8.4
P/BVS (x)	1.74	1.79	1.55	1.46
Div. Yield	6.0%	2.7%	8.0%	9.5%
Earnings Growth	-30.0%	-74.5%	273.7%	4.0%
ROA	8.5%	2.0%	7.4%	7.2%
ROE	20.9%	5.5%	17.7%	17.3%

Source: Company Reports & AKD Research



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FE-25 receivables and PkR32.8bn received under RLNG and power sector receivables have curbed ST borrowing (PkR42bn as of Sep'20 vs. PkR149bn as of Mar'20). Company has also announced plans to rehabilitate 165k tons of storage and add 159k tons of new storage. Alternatively, APL (TP:PkR434.3/sh, 29.7% upside; D/Y: 8.0%) has inherent 'anti-bodies' against sector headwinds with a strong balance sheet, high cash flow generation (PkR4.1bn avg. OCF for FY21-24) and progress on storage capability to improve market share.

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Neutral	> 8.5% to < 14.5% expected total return
Sell	< 8.5% expected total return (Rf: 8.5%)



AKD Securities Limited

602, Continental Trade Centre,
Clifton Block 8, Karachi, Pakistan.
research@akdsecurities.net