

Pakistan Strategy

Three graphs, three themes!

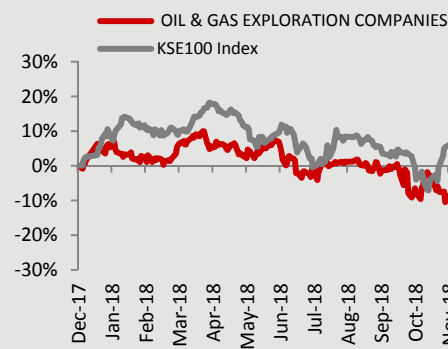
Thursday, December 27, 2018

Oil and Gas Sector Performance

	3M	6M	12M
Absolute %	-20%	-21%	-19%
Relative to KSE %	-13%	-13%	-16%

Source: PSX, BMA Research

KSE100 vs. Oil & Gas exploration



Source: PSX, BMA Research

Earnings sensitivity on different oil prices

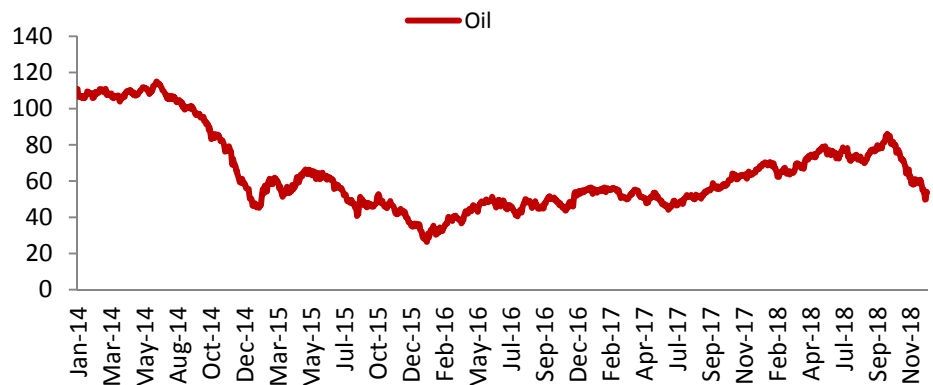
	USD/bbl	FY19	FY20	FY21
Mari	70	192.2	240.1	252.6
	60	189.0	240.0	252.4
	50	184.8	224.3	229.8
POL	70	63.0	56.3	55.3
	60	58.8	48.5	48.0
	50	54.6	40.8	40.7
OGDC	70	24.0	21.8	20.9
	60	22.8	19.4	18.6
	50	21.6	16.9	16.1
PPL	70	28.5	28.3	25.7
	60	27.3	25.0	22.3
	50	26.0	21.5	18.9

Source: BMA Research

- We graphically map oil prices with major commodities and listed sectors to chalk historical relationship vis-à-vis current dynamics and implied oil prices.
- At macro level, we flag every 10% change in oil prices leads to USD1.5bn impact on CAD. USD50/bbl oil price average suggests USD12.2/USD5.57bn CAD for FY19/FY20. Besides BoP, oil prices also positively impact inflation direction and expectations additionally removing pressure on the government to make significant increase in power tariff (20% generation on RLNG/FO).
- Correlation of oil with coal and urea is broken in the past few months. Coal prices are at 24% of oil prices given relative stickiness in coal prices in recent months. Urea prices have moved by -7/+13% in 3/6mths vis-à-vis stability in coal prices.
- A sustained drop in oil prices will result in normalization of historical relationship. We expect oil prices to remain in the range of USD45-55/bbl in 2HFY19 as concerns on global growth and unabated production addition in the US weigh on prices.
- Sectors views: E&Ps- Current stock prices imply oil prices at USD23-24/bbl hence downside volatility may not have big impact on E&Ps' stocks, in our view, whereby we prefer PPL and MARI. Cements- Softness in coal prices may play in favor of cements; top pick LUCK. Fertz- Local urea prices' discount relative to import leaves big downside cushion for urea players (EFERT, FATIMA). Contrary to market perception, we flag only dramatic moves in oil prices may impact earnings refineries, petro-chemical.
- Our other top picks are MCB, UBL, NML, HUBC, and EPCL.

Oil to remain downward sticky going into 2019: Global oil prices dropped down from USD67/bbl to USD54/bbl as US supply additions outpaced planned cuts by the OPEC garnering even further production cuts by member states. We expect oil prices to remain in the range of USD45-55/bbl in 2HFY19 as concern on global growth and unabated production addition in the US weigh on prices. Our base case assumption of oil prices for FY19/20/21E stands at USD66/63/60/bbl, respectively.

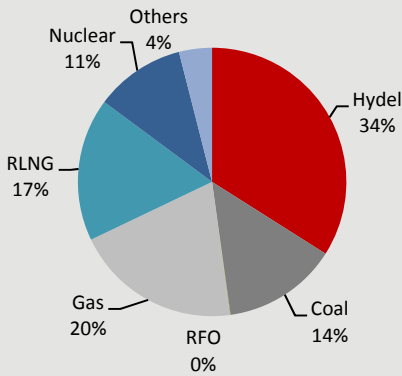
Oil prices since 2014



Source: BMA Research, Bloomberg

Current price trend to give in to supply pressures: Coal prices are strongly correlated to oil prices (correlation of 0.75) albeit with a lagged impact (usually two to three months). However, the recent price data (past six months) of the two commodities reflect a weaker

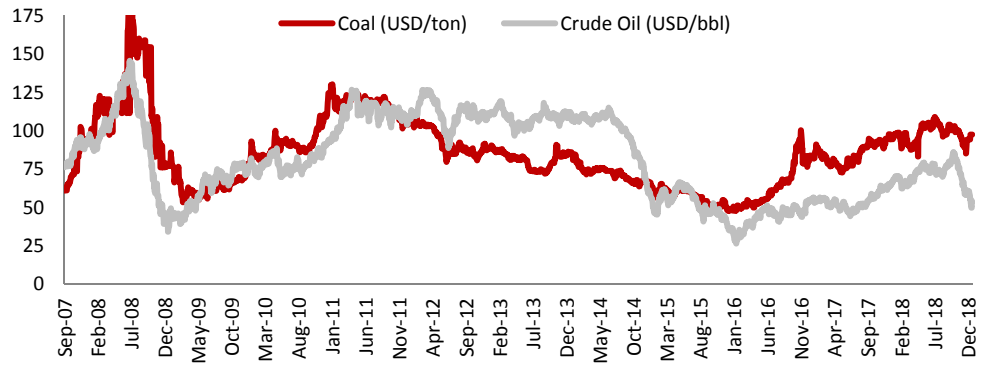
Power generation mix Nov'18



Source: NEPRA, BMA Research

trend mainly due to strong seasonal demand of coal (for power generation). We believe the stickiness in coal prices (trading at USD97.5/ton) may ease off in the near-term as demand pressure subsides (by Feb-Mar'18) amid increasing supply pressure (as Chinese mines recommence operations). Our full year forecast for coal stands at USD95/90 ton for FY19/20E.

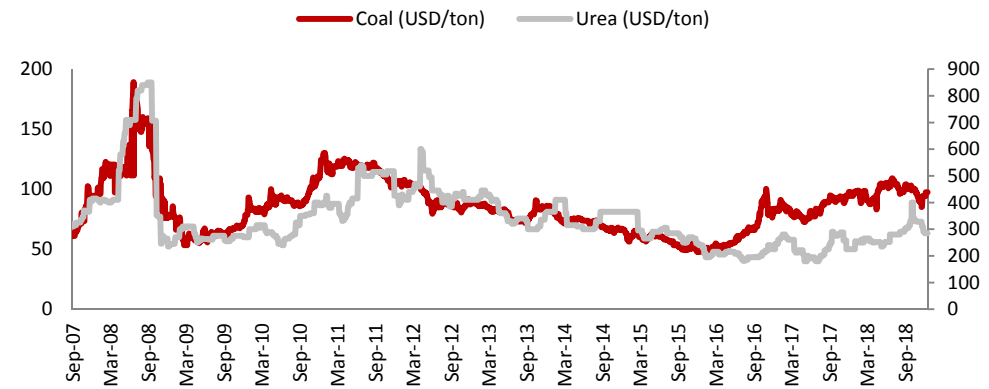
Coal prices vs. crude oil



Source: BMA Research, Bloomberg

Urea trades lower; disconnect witnessed domestically: Int'l urea prices have a strong correlation (0.698) with coal prices due to coal's usage in production of urea in China. In the past one month, however, a disconnect has been observed where int'l urea prices have come off from USD328/ton to USD285/ton (largely due to 8% dip in Brent crude prices, which is used to benchmark price natural gas, also used to produce urea) whereas, coal prices have risen 7% to USD98/ton. Currently, domestic urea prices are trading at 29% discount to int'l prices. We are not concerned on drop in international urea prices as PKR weakness is expected to maintain pricing buffer for domestic industry.

Coal prices vs. urea prices



Source: BMA Research, Bloomberg

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Buy	>20% expected total return
Neutral	0%-20% expected total return
Underperform	<0% expected total return

*Total stock return = capital gain + dividend yield

Old rating system

Overweight	Total stock return > expected market return + 2%
Marketweight	Expected market return \pm 2%
Underweight	Total stock return < expected market return - 2%

Valuation Methodology

To arrive at our period end target prices, BMA Capital uses different valuation methodologies including

- Discounted cash flow (DCF, DDM)
- Relative Valuation (P/E, P/B, P/S etc.)
- Equity & Asset return based methodologies (EVA, Residual Income etc.)