Faysal Asset Management

Oil & Gas Development Company (OGDC)

<u>Date:</u> 28st August 2012

KSE – 15,234
OGDCL – PKR 171.13

<u>OGDCL 52 week:</u>

High – PKR 178.9
Low – PKR 124.05

Shares Outstanding: 4,300.9mn
Market Capitalization: PKR 736,013
Last Full Year EPS: PKR 22.53
Price Target: PKR 200

<u>Board of Directors:</u>

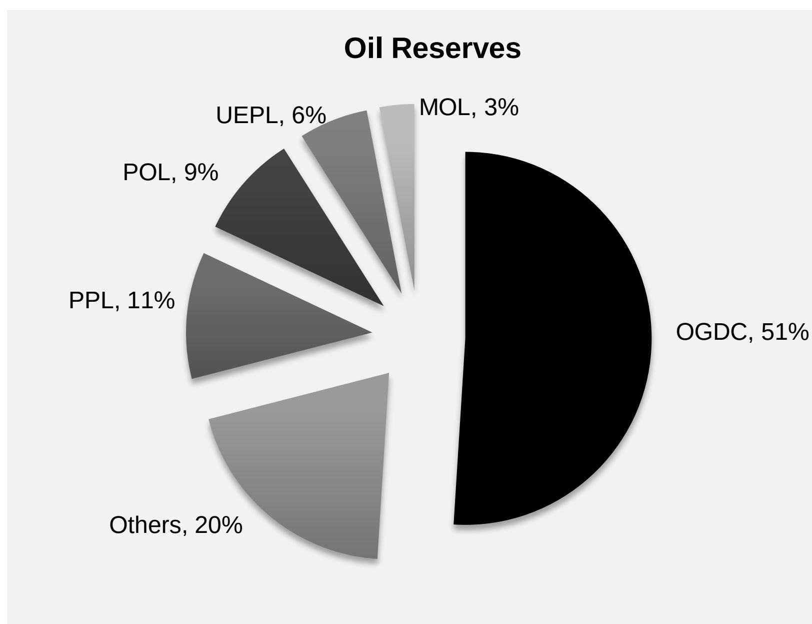
Shafi Arshad – Chairman
Masood Siddiqui
Syed Masieh ul Islam
Mir Wali Muhammad
Mohomed Bashir
Sheraz Hashmi
Iskander Mohammed
Raza Ullah Khan
Babar Yaqoob
Abid Saeed
Fahd Shaikh

Company Background

Oil and Gas Development Company Limited (OGDC) is a Pakistan-based company. The Company is engaged in the exploration, production and operations of oil and gas resources, including production and sale of oil and gas and related activities. During the year ended June 30, 2011, 21 wells were spudded. OGDCL owns 45 development and production/mining leases. OGDCL is engaged in exploring sedimentary basins including offshore areas of Pakistan. As of June 30, 2011, OGDCL operated 34 exploration blocks (22 blocks with 100% shares including an offshore block, and 12 blocks as operated joint ventures including two offshore blocks). Its projects include UCH-II project, Qadirpur Compression project, Dhakni Expansion project, Sinjhoro Development project, and Kunnar and Pasahki Deep/TAY Integrated development project.

Operating Performance

Oil & Gas Development Company delivered positive surprises on earnings and dividend in its FY12 results with EPS of PKR 22.5 and DPS of PKR 2.75. FY12 turned out to be a fruitful year with EPS growth of 53% and progress on company's growth strategy. All round improvement in (a) production (up 7%), (b) oil prices (up 15%), (c) exploration expenses (down 40%), (d) other income (up 1.8x due to heavy surplus cash+ FX gains of PKR 2.2bn) and (e) lower effective tax drove 53% bottom-line growth. Key negatives in FY12 were (a) drilling target slippage by 40%, (b) sharp receivables buildup (PKR 138bn in FY12 versus PKR 78bn in FY11) and (c) 6% jump in production cost to US$ 3.05/boe.



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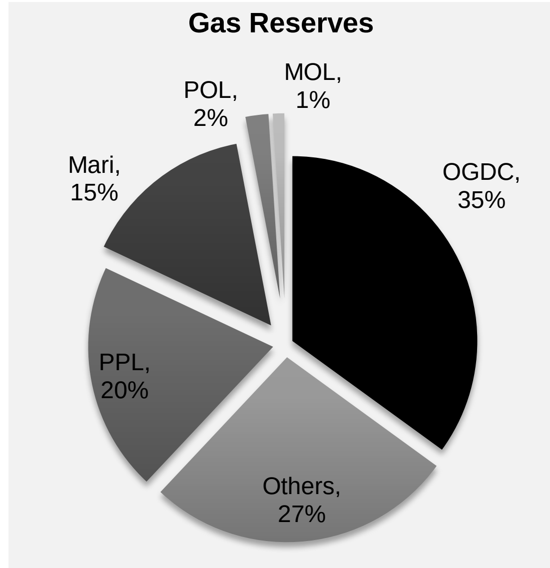
Exploration & Development Activities



OGDC presently owns largest exploration acreage which includes 34 operated blocks and 07 non operated blocks as of 31st March, 2012. Company was aggressively involve in the exploration activities historically, which is now slow down due to prevailing bad law and order situation in the country specially in Baluchistan & Khyber Pakhtunkhwa (KPK) as company has 15 operated and 3 non operated blocks in both provinces which accounts ~44% of total blocks. Despite the uncontrollable law and order situation in the country company has 10 wells were spudded in 9MFY12 which includes 1 exploratory well at Uch Deep-1B and 9 appraisal/development wells at Dhacharapur-2, Zin-2, Rajian-6, Uch-19,27,32, Qadirpur-43&44 and Pasakhi-8. Further, during the period OGDC has made two discoveries. However, company is expected to embark once again on its aggressive stance on exploration front in coming year as Government of Pakistan (GoP) is supporting oil and gas exploration industry of the country to enhance its exploration activities and production levels where currently approved 'Petroleum Policy 2012' is the clear indication of Government's intention to raise E&P activities in Pakistan. Moreover, OGDC is currently having highest success ratio in its exploration activities in the country and region as well. Present success ratio of the company is 1:3 against local industry of 1:3.5 and the regional players have 1:10.

The largest Oil & Gas Producer of the country

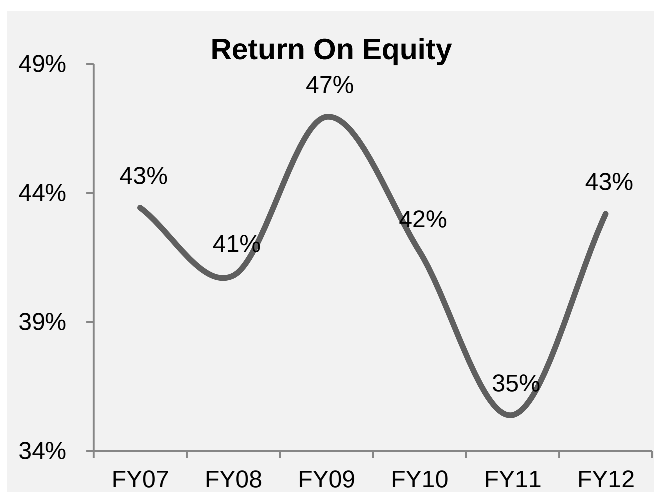
OGDC is the largest oil and gas producer of the country with the oil and gas production of ~41,000bpd of oil and 1,150mmcfd respectively accounting ~59% and 26% of the total production.

Oil Production

Oil production of the company is presently drained out through across Pakistan via ~52 oil fields which include 26 operated and 26 non operated fields in the country. The main contributor in the oil production of the company are Kunnar, Pasakhi, Nashpa, Chanda, Mela and Adhi fields which are currently producing (OGDC Share) 5,423bpd, 3,288bpd, 2,941bpd, 3,006bpd, 2,550bpd, and 2,941bpd of oil respectively. During the last five years oil production of the company has increased by ~2% mainly due to higher production from Dakhni, Mela, Kunnar, Adhi, and Manzalai which has offset the decline in production from Pindori, Dhodak and Sono during the period.

Gas Production

Gas production of the company is presently supported by its 14 operated files and 25 non operated fields. Currently company is contributing around 26% in the total production of the country. In first nine month of current financial year OGDC gas production has increased by 6.7% to 1,064 mmcfd from 1001 mmcfd last year mainly supported by higher production from Qadirpur, Nashpa, Uch, Mela and startup of production from Kunnar Pasahi Deep-Tando Allah Yar (KPD/TAY) due to completion of Phase-1. Qadirpur, Uch, Manzalai and Bhit are key fields of the company as they contributed 35.4%, 18.5%, 7.6% and 7.4% in the total production during FY11.



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Crude Oil Price

Crude oil prices remain very volatile in last three years. During the period oil prices make historic high of USD 147/bbl in July 2008 and decline to USD 38/bbl in less than six month period due to global economic turnaround. However, oil prices have stabilize in 2012 and trading in the band of USD 15/bbl to USD 100-115/bbl. The volatility in the oil prices mainly relates worldwide oil consumption backed by global economic growth and the geo political situation in the gulf region specially the relationship of US and Iran.

However, in Pakistan all E&P player realized lower crude oil prices as compared to international prices due to the fact that there are Cap on cretin field's oil prices by GOP. Historically OGDC actual realized prices remain on the lower side on Arab light due to cap on cretin fields prices. Oil prices contribute a vital role in the profitability of the company, it account for ~50% in total revenue. Whereas gas revenue contributes ~48% and remaining 2% is participated by other producers like LPG, Sulphur and Kerosene oil.

Well Head Gas Prices

Well head gas prices are continually showing inclining trend due to worsen gas crises in the country during last five years. It forces GoP to increase benefit to the Oil and Gas exploration sector, so they can enhance gas production in the country. Last five years well head gas prices of OGDC increased by GoP, ~53% to PKR 220/mmbtu from PKR 145/mmbtu previously. It played a key role in the profitability of the company.

New E&P policy may deliver long-term benefits

The government has unveiled the final version of the E&P Policy 2012. Overall, the policy provides improved oil & gas pricing terms, favorable conversion option for existing exploration leases, incentives for increasing production from producing fields and potential lower development cost for new finds. The policy should pave the way for the much-awaited bidding round for new licenses (36 licenses to be awarded).

Not many changes to the draft policy

Other than the reversion to a more price-favorable zonal system, most of the terms in the final version are unchanged compared to the draft policy. Key highlights include:

a. Though the government has not removed the ceiling on oil prices, base price for windfall levy has been pushed to US$40/bbl from US$30/bbl with the reduced windfall levy of 40%, resulting in up to 26% higher oil prices over the 2009 pricing. The new gas pricing formula results in a US$6.6/mmbtu wellhead gas price or a 32% upside over the 2009 policy pricing.

b. Requirement for constructing up to 25km2 transmission-lines removed.

c. E&P companies can convert exploration blocks and recent finds on which drilling commenced after November 2007 into the new policy. This may result in limited benefits for OGDC.

d. Subject to approval from provincial governments, an E&P firm can sell up to 10% of pipeline-quality gas to a non-government nominated buyer.

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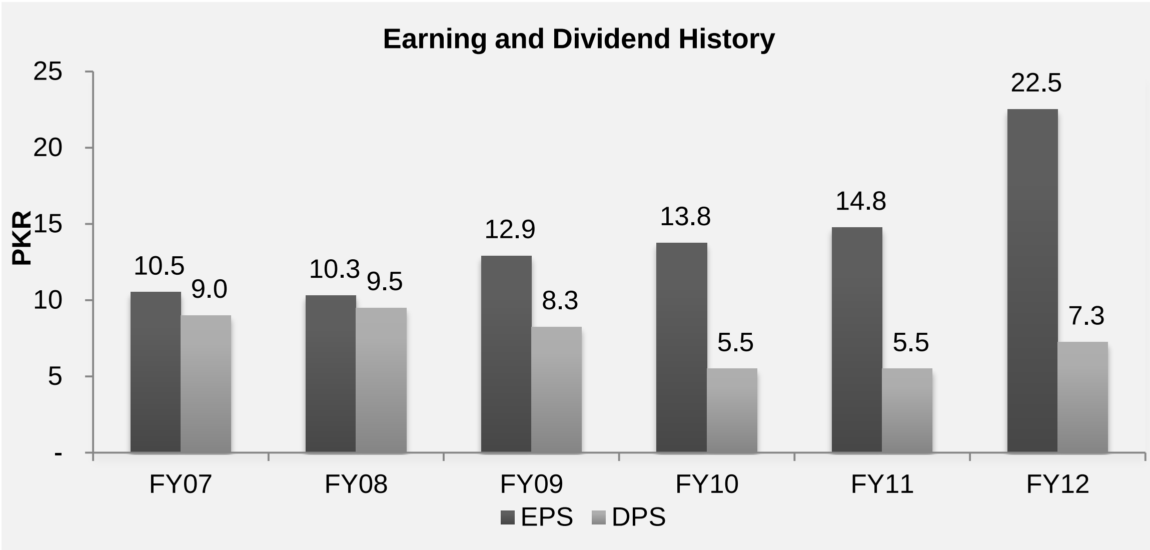

26% higher oil prices

The government has improved the formula for the calculation of realized oil prices though the ceiling of US$110/bbl on oil prices is still applicable. The base price for crude oil and condensate will be US$40/bbl. This base price for crude and condensate will escalate each calendar year by US$0.5/bbl starting from the date of first commercial production in the contracted area. In the event the Market Price of Crude Oil/Condensate exceeds US$110/bbl, the 100% benefit of Windfall Levy will pass on to the government. The ceiling would be reviewed as and when the pricing dynamics change significantly in the international market.

Three changes

There are three changes in the revised formula (1) Base price has been raised to US$40 from US$30 under the 2009 and 2001 policies (2) Windfall levy has been reduced to 40% from 50% and (3) the ceiling of US$100/bbl has been pushed to US$110/bbl. These changes will result in a maximum upside of 26% on realized oil prices with the Market Price at US$110/bbl.

Improved gas pricing terms

While the overall structure of the gas-pricing formula remains unchanged with imported crude price in Pakistan taken as a benchmark, the new policy proposes improved boundaries/scale which can result in 25-30% higher wellhead gas prices. Earlier, the draft policy proposed uniform gas prices across the country regardless of the risk and the cost involved in drilling, thereby doing away with the zonal system as contained in the previous policy. The final version has reintroduced the zonal system.

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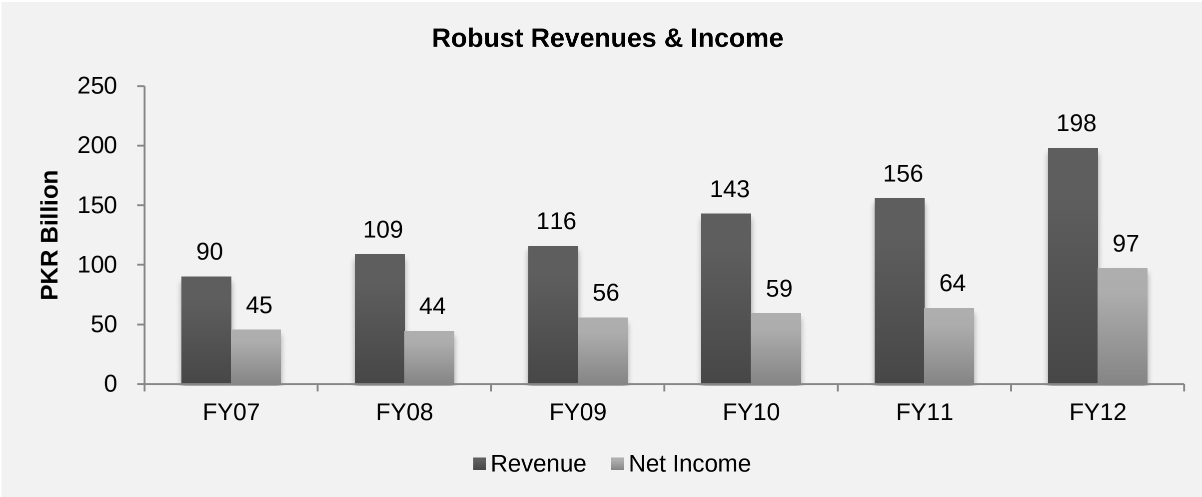

Investment Rationale

Apart from the healthy earnings growth for FY12, there are numerous triggers lined up for FY13 which would provide further stimulus to the stock price.

a) As per industry checks, Nashpa-03 has been successful with flows of 3000-3500bpd oil and 10-12mmcfd gas. Considering the success rate of Nashpa block and the region potential, the actual results may not be very different. This will have an EPS impact of PKR0.60-0.70/share for OGDC (56.45% stake)

b) According to news reports, the government is likely to revise Qadirpur gas field well-head price from USD 2.56/mmbtu to USD 3.2/mmbtu. The issue of enhancing well-head gas price for Qadirpur gas field has been pending since 2005 and Secretary Petroleum Ministry, taking notice of the issue directed concerned officials to prepare a summary for ECC's approval. The increase is likely to be effective from Jan12 which could lead to retrospective application for Jan-Jun12 in 1QFY13 if the increase is approved. The annualized incremental earnings impact on OGDC is PKR 1.3/share

c) Progress on Sara West field likely to add 100mmcfd of volume (PKR 1/share)

d) Progress on Zin 2 block (currently under appraisal stage)

e) TFC issue of PKR 82bn to reduce energy debt to represent a win-win proposition for OGDC (PKR 2.6/share) and energy chain.

f) Commencement of production from Makori East 2 (expected in September)

Based on the upbeat performance in FY12, number of positive triggers lined up for FY13 and 17% upside potential to target price of PKR 200, Research has positive stance on the scrip.