

## Pakistan OMCs

### Margins revision to augment profitability

In latest development, Economic coordination committee (ECC) has approved the increase in Oil Marketing Companies (OMCs) margins by ~63% to PKR6/litre from PKR3.68/litre on both retail fuels, i.e Motor Spirit (MS) and High Speed Diesel (HSD). Assuming current petroleum product prices, the incremental impact of increased margins will result in higher retail gross margins to 2.67%/2.55% (from 1.64%/1.56% on MS/HSD, respectively). OMCs would greatly benefit from this since it will aid them in maintaining margins on the face of higher working capital requirements, inflationary pressure and PKR devaluation. The earning impact of revised margins is given in the table. Volumetric sales of petroleum products have witnessed a slump in recent months amid lackluster economic activity and floods in southern part of the country. However, Given the recent hike in margins, we remain bullish on the sector, where APL remains our top pick.

#### Long awaited approval in margin revision is finally here

As per news reports, Power Division presented a summary for the revision of OMCs margins on MS and HSD in ECC meeting, where they approved the summary in principle, taking revised OMCs margins to Rs6/litre from PKR3.68/litre. However, there is no clarity on the date of implementation of revised margins. We opine that the revised margins will be implemented whenever there is adequate room to increase petroleum prices, arising from either lower ex-refinery prices or lower PKR/USD parity.

#### Declining oil prices to give some breathing space

International oil prices are on bearish trend due to demand slowdown and FED's aggressive tightening. This has brought ex-refinery prices of MS and HSD down by 15% and 8%, respectively in Sep-22 from its peak in Jul-22. Currently, Gov't is in tough spot on petroleum pricing front due to mounting inflation and eroding political capital. To recall, after the protest from petroleum dealers, Government decided to increase the dealer margin to PKR7/litre on both MS and HSD during July. Furthermore, in last fortnightly revision in POL prices, Govt has increased the levy to PKR50/ltr. Any reduction in crude oil prices will provide the cushion to implement this revised OMC margins.

#### Outlook

Despite slowdown on economic and volumetric front (down by 23% YoY in 1QFY23), we maintain our overweight stance on the sector attributable to revision in OMC margins, recent reduction in turnover tax and talks regarding deregulation of the sector. APL remains our top pick from the sector due to its i) Aggressive expansion plans, ii) Continuous investment in oil terminals to gain higher market share, iii) Debt-free balance sheet to ensure attractive payout and iv) Effective inventory management amid backward integration with associated companies.

#### PSO Earning sensitivity

##### Annualized impact of increase in OMC margins

PKR/sh		Volumes (mn' litres)		
		8,256	8,691	9,126
Margins	5.50	19.94	20.99	22.04
on retail	6.00	25.42	26.76	28.10
fuel	6.50	30.90	32.53	34.15
(PKR/ltr)	7.00	36.38	38.30	40.21

Source: OGRA, Insight research

#### APL Earning sensitivity

##### Annualized impact of increase in OMC margins

PKR/sh		Volumes (mn' litres)		
		1,580	1,663	1,746
Margins	5.50	14.40	15.16	15.92
on retail	6.00	18.36	19.33	20.29
fuel	6.50	22.32	23.49	24.67
(PKR/ltr)	7.00	26.28	27.66	29.04

Source: OGRA, Insight research

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

### Frequently Used Acronyms

<b>TP</b>	Target Price	<b>DCF</b>	Discounted Cash Flows	<b>FCF</b>	Free Cash Flows
<b>FCFE</b>	Free Cash Flows to Equity	<b>FCFF</b>	Free Cash Flows to Firm	<b>DDM</b>	Dividend Discount Model
<b>SOTP</b>	Sum of the Parts	<b>P/E</b>	Price to Earnings ratio	<b>P/Bv</b>	Price to Book ratio
<b>P/S</b>	Price to Sales	<b>EVA</b>	Economic Valued Added	<b>BVPS</b>	Book Value per Share
<b>EPS</b>	Earnings per Share	<b>DPS</b>	Dividend per Share	<b>DY</b>	Dividend Yield
<b>ROE</b>	Return on Equity	<b>ROA</b>	Return on Assets	<b>CAGR</b>	Compounded Annual Growth Rate

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