Pakistan OMCs

APL PA: SHEL transaction to unlock valuation

In FY22, the OMC sector witnessed impressive growth, with profitability increasing by 188% YoY, fueled by the rise in oil prices. Conversely, when oil prices started to decline, the sector faced a decline of 91% YoY in the 9MFY23. However, despite testing times, APL remained resilient and recorded a decline of only 13% YoY. This is due to APL's effective inventory management coupled with local procurement from its sister companies which shielded them from incurring major exchange and inventory losses.

We maintain a BUY stance on APL with Jun'24 target price of PKR404/sh based on DCF, depicting capital upside of ~38% along with an attractive dividend yield of ~16%. Our liking for APL stems from the following facts i) Effective inventory management, ii) Attractive payout ratio, iii) Lower exposure to circular debt, and iv) Investments in oil terminals to expend footprint & strengthen market share. To highlight, APL is currently trading at P/E of 4.6x.

Furthermore, recent development of SHEL, where major sponsor is exiting Pakistan can unlock valuations of the sector and APL's strong balance sheet and decent profitability can help in re-rating of the stock. In addition, APL is also a strong candidate for takeover backed by company's healthy balance sheet, liquidity position and group's strong presence in the country.

Key risks associated with our investment thesis include i) Increased competition in retail fuel segment, ii) Adverse movement in oil prices (inventory losses), iii) Delays in project commissioning and slower than expected retail expansion, iv) Delays in implementation of margin revision by GoP and v) Unfavorable change in regulatory framework.

Group companies to shield APL against volatility

APL has consistently outperformed its peers in terms of lower forex and inventory losses, thanks to its strong group synergies. The company procures a significant portion, averaging 65-70% between FY17-22, of its oil products from its affiliated refinery arms (ATRL & NRL) which shielded it against volatility in oil prices and exchange rate. Despite facing adverse oil movement in the 9MFY23, APL has managed to maintain its gross margins at 5.6% (9MFY22: 8.8%), while other players such as PSO and SHEL have reported lower gross margins of 2.3%/5.5% respectively. Similarly, APL recorded net margins of 2.8% in 9MFY23 whereas PSO and SHEL net margins clocked in at 0.4%/-3.8%, respectively. APL has managed to remain almost debt-free over the years, despite operating in a working-capital intensive sector, thanks to factors mentioned above.

Healthy Payout to continue

APL is the only listed player in OMC space with attractive and consistent payouts. Company's 5-year average payout ratio stands at ~72%. Company holds ample cash & short term investment of PKR15.8bn (~PKR127/share).

Attock Petroleum Limited

BUY | HOLD | SELL

We recommend BUY with Jun'24 DCF based target price of PKR404/sh, providing 38% capital upside

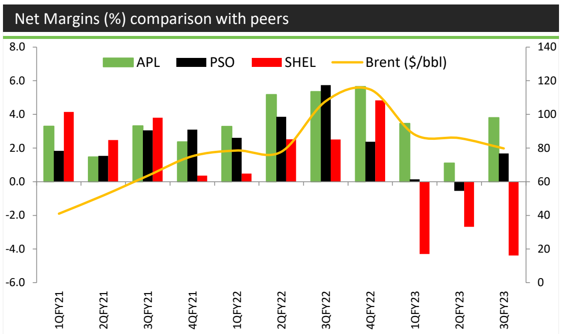
Current Price		293.5
Market cap	PKR b	36.5
Market cap	US$ m	128.1
Free Float Market cap	US$ m	32.0
30-day Avg. turnover	m Shares	0.03
30-day Avg. turnover	PKR m	9.5
52 week range	PKR/sh	275-399
Shares Outstanding	m	124
Free float	%	25%
Major Sponsors	Pharaon Investments	
Bloomberg Ticker		APL PA

Financials (PKRmn)	FY22A	FY23E	FY24E
Net Revenue	370,075	473,970	554,176
Cost of sales	329,072	452,019	539,935
Gross profit	41,003	21,952	14,241
Finance cost	1,587	2,230	2,679
Profit before tax	30,610	16,609	13,099
Profit after tax	18,536	11,065	7,990

Key Ratios	FY22A	FY23E	FY24E
EPS	149.0	88.9	64.2
DPS	45.0	52.5	48.2
P/E	1.7	3.3	4.6
Div. Yield	17.5%	17.9%	16.4%
ROE	49.7%	26.1%	18.0%
Gross margins (%)	11.1%	4.6%	2.6%

Source: Company Accounts, Insight Research

Net Margins (%) comparison with peers



Source: Company Accounts, Insight Research

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Pharaon group companies have a history of paying excess cash in the form of dividend (POL 5 year payout ratio: 88%).

Declining Volume trend

Industry oil sales fell by 26% YoY in 11MFY23 due to i) higher petroleum product prices, ii) slowdown in economic activity, iii) influx of smuggled petroleum products, and iv) lower demand of FO for power generation. At current pace, FY23 volumes will close the year at ~16.6mn tons, down by 26% YoY. With GDP expected to be rebound in FY24, oil sales are expected to recover on the back of higher economic activity coupled with lower petroleum prices. We expect 10%/4% volumetric growth in FY24/FY25 on the back of aforementioned reasons.

Strong retail network

APL's share in retail fuels (excluding HOBC) has remained relatively constant (approx. 9%) over the past 7 years, unlike its peers (SHEL and HASCOL) which have all lost market shares after touching their peak levels. APL's strategy of gradually opening retail outlets in Punjab and KPK territory (relatively less competitive than the Sindh market) and high focus towards highway sales (above 50% outlets on highway terrain) have served it well in the past.

Company is now focusing towards Sindh region with commissioning of port Qasim storage facility, we expect volumetric offtakes to improve in southern region. Based on their MS storage, allowed limit of retail outlets to be run in Sindh stands at ~1200 (40MS storage/Retail Outlet) where they have constructed only 103, as per latest available data.

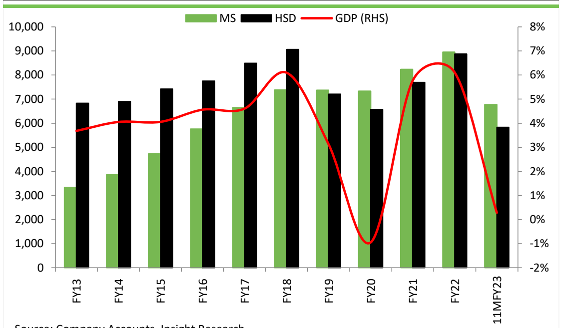
SHEL transaction to unlock valuation

In a recent notification, Shell Pakistan (SHEL) has officially announced that its major sponsor, Shell Petroleum Company Ltd (SPCo), has conveyed its intention to divest its 77.4% shareholding. Considering the current scenario, there is a possibility that APL could potentially take over SHEL due to its strong balance sheet position and backing of Foreign company (Pharon Investment). In terms of valuation, SHEL's enterprise value currently stands at PKR184/share, representing a 62% increase from the last close. We have assessed the market value of SHEL's assets, including 125 acres of land, a storage terminal with a capacity of 156k tons, and a lube blending plant, which collectively contribute PKR181/sh to the overall value. After accounting for other assets and net liabilities, the estimated value of SHEL stands at PKR184/sh.

When comparing APL with SHEL, APL possesses 127 acres of land, a storage terminal with a capacity of 192k tons, and 6 CO retail sites, surpassing SHEL in these aspects. Additionally, APL boasts a cash position of ~PKR15.6bn. Furthermore, APL demonstrates higher cashflow generation compared to SHEL, making it more attractive for potential investors.

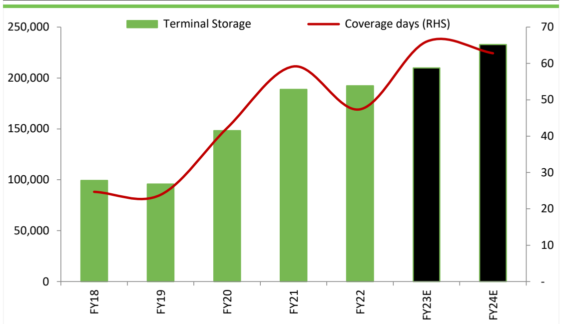
With cash position of PKR15.6bn, APL has the financial capacity to acquire a 77.4% stake in Shell Petroleum Company. According to news reports, Shell Petroleum Company is seeking a foreign company to take over SHEL, as country is facing a forex liquidity crisis and acquisition from foreign company

Industry Retail sales (000'tons) in comparsion of GDP



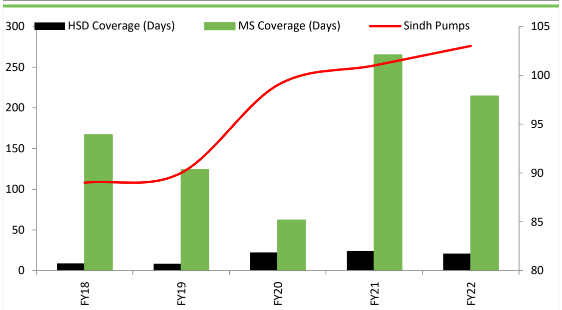
Source: Company Accounts, Insight Research

Terminal storage vs retail coverage



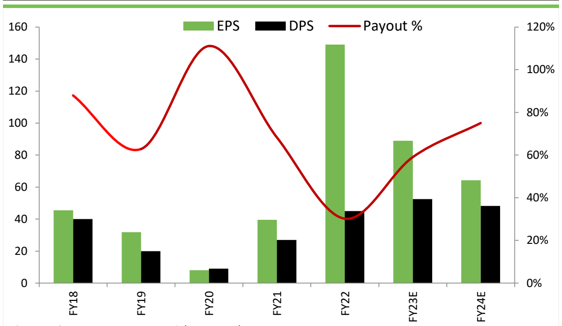
Source: Company Accounts, Insight Research

Ample storage in Sindh signals retail pump expansion



Source: Company Accounts, Insight Research

APL: DPS and Payout Ratio



Source: Company Accounts, Insight Research can smooth out the process.

Overall, the strong financial position, superior asset portfolio and ability to acquire a significant stake in Shell Petroleum Company make APL a compelling candidate for the potential takeover of SHEL.

Potential benefits of acquiring SHEL

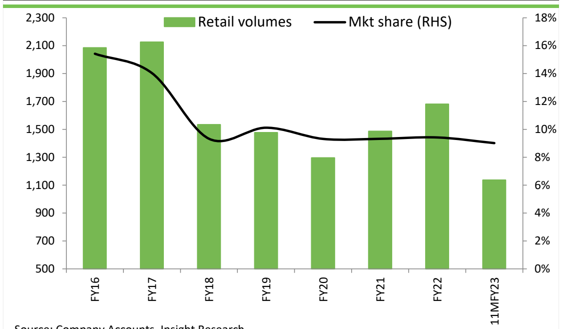
APL currently holds a retail market share of 8.5%, whereas SHEL has a market share of 9%. SHEL has a significant presence in the Sindh with a market share of ~13.3%, while APL holds only ~5.3% market share in Sindh, as per OCAC, APL is predominantly focused on the Punjab region, where it operates 499 retail locations and enjoys an market share of ~9.2% in Punjab. If APL acquires SHEL, it would significantly increase its overall retail market share to 17.5% (based on 11MFY23 data).

Furthermore, the acquisition of SHEL would provide APL with a major advantage in the lubes market, which offers attractive margins ranging from 20% to 25%. Currently, APL only holds a 1.4% share of the lube market segment, while SHEL commands a substantial share of 36% (based on FY22 OCAC report). By acquiring SHEL, APL would not only expand its retail presence but also strengthen its position in the lucrative lubes market, allowing for increased profitability and market competitiveness.

SHEL valuation (PKRmn)	
Land	32,120
Tank Storage	3,510
PAPCO	5,311
Blending Plant	3,212
Other assets	6,642
CWIP	4,893
Net Liabilities	(16,413)
Total Value	**39,274**
Value (PKR/sh)	**184**

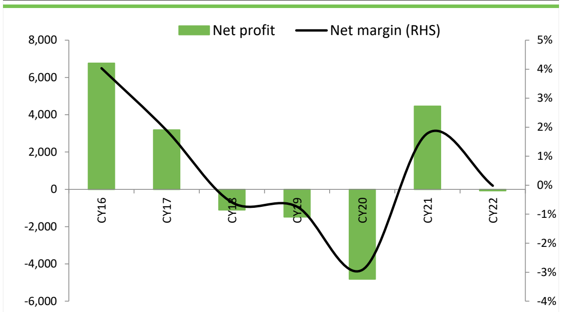
Source:Company Accounts, Insight research

SHEL: Retail volumes (000' tons) vs Mkt Share (%)



Source: Company Accounts, Insight Research

SHEL: Net profit(PKRmn) vs. Net Margin (%)



Source: Company Accounts, Insight Research

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Valuation Methodology: To arrive at our period end target prices, ISL uses different valuation methodologies including

- 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

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

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