TOPLINE

Pakistan Equity | Oil & Gas Marketing

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REP-057

Deregulation of petroleum product on cards

Competition to increase, slightly positive for OMCs

CFA Society Pakistan
Best Local Brokerage House 2015-16, FY2020

ASIAMONEY
Best Local Brokerage House Brokers Poll 2011-14, 2016-21

COUNTRY AWARDS FOR ACHIEVEMENT 2018 FinanceAsia
Best Brokerage House 2018,19-20

2019 International Finance Brokerage Awards
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Asset Asian Awards 2019 The Asset Triple A
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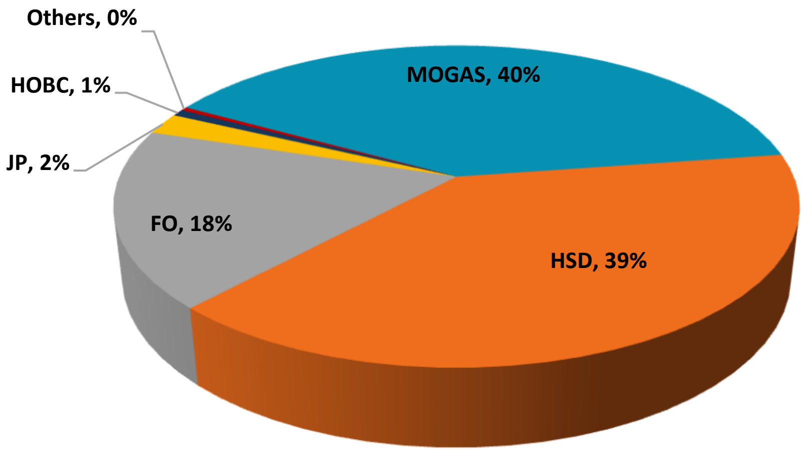
Pakistan has agreed to deregulate Petrol prices with IMF

Petrol Price Breakup (Rs/liter)

Category	1-Sep-22
Ex Refinery	183.04
IFEM	4.76
Sub Total	**187.80**
Price differential claim	0.00
Sub Total	**187.80**
OMC's Margin	3.68
Dealers Commission	7.00
Petroleum Levy	37.50
Sub Total	**235.98**
Sales Tax	0.00
Total	**235.98**

Source: OGRA, Topline Research

Product wise Consumption of Petroleum Products (in tons) in FY22

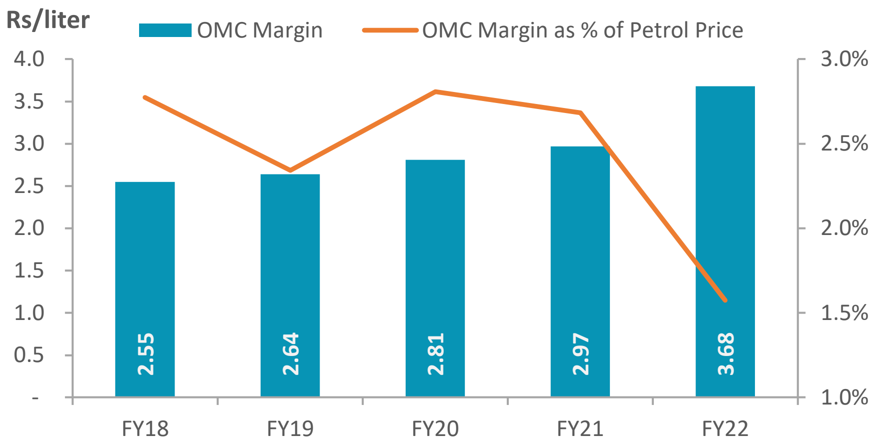


Source: OCAC, Topline Research

- Once again there are news circulating that government has decided in principle to deregulate petroleum prices. Pakistan has also agreed in principle to implement automatic pricing mechanism with IMF which will end/reduce government involvement in setting of petrol prices/margins.
- To recall, petrol prices were fixed at Rs150/liter for a period of 3-months (Apr-Jun) and huge subsidy was given which led to delay in IMF program amid slippages in fiscal targets.
- For this purpose, Oil and Gas Regulatory Authority (OGRA) has also asked for recommendations from various stakeholders. After the recommendations, OGRA would finalize the terms of reference for government’s consideration on how to advance on the deregulation of the oil sector. Then, the summary will be moved to Economic Coordination Committee (ECC) of Cabinet and Federal Cabinet for final approval.
- Deregulation of petroleum products has been considered multiple times previously but has not gone through completely due to political pressures and risk of increase in prices of petroleum products. Given the fact that there are many complexities involved, there is a likelihood that government may opt for a phase wise deregulation this time around where any single component of petrol price like OMC margin or IFEM is deregulated and than it is completely deregulated eventually.
- Currently, Petrol, Diesel, Kerosene, Light Diesel Oil are regulated whereas High Octane (high grade petrol) and Furnace Oil are deregulated.
- If government implements this deregulation policy, OMCs would be free to set their own prices on competitive basis instead of looking for fixed margins or ex-refinery prices set by the government. That said, POL prices would differ based on how far an area is from the port or refinery and depending on the import price by OMC.
- This will be in much contrast to the existing mechanism where prices are uniform across the country through the use of Inland Freight Equalization Margin (IFEM). Currently, OMC and dealers margins are also fixed in rupee term for a year by government which will be in hand of OMCs to decide post deregulation, we believe.

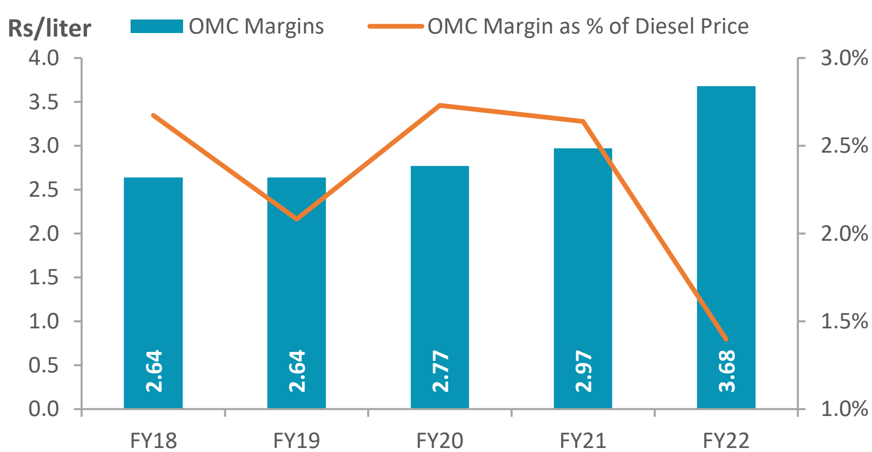
Rationale for deregulation

Declining OMC margin as % of Petrol Prices*



Source: OGRA, Topline Research; *Period End Prices and Margins

Declining OMC margin as % of Diesel Prices*



Source: OCAC, Topline Research; *Period End Prices and Margins

- Currently, OGRA takes the average of Platts oil prices, adds freight & premium, add dealer/OMC margins, & PDL/sales tax and multiply at the current exchange rate to arrive at Petrol & Diesel prices.
- OMCs are of the view that since this is based on average prices and their actual procurement price is different from average of Platts oil prices. Deregulation of OMCs will be beneficial as it will help companies to set their pricing according to their cost and will allow them to set their margins accordingly.
- OMC margins as a % of petrol prices have also come down sharply over the years due to rising oil prices and currency devaluation.
- Deregulation of the margins will also allow OMCs to independently set their margins. Currently, the regulated OMC margin on Petrol/Diesel is Rs3.68/liter.
- OMC margins as a percentage of petrol prices have fallen from 2.8% in FY18 to 1.8% in FY22 with Diesel margins also facing similar situation. Hence, OMCs have demanded government to either substantially increase the margins (from Rs3.7/liter to Rs6-7/liter) or deregulate the sector so OMCs can set prices on their own.
- When the previous government fixed petrol prices, receivables of the OMCs had also piled due to development of price differential claim (PDC) or subsidy given by the government. Deregulation of the sector will help subside this issue going ahead as prices will be automatically adjusted.

Slightly positive for OMCs

PSO Sensitivity Analysis of change in OMC margins

Increase in Margins	EPS Impact	As % of FY23 EPS
5%	2.9	4%
10%	5.9	7%
15%	8.8	11%
20%	11.7	14%
25%	14.7	18%
30%	17.6	22%

Source: Topline Research

Company & Province Wise Retail Outlets in FY21

Symbol	Total	Sindh	Punjab	KPK	Baloc-histan	Azad Kashmir	Gligit Baltistan
PSO	3,501	691	2,087	440	198	49	36
SHEL	754	206	434	77	19	17	1
APL	739	101	508	96	5	21	8
HASCOL	622	184	359	47	17	10	5
BYCO	415	165	169	37	29	8	7
HTL	23	0	23	0	0	0	0
Others	3,551	693	2,467	259	44	54	34
Total	**9,605**	**2,040**	**6,047**	**956**	**312**	**159**	**91**

Source: OCAC, Topline Research

- We are of the view that if deregulation goes through, it may lead to increased competition between the OMCs and small players could find it difficult to compete on pricing and margins with big players.
- In order to maintain their market share, OMCs will have to compromise on their margins to maintain pricing close to that of other OMCs having any cost advantage.
- Furthermore, OMCs with a dominant position in Southern part of the country like Pakistan State Oil (PSO) will be better placed as the transportation cost will be lower for them being in close proximity to Refineries. Similarly, OMCs with backing of refineries will also be well placed as they will rely on local procurement of oil and would have lesser FX exposure and working capital requirements.
- We believe this development will be slightly positive for OMCs specially for companies like PSO and Cnergyico PK (BYCO) petroleum as they not only have their backing of refineries but also have a dominant position in Sindh where most of the refineries are located making them potential winners in terms of lower transportation cost. In the Northern region, Attock Petroleum (APL) will have an advantage over others.
- Amongst major products, Petrol and Diesel are regulated and currently constitutes around 79% of the total sales volumes. Hi-Octane, which is a high grade fuel is currently deregulated. It trades at over 3-5% premium over the regulated petrol prices.
- In either case of an increase in OMC margins or deregulation of sector, a 5% increase in OMC margin could impact EPS of PSO by around 4%. On companies like APL, SHEL, and BYCO, it is expected to impact earnings by around 2-3%.
- We maintain our ‘Market Weight’ stance on OMC sector with a ‘Buy’ rating on PSO.

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