Pakistan Oil & Gas Exploration

MARI PA: Premier in E&P space

In an environment of uncertainty, where domestic currency is fast losing its value and economic slowdown has severely impacted almost all sector, E&P sector's profitability will outpace other sectors. This is mainly due to dollarized revenue stream and country's acute need for hydrocarbon production. E&P sector posted 69% earning growth in 3QFY23, mainly led by PKR devaluation, and higher gas prices. Going forward, the profitability of E&P companies is expected to increase further due to continuous depreciation of PKR against USD, as well as ongoing exploration activities that will help them to counter declining reserves.

In this space, MARI petroleum remain our top pick due to i) Continuous increase in production volumes, ii) Limited exposure towards circular debt resulting in improved cashflows as compared to its peers, iii) Decent payout ratio and attractive yield and iv) Higher reserve life. We reiterate our 'BUY' stance on the stock with reserve based Jun'24 TP of PKR2,754/sh, offering total upside of 82% from last closing. The stock is currently trading at FY24 forward P/E of 2.7.

Key risk to our valuation thesis includes: i) Lower than expected gas production, ii) Decline in crude oil prices, iii) PKR appreciation, and iv) Changes in regulatory regime.

Increasing flows using untraditional approach

In 3QFY23, the company achieved a successful commissioning of SGPC Phase-II, leading to a significant milestone of crossing 850MMCFD in gas production. Within the framework of SGPC, the company has been supplying 100MMCFD pipeline quality gas to SNGPL. Under Phase II, company has to process 200MMCFD of low BTU gas to produce 90MMCFD of pipeline-quality gas. In this, low btu gas (raw gas) of above 110MMCFD will be priced on PP-12.

Along with this, company is exporting unutilized gas to SNGPL during fertilizer plants turnaround. Company has also increased the capacity to process unutilized volumes of HRL reserves by 8MMCFD, taking total capacity of pipeline quality gas to 68MMCFD for SNGPL. This will not only increase their production but also maximizes the utilization of incremental volumes that qualify for incentive pricing (PP-12). As per our estimates, every 10MMCFD of incremental production will increase earnings by PKR12/share. We have assumed HRL production of 640MMCFD of which volumes above 525MMCFD will be priced on PP-12 policy.

Investment in Exploration to Reap Rewards

Company has been aggressively working on exploration front where they have acquired 13 new blocks, taking cumulative count to 33 blocks. In-line with company's aggressive exploration strategy, company has also made new discoveries of Mari Ghazij (5.1MMCFD) and Mari 122H (21MMCFD) which

MARI Petroleum

BUY | HOLD | SELL

We recommend **'BUY'** with Jun'24 reserves based Target Price of **PKR2,754**, providing 82% total upside

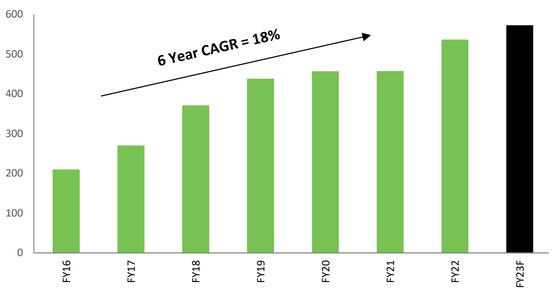
Current Price		1,515
Market cap	PKR b	202
Market cap	US$ m	709
Free Float Market cap	US$ m	142
30-day Avg. turnover	m Shares	0.04
30-day Avg. turnover	PKR m	60
Shares Outstanding	m	133
Free float	%	20%
Major Sponsors		Fauji Foundation
Bloomberg Ticker		MARI PA

Financial (PKRmn)	FY22	FY23F	FY24F
Net Sales	95,134	142,041	185,276
Royalty	12,000	17,748	23,038
Operating expenses	17,403	24,301	34,712
Operating profits	51,226	81,132	104,993
Profit Before Tax	52,116	87,910	110,822
Profit After Tax	33,063	58,358	73,862

Key Ratios	FY22	FY23F	FY24F
EPS	247.8	437.5	553.7
DPS	124.0	219.0	282.0
P/E	6.1	3.5	2.7
P/Bv	1.5	1.3	1.1
Div. Yield	8.2%	14.5%	18.6%
ROE	27%	41%	43%

Source: Company Accounts, Insight Research

Dollarized Revenue Trend (US$mn)



Source: Company accounts, Insight Research

Asad Ali[AC]

Asad.ali@insightsec.com.pk

+92-21-32462541 Ext 113

will ensure the production at optimal level. Due to lack to clarity on the execution and official level of 2P reserves, we have not accounted for additional flows from the ongoing exploration activities.

Addition of Bannu west to boost profitability

Company is in process to start the production from Shewa-1– formerly Bannu west (MARI stake: 55%) where post acid testing rate stands at 50MMCFD of gas and 300BPD of oil. Company has recently signed a gas processing contract to provide Early Production Facilities (EPF) for the Shewa-I on a turn -key basis. As per our working, Shewa-1 has an annualized EPS impact of PKR54/share (assuming Arab light: 80/bbl & Exchange rate: 285/USD). We have not incorporated the said development due to lack of clarity on the official level of 2P reserves.

Attractive dividend yield

Following the ECC's decision to lift the dividend cap in Feb-21, the company has consistently maintained a payout ratio of over 50% in both FY21 and FY22. Going forward, we expect the company to uphold a payout ratio of 50%. As the company's earnings set to cross ~PKR554/sh in FY24, we can expect MARI to pay a dividend of PKR282/sh, offering a dividend yield of ~19%.

Least affected from circular debt plague

While cashflows of exploration and production (E&P) companies are grappling with challenges due to the persistent growth of circular debt, MARI stands out as the least affected among its peers. This is mainly due to company's high exposure towards fertilizer sector with an allocation of ~600MMCFD. MARI's net receivables from gas companies currently stand at PKR23bn compared to ~PKR391bn/434bn of OGDC & PPL, respectively.

Following the launch of SGPC, the company's receivables towards SNGPL have risen to PKR20bn in 3QFY23 from ~PKR4bn in 4QFY22. We anticipate that the company's receivables from SNGPL is likely to increase, similar to OGDC & PPL. However, the impact will be minimal as only ~15% of the gas sales volumes are associated with SNGPL, making it less exposed to the effects of the circular debt.

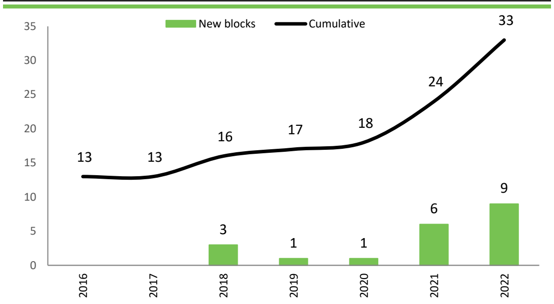
Focused towards diversification

The Company is continuously evaluating investment opportunities to diversify their portfolio. Under this, they have acquired exploration rights for Abu Dhabi's offshore block-5, with 25% equity stake. However, it will take some time to expedite things with regards to reserve size of the block. Other than that, company has approved the establishment of wholly owned subsidiary to focus on mineral mining projects within the country. We believe that these projects will support company's bottom-line in coming years.

MARI gas production (MMCFD)

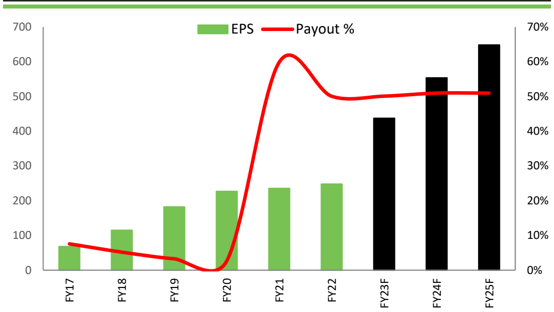
Source: Company accounts, Insight Research

Aggresive expansion in exploration portfolio



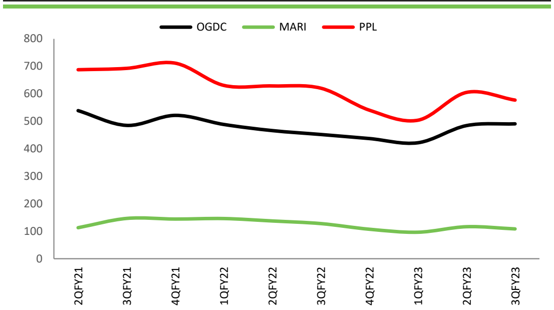
Source: Company accounts, Insight Research

Consistent Payout in last 2 year likely to continue in future



Source: Company accounts, Insight Research

Debtors day of E&P companies



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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Insight Securities (Pvt.) Limited

Suite 509, Business and Finance Centre,

I. I. Chundrigar Road , Karachi, Pakistan

+92-21-32462541-44