PAKISTAN INSIGHT

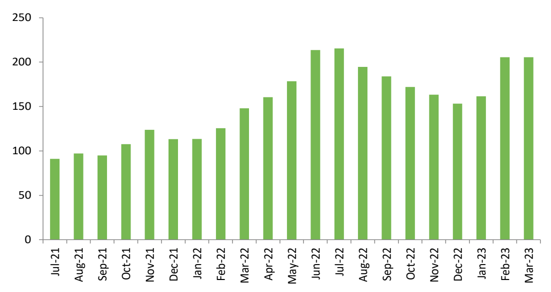
MARCH 21, 2023

Pakistan OMCs

Multiple headwinds ahead

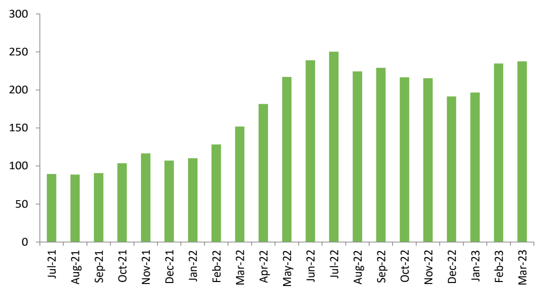
OMCs are currently confronted with several challenges that are unlikely to abate anytime soon. These challenges include i) import constraints, ii) increased L/C confirmation charges, iii) significant PKR devaluation, and iv) higher cost of working capital. OMCs have recently encountered a situation where their exchange losses are not fully adjusted, leading to a cash crunch. OMC's exchange losses are included in the fortnightly price adjustment set by OGRA, but recovery of these losses is sometimes delayed (Max: 3-4 months). This leaves companies with no choice but to borrow from commercial banks in order to maintain a minimum inventory of 20 days. In this rising interest rates environment, OMCs are facing an uphill challenge of maintaining profitability due to the escalating finance cost. However, on the flip side, recent decrease in oil prices may provide some relief to OMCs on liquidity front, but this will result in higher inventory losses in 4QFY23 since the ex-refinery prices of Motor Spirit/High Speed Diesel are expected to decline by ~13%/15% from current levels, assuming crude oil price $72/bbl and exchange rate of PKR282.

MS Ex-Refinary Price (PKR/ltr)



Source: OGRA, Insight Research

HSD Ex-Refinary Price (PKR/ltr)



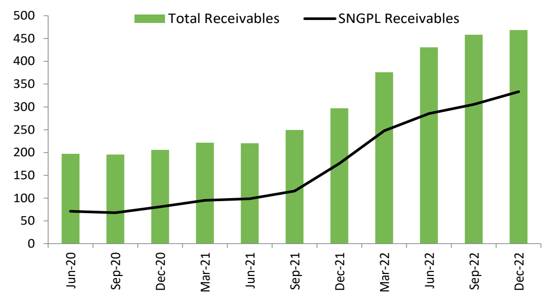
Source: OGRA, Insight Research

Multiple Worries for PSO

In our OMC universe, PSO is encountering an additional obstacle in the shape of circular debt. As per latest financial accounts, company's receivables have surged exponentially from PKR220bn in Jun'21 to PKR469bn in Dec’22 where SNGPL remains the biggest debtor with receivables of ~PKR334bn as of Dec'22, followed by GENCO/CPPA (PKR72bn), HUBCO (PKR18bn). To bridge the gap, PSO resorted to short-term borrowing which increased from PKR56bn in Jun’21 to PKR272bn in Dec’22.

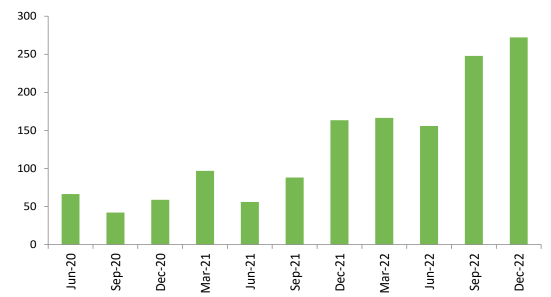
As per news flow, PSO's financial situation is deteriorating with its receivables reaching an all time high of PKR773bn (SNGPL receivables : PKR498bn). Similarly, short term borrowing has also increased to PKR411bn. Thus, with rising interest rates, finance cost is expected to reach ~PKR29bn. That said, increasing finance cost is likely to wipe out the thin bottom line. In recent development, ECC has approved extending sovereign guarantee for PKR50bn to SNGPL whose payment will be made to PSO. However, PSO has reported that even with the PKR50bn commercial borrowing, its liquidity requirements will not improve as their requirement is PKR156bn.

PSO receivables overview



Source: Company Accounts, Insight Research

PSO Short term borrowing



Source: Company Accounts, Insight Research

Brace for future

Recently, brent oil prices have come down to ~US$72.6, from average of US$88.4/bbl in 2QFY23. This will double the trouble for OMCs particularly PSO which is already struggling with higher finance charges. However, APL is likely to perform better in this case due to better inventory management, as evident from past results. As per our calculations, decline in oil prices by US$10/bbl will decrease the fuel prices by PKR20/ltr (assuming everything same).

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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

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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