

Oil & Gas Development Company

Qadirpur has more to offer

Company Update: **BUY**

Target Price: **Rs126**

Oil & Gas Producers

February 2010



JS Global Capital Limited

Last week, OGRA revised upward the provisional wellhead price of Qadirpur field by up to 32% for period ranging Jan 08 to Dec 09. After discussion with the company's management, we believe the revision mainly reflects Rupee depreciation for the respective periods. Post incorporating the recently notified provisional wellhead price of Qadirpur; our earnings estimates for OGDC have been upgraded with 7% rise in stock's target price to 126 per share. While the pricing revision is a positive development, we believe, the long pending issue of Qadirpur gas pricing discount issue is yet to be resolved which could prove to be a significant trigger for OGDC's valuation. Hence at these levels, we recommend our investors to 'Accumulate' the stock as it also offers an attractive dividend yield of 7%.

PT upgraded to Rs126 per share, more potential remains

Our upgraded target price of Rs126 per share is based on new provisional price notified by OGRA. Staying conservative, we have not yet incorporated any potential rise in wellhead price post resolution of the pricing discount issue. However, assuming a 65% discount rate to the new HSFO cap of US\$400 per ton, our valuation could rise up to Rs136 per share.

In addition, the stock also offers an attractive FY10 dividend yield of 7%. Our dividend estimate is relatively conservative as we have assumed a payout ratio of 64% compared to an average payout ratio of 85% in last 5 years. Compared to its regional peers, the stock is well placed in terms of offering attractive yields to the investors which we believe was one of the key reasons for foreign led activity in the stock during last few weeks as OGDC offered a decent arbitrage opportunity to the foreign investors with ample low cost fund to invest in global markets.

KATS Code:
OGDC

Bloomberg Code:
OGDC PA

Reuters Code:
OGDC.KA

Market Price:
Rs117.13

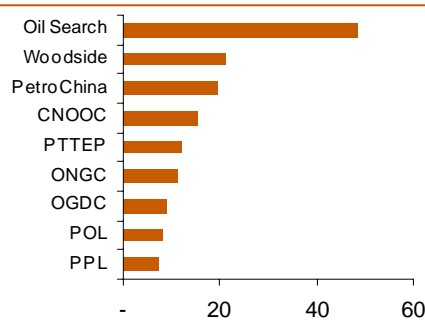
Market Cap:
Rs503.8bn
US\$5.9bn

1-yr Avg. Daily Volume:
7.9mn shares
Rs686.3mn
US\$8.1mn

1-yr High/Low:
Rs118.73/48.91

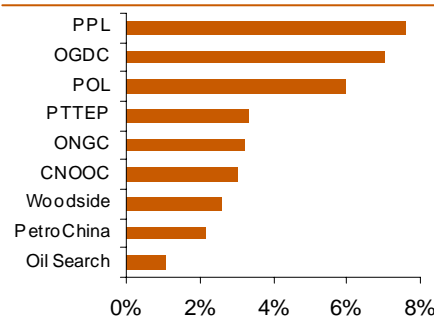
Estimated free float:
629.1mn shares (14.6%)

Graph: PE (x)



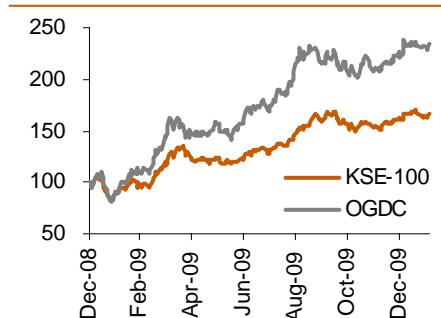
Source: JS Research, Reuters

Graph: Dividend yield (%)



Source: JS Research, Reuters

Graph: OGDC vs KSE-100 Index



Source: JS Research

Qadirpur; finally some progress on pricing

In a recent development over the long pending issue, OGRA recently has announced the revised provisional prices for the field. We believe, the upward revision in prices is mainly attributed to Rupee depreciation during the respective revision period and is applicable with retrospective effect. Based on our estimates, the revision would lead to a one time earnings benefit of Rs0.71per

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share (for prior periods until FY09). This impact is likely to be adjusted against the opening retained earnings if the company decides to recognize the price change on a retrospective basis. Moving ahead, beginning FY10 & holding the new provisional wellhead price of Rs213.17 per mmbtu constant, our annual earnings estimates would be upgraded by Rs0.7-0.9 per share.

According to Qadirpur's GSA (Gas Supply Agreement), the wellhead price formula for the field was based on first six month average international HSFO prices of the last seven month period with a series of discounts applied on the average HSFO price. In the event, where HSFO prices exceed US\$200 per ton level, the discount is to be renegotiated between OGRA and the company. So as in the period ranging Dec 2005-Jun 2006, average benchmark HSFO price stood well above the US\$200 per ton ceiling (US\$309 per ton), OGRA declared a provisional price of Rs161 per mmbtu (effective July 2007) for Qadirpur field until a new set of discount is approved by the government.

What if the issue is resolved completely?

As per FY09 company accounts, OGDC has already agreed a discount table with the relevant authorities for wellhead prices till US\$400 per ton, however, the formal notification of extension in discount table is still awaited. The final resolution of this pending issue could be a significant positive trigger for the company. Though, the international HSFO prices are currently hovering in the range of US\$600 per ton, the pricing would remain capped at US\$400 per ton (as the discount slabs are worked out till US\$400 per ton). Since, it is difficult to estimate the discount level to be applied on HSFO price at US\$400 per ton level; we have performed valuation sensitivity at various discount levels.

Valuation Sensitivity of discount over capped HSFO price (US\$400 per ton)

Discount over capped price	Wellhead price (Rs per mmbtu)	Valuation (Rs/share)
50%	416.70	150
55%	375.10	145
60%	333.39	141
65%	291.72	136

Source: JS Research

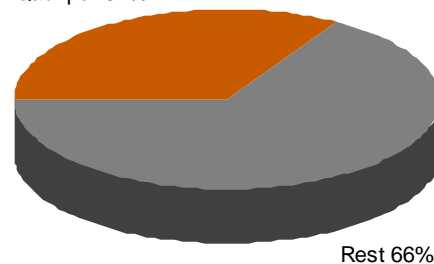
Since the current provisional price of Rs213 per ton is at a 74% discount to the proposed capped price of US\$400 per ton, we believe the final pricing arrangement would offer a discount of 65% at the cap price – the most conservative scenario in our sensitivity. Even in that case, our target price would reach Rs136 per share (16% upside from last closing).

Cash recovery of price increase

In order to recover the outstanding Rs8.8bn as gas price differential till Dec 2009, OGDC would record receivables against SNGP. SNGP in turn would seek an adjustment in its prescribed gas prices which could take a while before any decision is made. Hence we believe, although OGDC, would record an accounting adjustment soon, the receipt of actual cash would take sometime. However, OGDC would be required to pay royalty and tax on this amount as well and there is a possibility that SNGP's payment to OGDC would be a net amount of Rs4.5bn adjusted of these considerations.

Qadirpur's share in OGDC prod.

Qadirpur 34%



Source: JS Research

Qadirpur's revised well head gas prices

Period	Rs/MMBTU
January - June 2008	167.06
July - December 2008	185.96
January - June 2009	213.59
July - December 2009	213.17

Source: Company notice

Key Risks:

Litigation leading to delays in development: At present, progress on OGDC's various development projects is ceased or delayed due to pending litigation issues dragging company's production enhancement plans. The most highlighted amongst these is the Qadirpur project for installation of compression facility for improving fields output. The installation of front end facility is ceased due to litigation issues with China Petroleum Engineering which was suppose to complete the installation on the facility this year. As per the management, OGDC with the help of NR Petrotech and SNGPL is currently working to install an interim compression facility to maintain the flow from the field. The implementation of this project is expected to be completed by September 2010, after which the cumulative gas flow from the field, is expected to reach 600mmcf.

Bidding process on Sinjhora and KPD-TAY development projects is also pending due to litigation issues. The two projects are expected enhance production by around 7,000bpd oil, 300mmcf gas and 500M ton per day of LPG. Both projects have an estimated implementation period of around 2 years.

Circular Debt could affect Payout: With the accumulation of inter corporate debt in the country there are concerns regarding the liquidity situation and payouts from energy companies. Amongst E&Ps OGDC has been most affected being the major local supplier to cash lacking refineries. Although with the persistent rise in power and gas tariffs, removal of subsidies under the guide lines of IMF program and lending for budgetary support from IMF, the government is in a relatively better position to resolve the issue, however, we believe it could take a while before the issue is resolved. Resultantly, OGDC could limit its payout in the medium term to manage its cash flows.

FCFE projections

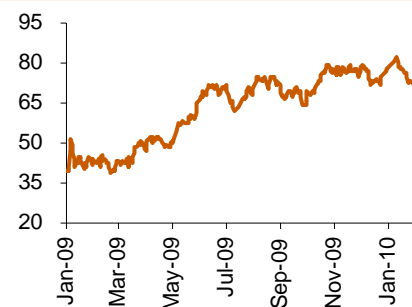
(Rs mn)	FY09A	FY10E	FY11F	FY12F
Profit after tax	55,482	55,161	65,813	69,797
Non Cash Expense	9,091	11,155	14,428	18,429
	64,573	66,316	80,241	88,226
Working Capital	(9,812)	(302)	(2,492)	(3,697)
	54,761	66,014	77,749	84,529
Capital Expenditure	(27,701)	(26,102)	(30,014)	(31,840)
	27,061	39,911	47,735	52,689
Financing	-	-	-	-
FCFE	27,061	39,911	47,735	52,689
FCFE/Share	6.3	9.3	11.1	12.3

Source: JS Research

Assuming capital expenditure of Rs26bn, OGDC is likely to generate free cash flow worth Rs40bn (Rs9.3 per share) in FY10. Based on this, the company could limit its dividend payment to Rs8.25 per share (payout ratio of 65%).

Volatility in oil prices: With rising volatility in the international oil prices, Arab Light crude prices so far in FY10 have hovered in the range of US\$61.7 – US\$81.6 averaging at US\$73 per barrel. Though, our Arab Light price estimate for FY10E, FY11F, FY12F currently stands at US\$73, US\$76 and US\$77 per barrel, respectively, any significant change in the crude price movement could compel us to revise our forecasts. As per our analysis, a US\$1 per barrel change in oil price forecast would impact OGDC's earnings estimate by 0.5%.

Graph: Arab light price



Source: Reuters

Oil & Gas Development Company – Financial Highlights

Year ended June (Rs mn)	FY08A	FY09A	FY10E	FY11F	FY12F
Income Statement					
Net Sales	125,908	130,830	135,487	161,490	175,241
Operating Costs	16,125	17,987	19,102	20,787	22,267
Royalty	17,320	15,156	14,604	16,369	17,845
Ammort of Exploration cost	1,473	1,522	1,689	1,841	1,970
Exploration Costs written off	6,613	7,460	7,840	9,486	10,759
Gross profit	84,377	88,704	92,252	113,007	122,400
Admin Expenses	1,249	1,333	1,480	1,613	1,726
Operating Profit	83,129	87,371	90,772	111,395	120,674
EBIT	79,119	81,796	84,233	100,275	105,887
PBT	78,582	80,870	83,205	99,155	104,688
PAT	44,613	55,482	55,161	66,309	70,320
Balance Sheet					
Paid up capital	43,009	43,009	43,009	43,009	43,009
Reserves	63,903	79,504	98,810	118,554	139,493
Shareholder's Equity	106,912	122,513	141,819	161,563	182,502
Long term liabilities and others	23,959	34,192	38,992	42,870	47,196
Current liabilities	21,439	21,287	17,974	20,910	22,830
Total Liabilities & Equity	152,309	177,992	198,785	225,343	252,529
Total Fixed Assets	72,486	91,158	106,105	121,691	135,102
Total current assets	79,824	86,835	92,680	103,652	117,426
Total Assets	152,309	177,992	198,785	225,343	252,529
Ratio Analysis					
Valuation					
Earning per share	10.4	12.9	12.8	15.4	16.3
Dividend per share	9.5	8.3	8.3	10.8	11.4
Book value per share	24.9	28.5	33.0	37.6	42.4
Price to earning ratio (x)	10.1	7.0	9.1	7.6	7.2
Dividend yield	8.1%	9.2%	7.0%	9.2%	9.8%
Price to book value (x)	4.7	3.1	3.6	3.1	2.8
Profitability					
Gross margin	67.0%	67.8%	68.1%	70.0%	69.8%
Operating margin	66.0%	66.8%	67.0%	69.0%	68.9%
Net margin	35.4%	42.4%	40.7%	41.1%	40.1%
Return on assets	29.3%	31.2%	27.7%	29.4%	27.8%
Return on equity	41.7%	45.3%	38.9%	41.0%	38.5%
Momentum					
Sales growth	25.5%	3.9%	10.3%	11.9%	8.5%
PBT growth	28.6%	2.9%	12.1%	9.3%	5.6%
Net profit growth	-2.4%	24.4%	9.3%	9.4%	6.0%

Source: JS Research & Company Accounts

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