ARIF HABIB LIMITED

REP-300

# Continuous Flight of Global Oil Prices

## Impact on Pakistan’s Economy and Sectors

09-Mar-2021

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Best Corporate & Investment Bank: 2020

ASIAMONEY

Best Domestic Equity House

PSX PAKISTAN STOCK EXCHANGE LIMITED

Top 25 Companies

CFA Society Pakistan

Corporate Finance House of the Year: 2020

CFA Society Pakistan

Best Equity Research Analyst: 2020

# Continuous Flight of Global Oil Prices

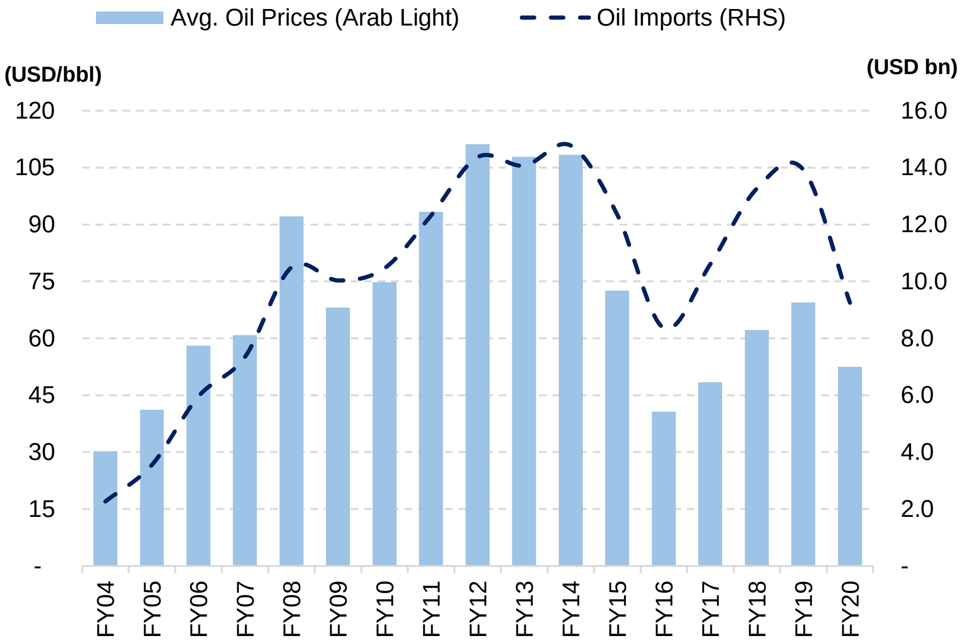
## Factors Leading to Oil Price Hike

Oil prices have been on a northward trajectory since Feb'21TD as WTI, Brent and Arab light prices are up 21%, 21% and 24%, respectively. This trend in oil prices is owed to a variety of reasons which have emerged during the last one and half month including:

1) Production disruption in the US in the wake of a snow storm that hit a major part of the US and particularly Texas which led towards a halt in US production, while on the other hand increasing demand due to severe weather,
2) COVID-19 demand recovery with vaccine roll out underway globally,
3) Decision of the OPEC+ to maintain supply cuts (except a meager increase of 150k bopd) for the month of Apr'21, and
4) Attacks on the oil facility at Ras Tanura in the Kingdom of Saudi Arabia (KSA) by Yemeni Houthi rebels.

We have analyzed the impact of oil price increase on Pakistan's macro-economy and listed sectors.

**Exhibit:** Historical Trend of Oil Prices and Oil Imports




Source (s): SBP, Bloomberg, AHL Research

# Continuous Flight of Global Oil Prices

## Macro-economy

During FY21 to date, oil prices have remained upbeat (Brent, WTI and Arab Light have increased 65.8%, 65.6%, and 95.1% YTD, respectively).

The rising international oil prices adversely affect economies like Pakistan whose major imports comprises of oil and oil products (17.6% of Total Import in 7MFY21). Pakistan heavily relies on oil as an input to the industrial, transport and power sector. This means, a hike in the oil price translates into an increase in the production costs, resulting in declining productivity due to higher cost of input (oil). This consequently results in decline in the consumption level, investment and economic growth of the country.

Broadly speaking, rise in crude oil prices means higher subsidy burden on the fiscal front and increasing pressure on external account. Moreover, some burden of this would eventually tip down to many other manufacturing companies and to some extent to the agricultural sector as well, hence growth may witness a slowdown. Specifically, a general hike in key macro risks, means it would eventually become difficult for Pakistan to come to terms with quantitative targets set by IMF such as power sector subsidies and FX reserve positions. Continued increase in oil prices and imported price inflation could all potentially tick up the domestic oil prices and other general prices in the economy. On external side, we estimate that every USD 10/bbl crude oil price increase, could cost an additional USD ~1.9bn in the import bill.

**Exhibit:** Historical Energy Imports

| Year | Qty (mn Ton) | Oil Import Bill (USD bn) | Avg. Price (USD/bbl) | RLNG Import Bill (USD bn) | Avg. Price (USD/MMBTU) |
|---|---|---|---|---|---|
| FY18 | 26.98 | 11.71 | 58.24 | 2.78 | 10.62 |
| FY19 | 20.28 | 10.85 | 71.85 | 3.80 | 11.51 |
| FY20 | 17.43 | 7.44 | 57.34 | 3.08 | 10.14 |
| 7MFY21 | 13.49 | 4.09 | 40.72 | 1.67 | 7.47 |

**For every USD 10/bbl higher Oil Prices**

| USD bn | Oil Bill | Incremental Oil Bill | RLNG Bill | Incremental RLNG Bill | Incremental Total Bill |
|---|---|---|---|---|---|
| FY18 | 13.72 | 2.01 | 3.18 | 0.39 | 2.40 |
| FY19 | 12.37 | 1.51 | 4.30 | 0.50 | 2.01 |
| FY20 | 8.74 | 1.30 | 3.53 | 0.45 | 1.75 |
| 7MFY21 | 5.10 | 1.00 | 2.00 | 0.34 | 1.34 |
| **Average** | | **1.46** | | **0.42** | **1.88** |

Source (s): PBS, OGRA, AHL Research

# Continuous Flight of Global Oil Prices

## Macro-economy

Since start of FY21, aligning with international oil prices trend, the government has revised up POL prices by an average 47% to date (Gasoline +50% to PKR 111.9/ltr, HSD +45 % to PKR 116.1/ltr) and there are prospects of more to follow soon given the sharp increase in international oil prices. Headline inflation as measured by CPI printed 8.27% YoY growth during the first eight months of FY21, compared to 11.7% YoY same period last year. However, despite the sizable increase in oil price, trying to ball-park a ‘direct’ impact on inflation would be rather insignificant. Primarily, we say this due to a smaller weightage of Motor Fuel in price basket (2.75%). Henceforth a 4% increase in motor fuel would hike CPI by 0.1% alone. However, since oil prices have a price roll-over impact, wherein an ‘indirect’ impact of the price hike would be even more.

# Continuous Flight of Global Oil Prices

## Local E&Ps to Benefit the Most

### E&Ps (Positive)

The upward movement in oil prices is positive for local E&P companies. Below is the sensitivity of every USD 5/bbl change in oil prices on the AHL E&P universe with oil price ranging between USD 55 to USD 80/bbl.

**Exhibit:** AHL E&P Universe Oil Price Sensitivity

| | USD 55 | USD 60 | USD 65 | USD 70 | USD 75 | USD 80 |
|---|---|---|---|---|---|---|
| **OGDC** | | | | | | |
| FY22 EPS | 28.06 | 30.01 | 31.97 | 33.92 | 35.88 | 37.83 |
| Target Price | 196.6 | 206.0 | 215.5 | 225.0 | 234.4 | 243.8 |
| **PPL** | | | | | | |
| FY22 EPS | 21.43 | 22.41 | 23.42 | 24.43 | 25.43 | 26.40 |
| Target Price | 153.7 | 158.0 | 162.3 | 166.9 | 171.1 | 175.0 |
| **POL** | | | | | | |
| FY22 EPS | 64.43 | 68.89 | 73.35 | 77.82 | 82.28 | 86.74 |
| Target Price | 584.6 | 612.6 | 640.5 | 668.5 | 695.5 | 722.5 |
| **MARI** | | | | | | |
| FY22 EPS | 254.06 | 260.40 | 266.74 | 273.08 | 279.42 | 285.76 |
| Target Price | 2,035.2 | 2,107.8 | 2,180.4 | 2,253.1 | 2,318.4 | 2,383.6 |

Source (s): AHL Research

# Continuous Flight of Global Oil Prices

## Other Sectors

**Banking Sector (Neutral to Positive)**

With increasing oil prices, the inflationary reading is also expected to move in tandem leading towards a possibility of an earlier than expected rate hike.

**Cement and Steel (Neutral)**

Domestic cement and steel players may pass on the impact of higher coal and steel raw material prices assuming movement inline with oil prices, given buoyant demand and economic activity at large.

**Power Sector (Neutral)**

Increasing oil prices have a neutral impact on the profitability of the power sector as the fuel component is a pass-on item in an IPP tariff. However, as dependency on furnace oil based IPPs is very low (4% of total generation during the last 12 months) and Pakistan is only utilizing local FO production, the impact on IPPs tariff would be minimum, in our view. However, given that the country has given long term contracts for import of RLNG, whose price is dependent on 3-month average Brent prices, along with our dependency on RLNG based power plants (RLNG based generation: 20% of total generation during the last 12 months), we may see an increase in power tariff with a lag which is negative for local manufacturing industries.

**Oil Marketing Companies and Refineries Sector (Neutral to Positive)**

Oil marketing companies and refineries are likely to witness a one-time inventory gain in 3QFY21 due to higher oil prices.

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## Other Sectors

**Textile Sector (Mixed)**

The increase in oil prices will have a mixed impact on local textiles, assuming increase in international cotton prices which may lead towards higher margins for the spinning sector while reduced margins for value added sector as their input costs will increase. Moreover, the gov't has fixed prices for RLNG (USD 6.5/mmbtu) and subsidized electricity rates for export oriented sectors, therefore higher prices should not affect the sector.

**Autos (Neutral)**

Assuming increase in steel prices, the impact is expected to be neutral contingent upon passing the same to the end consumer.

**Chemicals (Neutral to Positive)**

Higher oil prices could augment raw material costs and end product prices of the petro chemical chain albeit, end product prices are more dependent on various demand-supply dynamics.

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Equity Research Ratings
Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as Dec'21 for Target Price. In addition, return excludes all type of taxes. For more details kindly refer the following table;

| Rating | Description |
|---|---|
| BUY | Upside* of subject security(ies) is more than +10% from last closing of market price(s) |
| HOLD | Upside* of subject security(ies) is between -10% and +10% from last closing of market price(s) |
| SELL | Upside* of subject security(ies) is less than -10% from last closing of market price(s) |

* Upside for Power Generation Companies (Ex. KEL) is upside plus dividend yield.

**Equity Valuation Methodology**
AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- Discounted Cash Flow (DCF)
- Dividend Discount Model (DDM)
- Sum of the Parts (SoTP)
- Justified Price to Book (JPTB)
- Reserved Base Valuation (RBV)

**Risks**
The following risks may potentially impact our valuations of subject security (ies);

- Market risk
- Interest Rate Risk
- Exchange Rate (Currency) Risk