11 January 2022

Oil & Gas Development Co. (OGDC PA)

Wali discovery: Promising to be a material addition

In July 2021, Oil & Gas Development Co. (OGDC) notified a discovery in the exploratory well, Wali-1 (KPK). The well initially flowed about 1,000bpd of oil and 12mmcfd of gas – from one of three formations (Kawagarh, Hangu and Lockhart). Note that the well is located in close proximity to two of Pakistan's largest oil assets – Nashpa and Tal block – both of which produced over 20,000bpd of oil at peak. OGDC has 100% stake in Wali block.

Flows have improved significantly

A recent news report indicated that the total production from the three formations is about 3x the initial flow – 2,950bpd oil and 36mmcfd gas – which translates into an earnings impact of c.PKR2.5/sh for OGDC (c.9% of FY23f EPS). As per management guidance, production from the field will start upon successful negotiations with the gas utility, SNGPL, for future offtake, which may take about a year's time. Also, timing of production from all three formations will depend on the success of future wells drilled at the block. Conservatively, we assume that the well will start producing from the Lockhart formation with c.1,000bpd oil and 15mmcfd gas – equivalent to about PKR1.0/sh in earnings.

Indication of large reserves

We understand that the initial estimate of reserves of the discovery is similar to earlier estimates of Nashpa (the largest oil asset of OGDC which contributes c.22% of total oil output); but this can be ascertained only with further drilling in the block. OGDC plans to spud an appraisal well by June 2022. We also await PPIS Reserves data for December 2021 for more clarity.

Nashpa was discovered in 2009 by OGDC; its initial flows were about 7,000bpd of oil from two formations. Wali's total production is estimated to be less than half of that. But findings from the appraisal well Wali-2 and the field's development plan will determine its future production trajectory. In case of Nashpa, OGDC drilled five more wells in the block after the discovery until July 2016, which led to peak oil production of over 25,000bpd by January 2017.

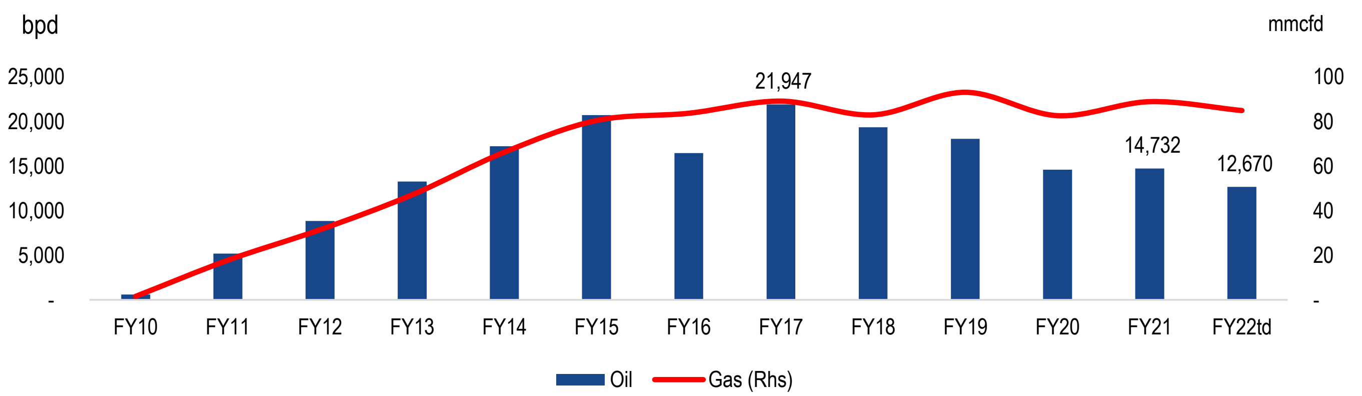
Given that production at Tal block and Nashpa have been depleting fast in recent years, we think it will be easier for OGDC to sell the crude oil from Wali to North based refineries in Pakistan (in case it produces more than 5,000bpd in a few years), in our view.

Can help with price discovery for the stock

While it is still very early in the development of Wali, it is nonetheless an exciting prospect for OGDC, which is otherwise plagued by deep undervaluation due to circular debt. Note that oil contributes much less to the buildup of circular debt than it did before 2018, as there is now much more power generation on coal and RLNG than on furnace oil. We think if the discovery ultimately produces more than 5,000bpd of oil (c.14% of present total oil output of OGDC), it will prove to be a more durable catalyst for price discovery for the stock than any circular debt injection by the government.

We have a Buy rating on OGDC with a June 2022 TP of PKR165/sh. The stock is trading at very undemanding valuations – FY22f P/E of c.3.0x and EV/EBITDA of less than 2.0x.

Nashpa has been one of the most lucrative discoveries in Pakistan in the past 20 years



Source: PPIS, IMS Research

Muhammad Saad Ali, CFA
saad.ali@imsecurities.com.pk
+92-21-37131610

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Ratings Guide*	Criteria
Buy	Total return expectation of ≥ 15% or expected to outperform the KSE-100 index
Neutral	Total return expectation of > -5% or expected to match the return of KSE-100 index
Sell	Expected downside of more than 5% or expected to underperform the KSE-100 index

*Based on 12 month horizon unless stated otherwise in the report.

Valuation Methodology: We use multiple valuation methodologies in arriving at a Target Price including, but not limited to, Discounted Cash Flow (DCF), Dividend Discount Model (DDM) and relative multiples based valuations.

Risks:(i) Rise in circular debt amid high oil prices – leading to dividend cuts, (ii) GoP reviving plans to sell stake in the company, and (iii) depletion at mature fields accelerates.

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