Oil Marketing Companies

OCTOBER 2017

INDUSTRY STRUCTURE

Since 2016, Oil and Gas Regulatory Authority (OGRA) has issued 11 new marketing licenses taking the total number of Oil Marketing Companies (OMCs) to 22 (FY16: 11) as at end-FY17. OGRA also granted 12 construction licenses to new firms. Subject to compliance with regulatory requirement for storage capacity, these licenses may be converted to marketing licenses in coming years. Despite new entrants, industry structure has remained at a semi-oligopolistic level, with few players dominating the market.

Table 1: Oil marketing licenses holders

	Name	Permitted Region
1	Pakistan State Oil Company Limited (PSO)	Nationwide
2	Shell Pakistan Limited (Shell)	Nationwide
3	Attock Petroleum Limited (APL)	Nationwide
4	Byco Petroleum Pakistan Limited (Byco)	Nationwide
5	Admore Gas Private Limited (Admore)	Nationwide
6	Total Parco Marketing Limited (TPML)	Nationwide
7	Total Parco Pakistan Limited (TPPL)	Nationwide
8	Bakri Trading Company Limited (BTCPL)	Nationwide
9	Hascol Petroleum Limited (Hascol)	Nationwide
10	Askari Oil Services Private Limited (AOSPL)	Punjab & KPK
11	Zoom Petroleum Private Limited (ZOOM)	Punjab
	New OMCs	
12	Hi-Tech Lubricants Limited (HTL)	Nationwide
13	Exceed Petroleum Private Limited (XPPL)	Punjab
14	Horizon Oil Company (Private) Limited (HOCPL)	Punjab
15	Quality-1 Petroleum (Private) Limited (QPPL)	Punjab
16	Outreach (Private) Limited (OPL)	Punjab
17	Z&M Oils (Private) Limited (ZOPL)	Punjab
18	Oilco Petroleum (Private) Limited (OPPL)	Punjab
19	Gas & Oil Pakistan Private Limited (GO)	Punjab & Sindh
20	Petrowell (Private) Limited (PETRO)	Sindh
21	Kepler Petroleum (Private) Limited (KPL)	Sindh
22	Fast Oil Company (Private) Limited (FOCL)	Sindh

During FY17, Pakistan State Oil Company Limited (PSO) retained its position as the largest OMC with a market share of 54.4%, though declining over past three fiscal years. Along with PSO, five major players including Shell Pakistan Limited (Shell), Total Parco Marketing Limited/Total Parco Pakistan Limited (Total), Attock Petroleum Limited (APL) and Hascol Petroleum Limited (Hascol) account for almost nine-tenth of industry sales. Over past year, increase in foreign interest has been observed with Trafigura Group Pte Ltd (a Singaporean multinational commodity trading firm) acquiring 51% stake in Admore Gas Private Limited[1] and Vitol Dubai Limited (subsidiary of The Vitol Group, a global energy and commodity trading company) increasing its shareholding in Hascol to 25%.

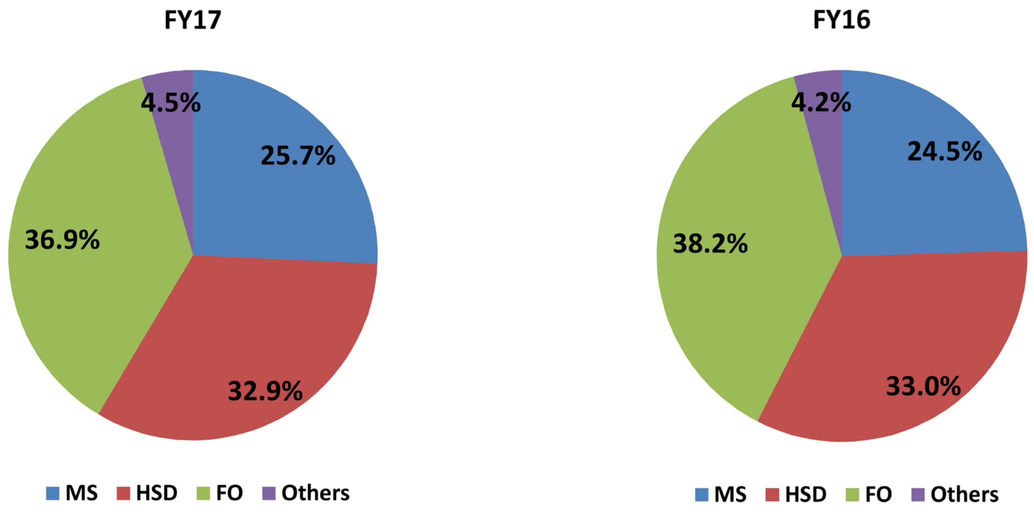
1) *https://profit.pakistantoday.com.pk/2017/08/21/trafigura-to-acquire-51pc-stake-in-pakistani-oil-marketing-company-admore/*

Demand and Supply

RETAIL FUELS DEPICT HEALTHY GROWTH; FO SALES SLOWDOWN DUE TO LNG AND COAL SUBSTITUTION

Transportation segment is the largest consumer of petroleum products followed by power sector. Over past five years, petroleum sales increased at a compounded annual growth rate (CAGR) of around 5% to 26.1m tons (FY16: 23.5m tons). Growth of 11% during FY17 was higher than 3.5% in preceding fiscal year primarily due to higher retail (MS and HSD) fuel consumption.

Figure 1: Product-wise distribution of petroleum sales



During FY17, sales volumes for HSD depicted largest growth followed by MS and FO. HSD sales increased due to low prices along with infrastructural development spending by Government of Pakistan (GoP) which translated into higher consumption by industrial vehicles. Demand for MS was supported by healthy automobile off-take and low prices (better purchasing power). In contrast, FO sales growth was subdued as power generation mix tilted towards cheaper Liquefied Natural Gas (LNG) and coal. LNG imports have increased post commissioning of the country's first LNG terminal by Engro Elengy Terminal Private Limited in August 2016 with 600mmcfd of imports. Going forward, GoP plans to ramp up LNG imports to 2bcfd over next two years.

As per Oil Companies Advisory Committee (OCAC), volumetric sales of petroleum products are estimated to reach 31.8m tons by 2021. OCAC has projected volumes of both, MS and HSD to grow at CAGR of 10% over next five years while FO demand is estimated to stay at current levels. Growth in car sales, rising income levels and low prices are expected to drive retail volumes while FO sales will be impacted by substitution with cheaper fuels such as LNG and coal.

CONTINUED DEPENDENCE ON IMPORTS

Currently, around two-thirds of domestic demand is met through imports while remaining demand is catered by local refineries. Since OMCs are required to maintain minimum inventory levels, rising/declining crude oil prices lead to inventory gains/losses for OMCs thereby affecting their earnings. In view of declining crude oil rates during FY14-16, the OMC sector booked sizeable inventory losses over the period. However, the same have been curtailed in FY17 on account of relatively stable crude oil prices.

REGULATIONS AND PRICING MECHANISM

In Pakistan, OMCs operate under the regulatory framework developed by GoP through Ministry of Petroleum & Natural Resources (MP&R) and OGRA. At present, prices of MS, HSD and Kerosene are regulated while rates of FO, HOBC and non-energy products are unregulated. Current distribution margins for regulated products are given in the table below:

Table 2: Distribution margins (per liter)

Products	Sep-17	Sep-16
MS	2.41	2.41
HSD	2.41	2.41
FO*	3.50%	3.50%
Lubricants	Unregulated	Unregulated
*may vary		

In the backdrop of subdued oil price environment, margins on retail fuels compare favorably to FO. OMCs with greater proportion of high margin products including retail fuels are likely to post greater earnings growth, going forward.

Business Risk Factors

COMPETITION

Sizeable capital expenditure (Rs. 44b by PSO) has been planned by existing leading players for expansion of retail distribution network and storage capacity. Moreover, increasing foreign ownership in local firms (Hascol and Admore Gas Private Limited) is expected to improve their ability to fund capital expenditure. Therefore, competition among existing players may intensify. However, competition from new entrants over the medium term will be limited as creation of retail outlet network and storage facilities at ports & strategic locations is both time and capital intensive, and would constitute a key entry barrier.

PRODUCT SUBSTITUTION WITH ALTERNATE FUELS

Over the long term, if LNG imports become sizeable and price differential between MS and Compressed Natural Gas (CNG) turns significant, growth in MS volumes will be affected. However, at current price levels, JCR-VIS believes that negative impact of LNG imports on MS will not be significant. Growth in FO offtake will be impacted by LNG/coal substitution while effect of the same on HSD volumes will be limited (power sector constitutes small proportion of HSD sales).

REGULATORY RISK

Given that OGRA exercises control on pricing of petroleum products, regulatory risk has historically had significant influence on the credit profile of OMCs. While the Economic Coordination Committee (ECC) had announced linkage of MS and HSD margins to Consumer Price Inflation (CPI) in July 2016, official confirmation of the same from GoP is awaited. Regulatory risk can also surface in the event of sharp rise in taxes on petroleum imports to curtail the country's rising current account deficit (US$ 12.09b for FY17 vis-à-vis US$ 4.86b in FY16).

CIRCULAR DEBT

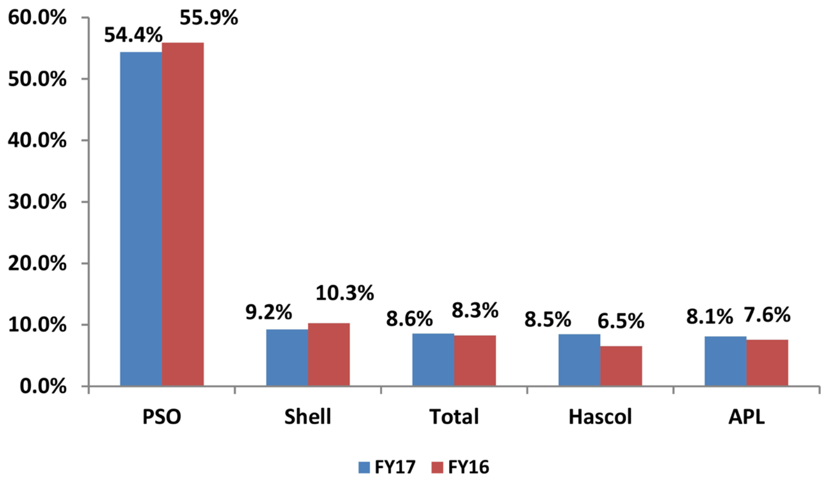
A rise in international oil prices could lead to resurgence of circular debt for OMCs.

CURRENCY DEPRECIATION

Since August 2015, the Pakistani Rupee has depreciated by 3.5% against United States Dollar. Any significant rupee depreciation will result in increase in product prices and may impact demand. Rupee depreciation is also expected to increase working capital requirements and hence finance cost of industry players.

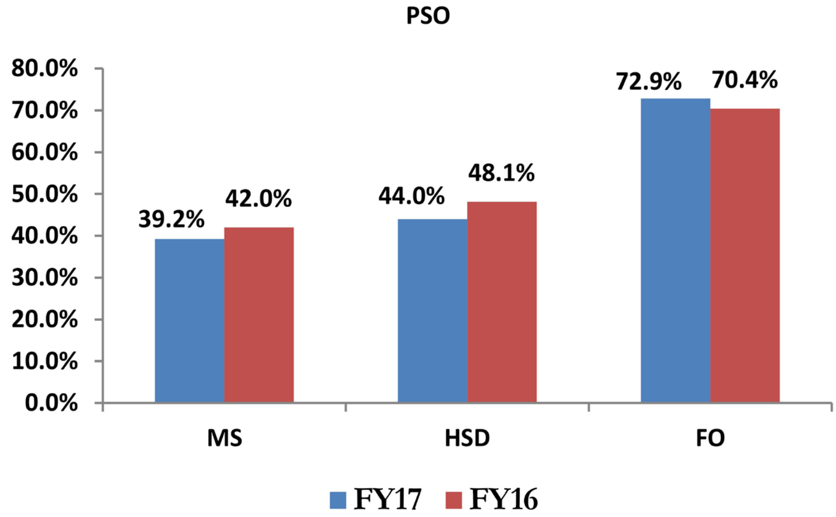
VOLUMETRIC SALES (COMPANY-WISE)

Figure 2: Company-wise market share



In the backdrop of sizeable market growth, two largest OMCs (PSO and Shell) have witnessed decline in market share over past five years. This is attributed to greater competition from smaller firms particularly Hascol, which has showcased improvement in market share through steady retail footprint and storage capacity expansion. PSO remained the largest supplier of petroleum products accounting for over half of industry's volumetric sales.

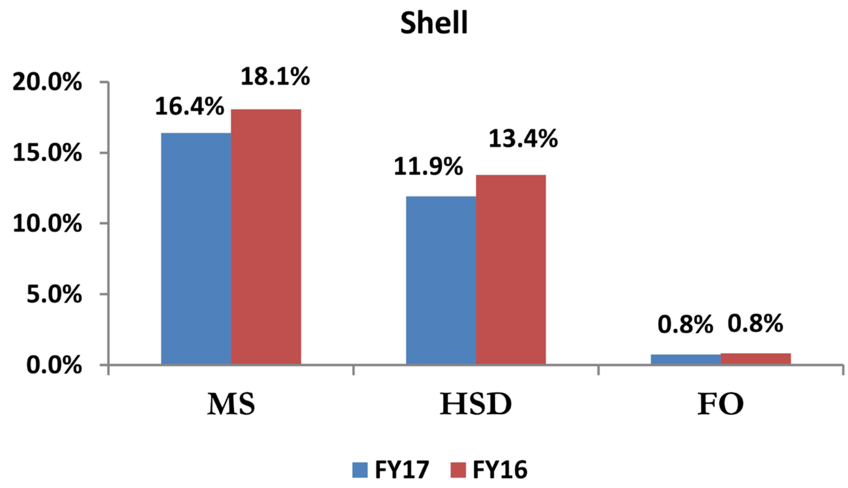
Figure 3: PSO Product wise market share



PSO's sales volumes increased by 7.8% in FY17 vis-a-vis industry growth of 10.9% while its overall market share declined to 54.4% (FY16: 55.9%). Retail market share continued to trend downwards; this was offset by 10.8% growth in FO volumes. During 2MFY18, PSO's market share depicted sharp recovery to 58% on the back of 57% growth in HSD sales.

2) *https://tribune.com.pk/story/1455575/shell-pakistan-says-pay-fine-bahawalpur-tanker-fire-killed-217/*
3) *Pakistan Oil Report 2015-16, OCAC*

Figure 4: Shell Product wise market share



Shell's market share declined in FY17 as its overall volumes were largely stagnant. In line with focus on retail business, MS volumes depicted largest growth while market share in FO segment remains nominal at 0.8%. Shell's overall market share further dropped to 5% during 2MFY18. The company's market position has also been impacted by the Bahawalpur tanker fire incident in June'2017[2]. However, Shell enjoys greater penetration in lubricants business vis-a-vis other top tier OMCs with a market share of around 34% as at end-2016[3].

Figure 5: APL Product wise market share

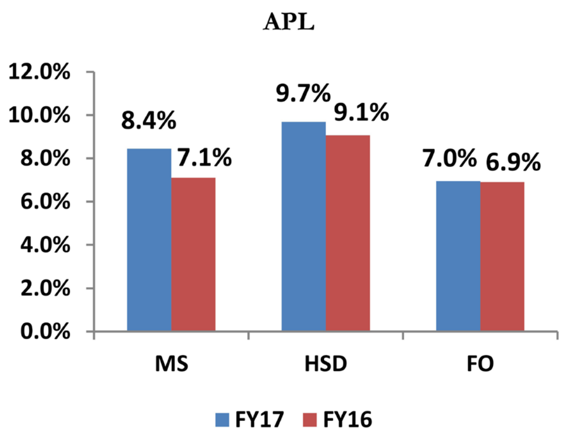
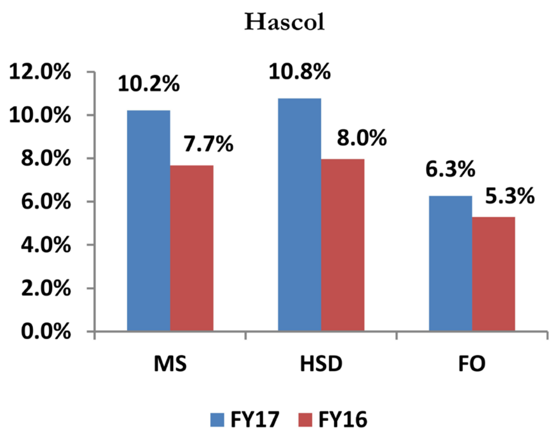


Figure 6: Hascol Product wise market share



Total retained its position as the third largest OMC with its overall market share increasing slightly during FY17. Majority proportion of Total's sales are generated through retail segments (the company holds market shares of 15.5% and 10.9% in MS and HSD categories respectively).

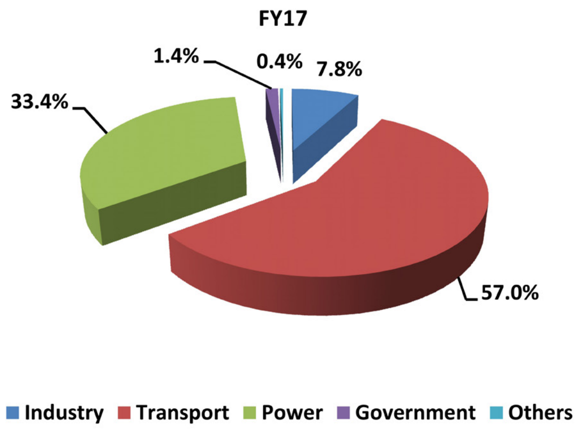
APL's overall market share slightly recovered in FY17 after witnessing a decline in preceding fiscal year. The company's market position improved across all segments.

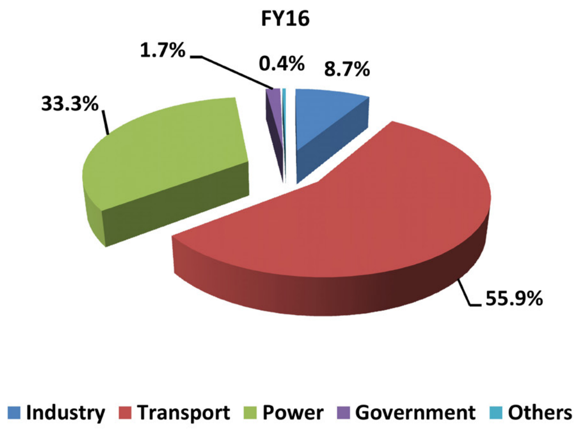
Hascol continued to outperform the industry in terms of overall volumetric growth which was reported at 43.9% during FY17. As a result, Hascol's market share augmented to 8.5% (FY16: 6.5%) in FY17. Moreover, the company overtook Shell as the second largest OMC in 2MFY18 with over 10% market share during the period. Growth in overall sales was achieved through dealer discounts increase in storage and retail footprint. The company's retail sales depicted highest growth among peers while 26.9% increase in FO volumes was also observed.

SECTOR-WISE SALES

Transport sector continues to account for largest proportion of consumption. Despite better gas and LNG availability, proportion of power sector consumption increased on account of higher FO utilized by an Independent Power Producer (IPP) and Pakistan Electric Power Company (PEPCO).

Figures 7 and 8: Sector-wise Sales





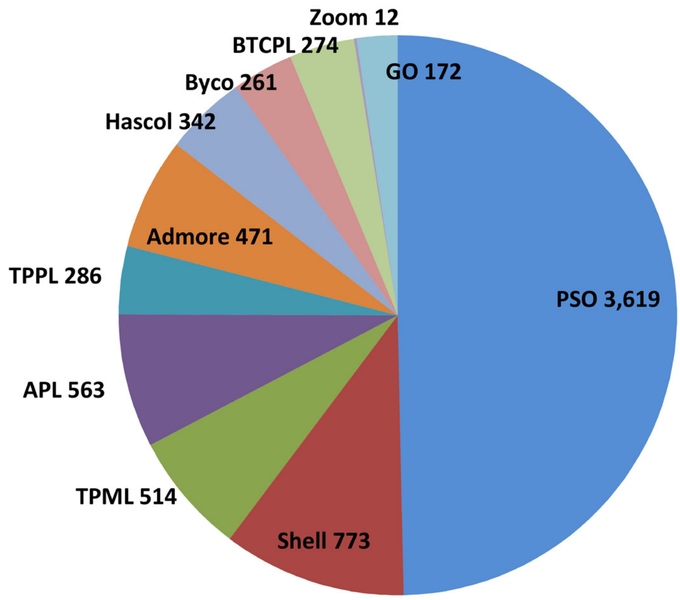
INFRASTRUCTURE

Given the importance of marketing and transportation infrastructure in securing market share, nearly all OMCs are undergoing capacity and retail network enhancements.

STORAGE CAPACITY

PSO has the largest storage capacity in the country. During FY17, Hascol surpassed Shell in terms of storage capacity with new installations in strategic locations including Mehmood Kot (Punjab) and Daulatpur (Sindh) along with augmentation of existing facilities. With sizeable capital expenditure planned by PSO and Hascol, their storage capacities are expected to grow further over next two years. JCR-VIS believes that storage facilities and their installation at strategically important locations and ports will be a key factor for maintaining/increasing market share, going forward.

Figure 9: No # of Retail Outlets 2015-16[5]



5) *Pakistan Oil Report 2016-16, OCAC*

Table 3: Storage Capacities at end-FY17 (MT)

	Karachi	Upcountry	Total	Percentage
PSO	452,000	303,426	755,426	73.8%
Shell	61,125	69,422	130,547	12.8%
Hascol			136,350	13.3%
TPML	35,069	14,073	49,142	4.8%
TPPL	4,500	35,950	40,450	4.0%
APL	18,425	14,073	32,498	3.2%
BTCPL	4,475	6,100	10,575	1.0%
ZOOM	0	684	684	0.1%
GO	0	3,735	3,735	0.4%
Total	**575,594**	**447,463**	**1,023,057**	**100.0%**

RETAIL NETWORK

In terms of retail outlet dispersion, PSO continues to possess the largest retail footprint in the country with 49.7% of total outlets, followed by Shell, Total and APL with 10.6%, 11.0% and 7.7% share, respectively. Hascol which has gained significant ground in terms of storage capacity expansion still lags other large players in terms of retail footprint expansion.

Financial Performance

PROFITABILITY

During FY17, overall sales of the OMC sector increased due to significant volumetric growth. With oil prices being range bound, quantum of inventory losses was largely minimal vis-à-vis FY16. Shift in product mix towards high margin categories supported improvement in gross margins. Thus, healthy growth in overall profitability of the sector was recorded.

Table 4: Profitability Indicators (Rs. m)

	PSO*		Shell		APL		Hascol	
	FY17	FY16	FY17	FY16	FY17	FY16	FY17	FY16
Net Sales	878,147	677,940	172,527	176,546	138,661	109,234	133,743	83,679
Gross Profit	37,199	22,525	15,150	11,532	7,335	5,749	5,588	3,616
Gross Margin	4.2%	3.3%	8.8%	6.5%	5.3%	5.3%	4.2%	4.3%
Operating Profit	34,662	22,826	5,584	3,462	6,367	4,985	3,112	1,977
Profit before Tax	29,347	16,289	6,219	3,807	7,699	5,633	2,598	1,495
*net sales adjusted for inland freight equalization margin								

In August 2017, PSO announced a three-year capital expenditure plan worth Rs. 44b which envisages revitalization of existing storage facilities & pipeline structure, capacity expansion, supply chain efficiency enhancement and product diversification. Shell's focus on retail business and enhancement of lubricant sales is expected to continue. APL's earnings may be further supported by higher bitumen sales. Hascol is venturing into import/marketing of lubricants, bitumen, LNG and LPG while maintaining growth momentum in retail sales. Across all major players, retail fuels and non-energy products (including lubricants and bitumen) are expected to be key revenue drivers.

CAPITALIZATION AND LIQUIDITY

JCR-VIS notes that the OMC sector generally benefits from a favorable working capital cycle because of large cash sales in retailing, low inventory days and moderate creditor days. Among listed firms, overall leverage indicators have trended upwards in FY17 on account of sizeable debt funded capital expenditure for capacity expansion. At end-June 2017, Hascol had the highest gearing among listed companies; leverage is expected to decrease post issuance of 20% right shares during ongoing year. With oil prices expected to remain low, buildup of receivables is likely to be limited. APL remains strongest in terms of financial strength with no debt and sizeable liquid assets in relation to peers. Cash flows for most players remain healthy in relation to outstanding debt obligations.

CONCLUSION

- Competition among existing players is likely to intensify as major OMCs have embarked on extensive expansion plans while threat from new entrants is considered low over the medium term. Industry structure is likely to remain semi-oligopolistic.
- JCR-VIS believes that at current price levels (with low differential between MS and CNG rates); MS volumes will not be significantly affected by LNG imports. Decline in FO sales is expected to emanate from coal/LNG substitution while impact of the same on HSD volumes will be limited. Retail fuels are expected to drive overall volumetric sales of petroleum products supported by low oil prices, growing aggregate demand, increasing automotive sales and upcoming infrastructural development projects.
- In a bid to augment margins, a number of OMCs are diversifying towards higher margin non-regulated products (jet fuel, lubricants, bitumen, LNG and LPG). In the backdrop of subdued oil price environment, margins on retail fuels compare favorably to FO. OMCs with greater proportion of high margin products including retail fuels are likely to post greater earnings growth.
- Efficient inventory management can partially offset risks associated with a volatile price environment for petroleum products. Stability in oil prices during FY17 has limited significant inventory losses and accumulation of circular debt. With oil prices forecasted to remain stable during FY18, inventory management is likely to be easier for OMCs.
- Financial profile of the sector is satisfactory with manageable leverage indicators and adequate cash flows. Profitability of the sector is expected to improve with volumetric growth in retail sales and improving gross margins due to shift in sales mix towards high margin products.

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