Oil Marketing Companies

SECTOR UPDATE

August,2019

Industry Structure

Oil marketing industry structure is semi-oligopolistic with few large players dominating the market. During FY19, top 5 players accounted for around four-fifth of the total industry volumes. Nevertheless, smaller Oil Marketing Companies (OMCs) and new entrants have increasingly made inroads in the market share of top 5 OMCs (Primarily PSO and Shell) and have captured around 10% of the total market share over the last 2 years. Post end-FY17, the number of OMC's has continued to increase as new licenses were granted by Oil and Gas Regulatory Authority (OGRA) to 9 companies that fulfilled financial and oil storage requirements as per OGRA technical standards. Resultantly, the total number of OMCs operating in Pakistan increased to 28 (FY17: 21) at end-December 2018. Total number of companies that have been granted marketing licenses presently stand at 59[1].

Going forward, entry barriers for OMCs are being enhanced given the requirement to invest at-least Rs. 6 billion, in the infrastructure and transport development (exclusive of the investment on retail development) with a minimum upfront equity of Rs. 3 billion in the shape of paid-up capital, at the time of the application for license. Moreover, the new OMC must construct mandatory storages equivalent to 20,000 MT each of HSD/MS or 20 days demand for products to be sold, whichever is higher, in accordance with their marketing and infrastructure plans.

Figure 1: Oil marketing license holders that are operational

Name	Permitted Region
Pakistan State Oil Company Limited (PSO)	Nationwide
Shell Pakistan Limited (Shell)	Nationwide
Attock Petroleum Limited (APL)	Nationwide
Byco Petroleum Pakistan Limited (Byco)	Nationwide
Total Parco Pakistan Limited (TPPL)	Nationwide
BE Energy Limited (formerly Bakri Energy Limited (BEL))	Nationwide
Hascol Petroleum Limited (Hascol)	Nationwide
Askari Oil Services Private Limited (AOSPL)	Punjab & KPK
Zoom Petroleum Private Limited (ZOOM)	Punjab
Puma Energy Private Limited (formerly Admore Gas (Pvt.) Limited)	Nationwide
Exceed Petroleum Private Limited (XPPL)	Punjab
Horizon Oil Company (Private) Limited (HOCPL)	Punjab
Quality-1 Petroleum (Private) Limited (QPPL)	Punjab
OTO Pakistan Private Limited (formerly Outreach (Pvt.) Limited)	Punjab
Z&M Oils (Private) Limited (ZOPL)	Punjab
Oilco Petroleum (Private) Limited (OPPL)	Punjab
Gas & Oil Pakistan Private Limited (GO)	Punjab & Sindh
Petrowell (Private) Limited (PETRO)	Sindh
Kepler Petroleum (Private) Limited (KPL)	Sindh
Fast Oil Company (Private) Limited (FOCL)	Sindh

1 https://fp.brecorder.com/2019/02/20190212446344/

New OMCs	Permitted Region
Fuelers Private Limited	Punjab
Al Noor Petroleum Private Limited	Sindh
My Petroleum Private Limited	Punjab
Jinn Petroleum Private Limited	Punjab
LaGuardia Petroleum Private Limited	Sindh
Oil Industries Pakistan Private Limited	Punjab
Euro Oil Private Limited	Punjab
Flow Petroleum Private Limited	Punjab
Zoom Petroleum Private Limited (ZOOM)	Punjab

Pakistan State Oil (PSO) continues to maintain its position as the market leader with a market share of 42% (FY18: 53%) in FY19, albeit the market share of the company has declined on a timeline basis. Along with PSO, the other major players including Shell Pakistan Limited (Shell), Attock Petroleum Limited (APL), Total Parco Pakistan (TPP) and Hascol Petroleum Limited (HPL) accounted for approximately 80% of the industry sales in FY19.

Figure 2: Major Petroleum Oil Products

	Description	Uses
ENERGY		
Motor Gasoline (MS)	Transparent, petroleum-derived liquid that is used primarily as a fuel in internal combustion engines	Automotive, industrial machinery, small electrical generators
High Speed Diesel (HSD)	Any liquid fuel used in diesel engines, whose fuel ignition takes place, without any spark, as a result of compression of the inlet air mixture and then injection of fuel	Automotive, industrial machinery, small electrical generators
Furnace Oil (FO)	Fraction obtained from petroleum distillation, either as a distillate or a residue	Commercial power generation
Kerosene Oil (KO)	A combustible hydrocarbon liquid which is derived from petroleum	Jet fuel, domestic fuel for heating, lighting & cooking
Liquefied Natural Gas (LNG)	Natural gas that has been converted to liquid form for ease and safety of non-pressurized storage or transport	Automotive, electricity generators
Liquefied Petroleum Gas (LPG)	Flammable mixtures of hydrocarbon gases	Cooking, rural heating and motor fuel
Compressed Natural Gas (CNG)	Methane stored at high pressure	Automotive, electricity generators
NON-ENERGY		
Automotive Lubricants	Lubricating base oil derived from crude oil	Automotive engines
Bitumen	Black viscous mixture of hydrocarbons obtained naturally or as a residue from petroleum distillation	Road construction, general construction

Demand and Supply Dynamics

Sharp decline has been noted in industry volumes. Reduction was more pronounced in Furnace Oil Sales while decline in HSD sales was higher than anticipated in FY19.

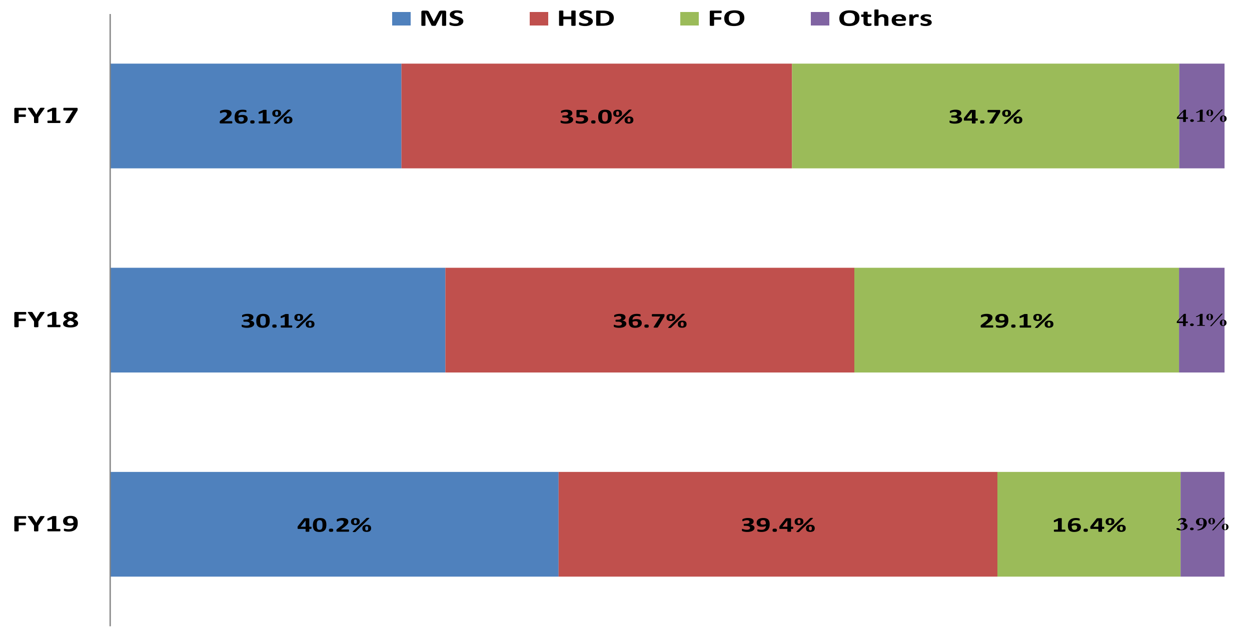
Transportation segment is the largest consumer of petroleum products followed by power sector. During the last five years (FY13-FY18), petroleum product sales (including lubricant sales and others) have increased at a compounded annual growth rate (CAGR) of 5.3% to 25.3m tons (FY17: 26.0m tons). Highest growth in sales has been recorded in MS segment which has grown at over double digits during the last 5 years followed by HSD volumes while FO volumes have declined during the period. Contrary to growth trend observed in the previous years (till FY17), overall volumes have depicted a decline of 6% and 25%, respectively in FY18 and FY19, respectively.

Figure 3: Product wise growth/decline

(000 metric tonnes)	FY19	FY18	% change
FO	3,004	7,118	-58%
HSD	7,189	8,965	-20%
MOGAS	7,351	7,351	0%
HOBC	80	127	-37%
JP	529	746	-29%
KERO	94	109	-14%
LDO	18	17	6%
Total	**18,264**	**24,433**	**-25%**

Sales of FO witnessed the largest decline of 58% in FY19 vis-à-vis the corresponding period. Availability of cheaper substitutes such as RLNG and coal has contributed to reduction in sales of FO. LNG imports grew by 36% during FY19 to $3.33b (FY18: $2.45b)[2] while in volumetric terms the increase was around 28% at approx. 368million mmbtu. Given the price differential between FO and LNG and higher efficiency of LNG based power plants, LNG imports are expected to remain elevated due to higher utilization in power generation. Excluding FO, overall industry volumes witnessed a reduction of around 12% in FY19, with second largest decline observed in High Speed Diesel (HSD). HSD sales declined by around 20% in FY19 on account of slowdown in the economy particularly in transport & Large Scale Manufacturing activities. In the absence of any direct substitutes, sharp decline in HSD sales is also attributable to increased smuggling from Iran.

Figure 4: Product-wise distribution of petroleum sales



2 https://customnews.pk/2019/07/20/pakistan-liquefied-natural-gas-lng-imports-surge-35pc-to-3-33bn-in-fy19/

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 KO 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:

Figure 5: Distribution margins (per liter)

Products	Sep-18	Sep-17
MS	2.64	2.41
HSD	2.64	2.47
FO	3.50%	3.50%
Lubricants	Unregulated	Unregulated

The margins on MS and HSD are fixed in terms of rupees per liter. Resultantly, margins of OMCs (in percentage terms) that primarily focus on retail fuels (MS and HSD) depict an upward trend in a depressed oil prices scenario, while vice versa is the situation when oil prices observe an upward trajectory.

The Economic Coordination Committee (ECC) has linked adjustments in margins of retail fuels (MS and HSD) to Consumer Price Index (CPI). In June 2018, the ECC increased the margins by Rs. 0.23 and Rs. 0.17 on MS and HSD, respectively.

Business Risk Factors

Competition: In the backdrop of declining volumes, competitive environment within the OMC landscape has intensified with leading players and new entrants trying to maintain and enhance market share. However, superior infrastructure in terms of sizeable storage capacities and extensive retail footprint will continue to be a source of competitive advantage for existing larger OMCs. Moreover, implementation of increasing equity requirements will also limit entry of new players.

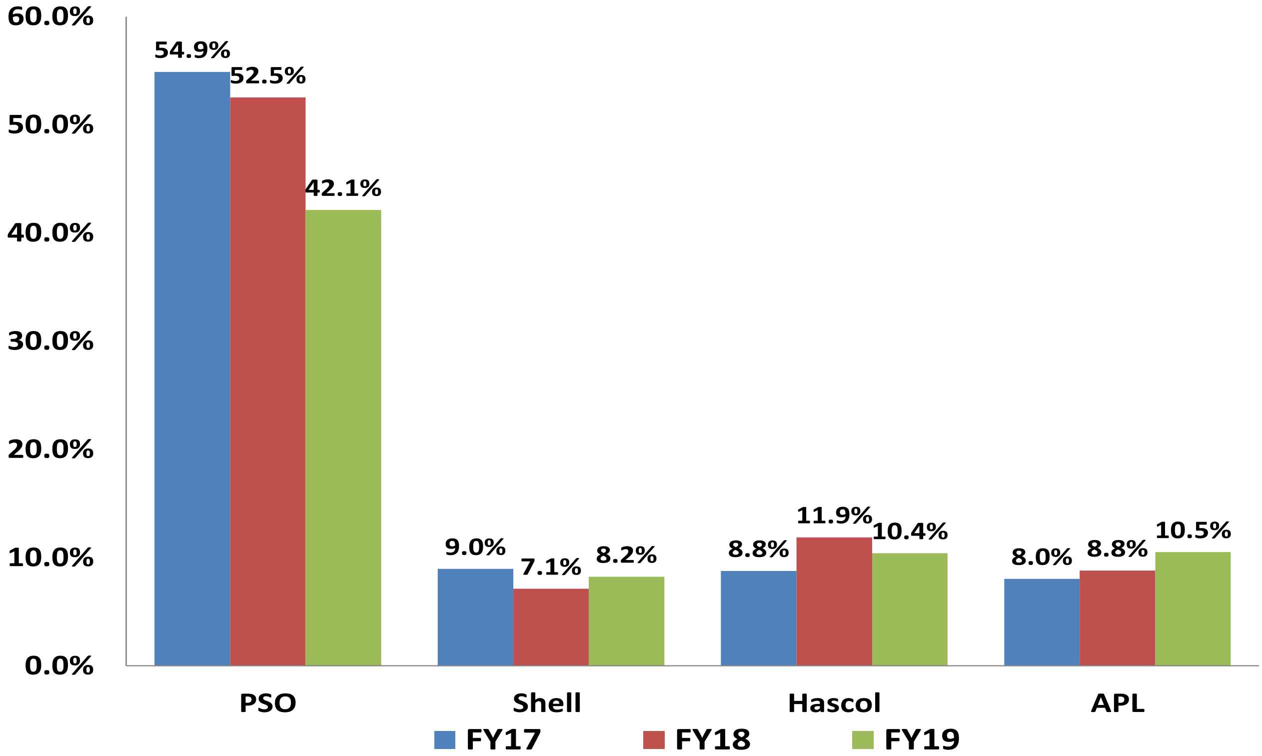
Challenging macroeconomic environment has translated into elevated business risk: Slowdown in GDP growth (impact on industry volumes), increasing interest rates and significant volatility in rupee-dollar parity has impacted the business risk profile of the OMC sector. The companies that have an import based model have experienced considerable foreign exchange losses on account of currency devaluation and volatility. Any further rupee devaluation is also expected to increase working capital requirements which along with rising interest rates will translate into higher finance cost for the industry players. Companies with sizeable procurement from local refineries and low leverage indicators are expected to have limited impact on profitability in the current macroeconomic environment vis-à-vis players that have a leveraged capital structure and rely on imports.

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. The decision to deregulate HSD prices by ECC could not be implemented due to inability of the stakeholders, particularly the Federal Board of Revenue to put in place recovery mechanism for taxes on deregulated margins. Recent budgetary changes relating to corporate and minimum turnover tax and increase from 0.5% to 0.75% is expected to increase the tax burden on the OMC sector. Regulatory risk can also surface in the event of sharp rise in taxes on petroleum imports to curtail the country's sizeable current account deficit (FY19: $13.59b; FY18: US$ 18.99b; FY17: US$ 12.62b).

Circular Debt: Due to prevalence of high electricity losses (due to theft and inefficiencies in the distribution system) and inability to recover the total amounts billed to consumers by power companies, circular debt has surged to Rs. 1.4tr at end-2018. The current situation may result in delay in payments to OMC, thereby presenting working capital issues for the OMCs. The government is in the process of issuing the 2nd Pakistan Energy Sukuk which will result in some reduction in quantum of overdue receivables for PSO. However, buildup in receivables will continue due to delays in payments being received for LNG supplies.

Volumetric Sales (company-wise)

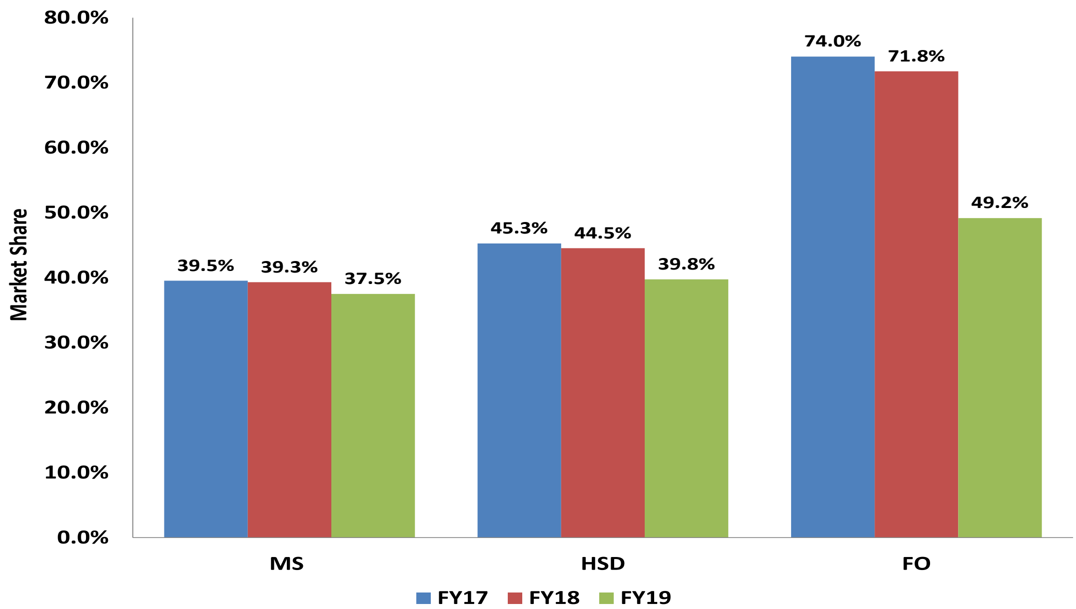
Figure 6: Company-wise market shares



PSO, the largest OMC, has lost its market share over the last 2 years. This decrease is attributed to greater competition from existing and new OMCs.

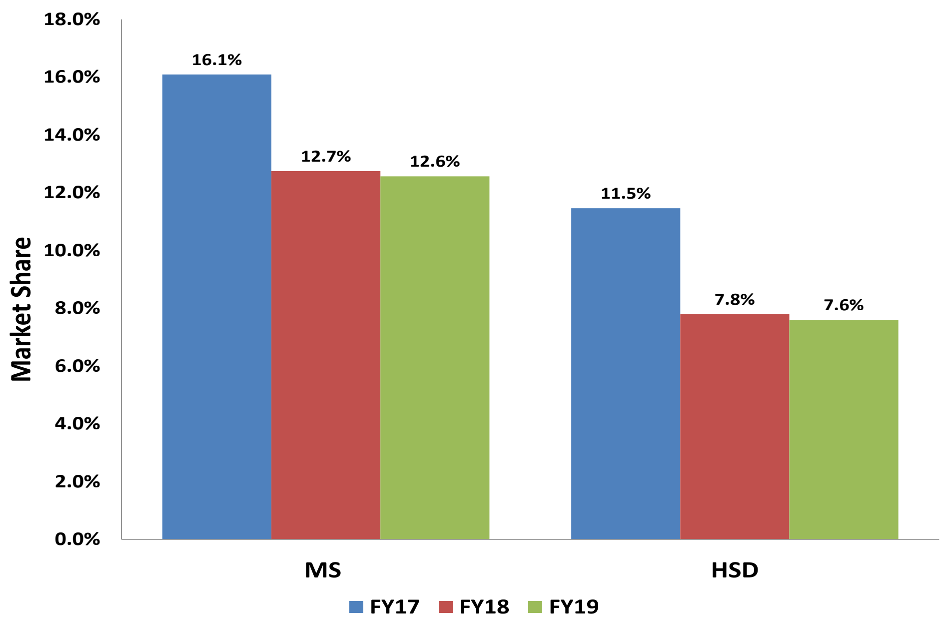
Product Wise Market Shares

Figure 7: PSO Product wise market share



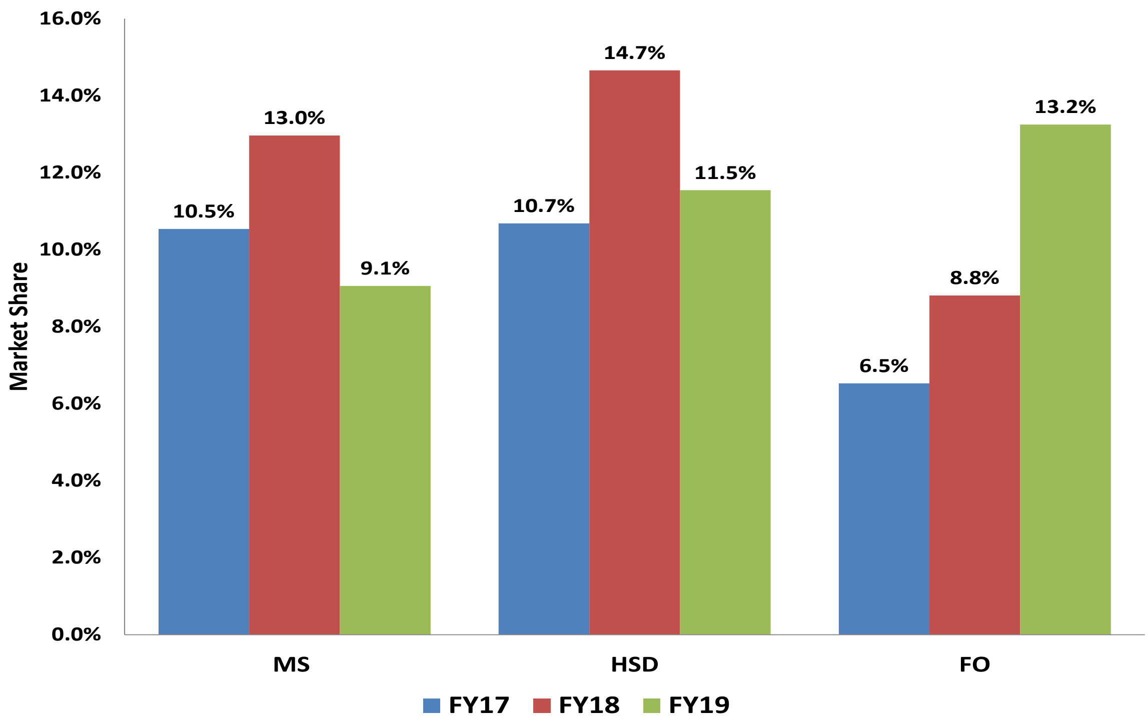
PSO's sales volumes decreased by 40% vis-à-vis industry decline of 25% in FY19, thereby resulting in lower overall market share. This declining trend in market share was more pronounced in FO and HSD segment. However, in recent months the Company has managed to recoup market share with overall market share improving to 49% in July'2019 and 45% in 7MCY19.

Figure 8: Shell Product wise market share



After a steep decline in market share in FY18 largely due to strengthening security infrastructure of its transportation fleet and increasing competition, Shell has managed to maintain market share in FY19. Retail fuels continue to remain focus of the company, going forward. Shell continues to maintain prominent position in the lubricants segment with a market share of 21%[3] in FY18.

Figure 9: Hascol Product wise market share

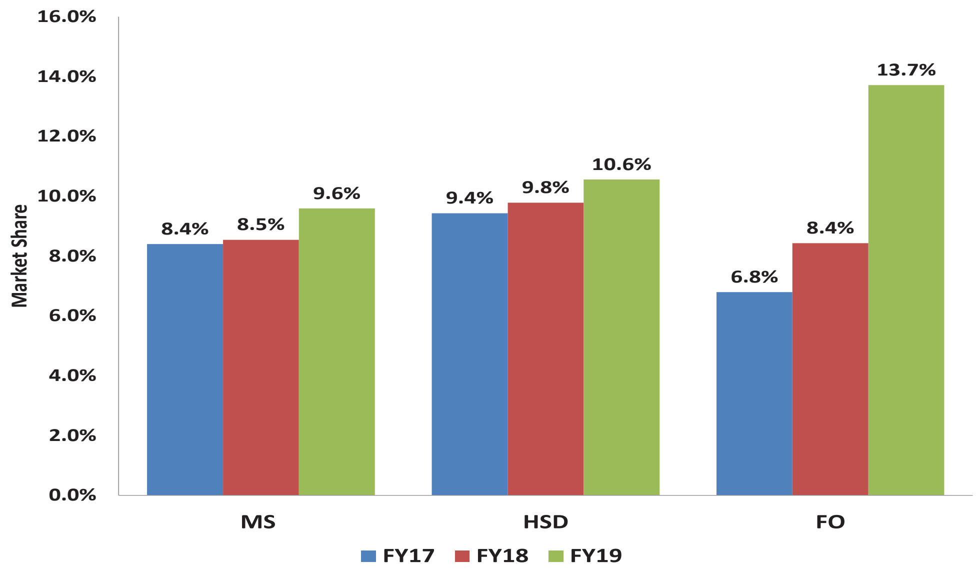


Hascol's market share witnessed attrition in FY19 with the decline being more pronounced in retail fuels while market share in FO segment witnessed an increase. Decline in market share has been more pronounced in recent months with Company focusing on enhancing profitability (through imposition of stringent credit terms and optimizing working capital cycle) rather than increasing volumes and market share. Market share in retail fuels has also observed a

3 https://fp.brecorder.com/2018/07/20180720392468/

downward trend partly due to a conscious strategy to minimize losses given significant fluctuation in foreign currency. Market share in OMCs has declined to 8% in 7MCY19 vis-à-vis 13% in 7MCY18.

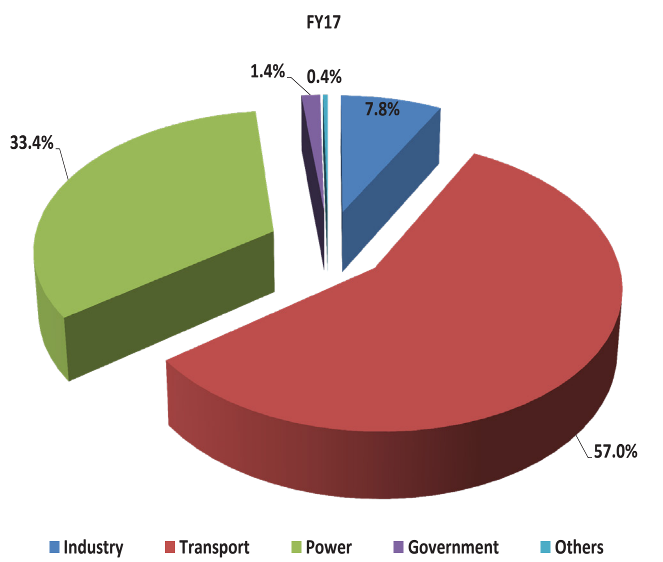
Figure 10: APL Product wise sales

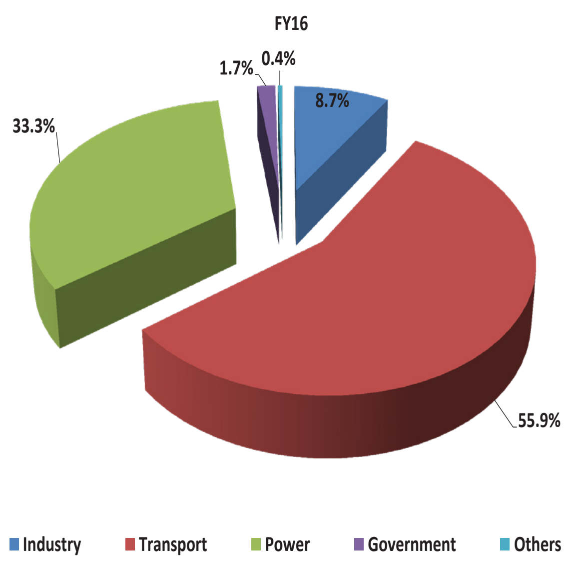


Amongst the 4 large listed OMCs, APL is the only OMC which has posted an increase in market share during FY19. The company's low risk business model as evident from modestly leveraged capital structure and backward integrated operations through group refineries while strengthening storage infrastructure have facilitated in increasing market share in challenging times.

Sector-wise Sales

Figure 11: Sector-wise Energy Product Sales





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. As at end-July 2019, VIS believes that Hascol is the second largest OMC in terms of installed storage capacity. VIS considers storage facilities and their installation at strategically important locations and ports will be a key factor for maintaining/increasing market share, going forward.

Figure 12: Storage Capacities at end-FY17 (MT)[4]

	Karachi	Upcountry	Total	Percentage
PSO	639,504	318,758	958,262	62.4%
Shell	59,490	67,980	127,470	8.3%
Hascol*	33,500	49,400	82,900	5.4%
TPML	28,064	15,821	43,885	2.9%
TPPL*	9,000	8,761	17,761	1.2%
BYCO	10,000	-	10,000	0.7%
APL*	41,485	35,598	77,083	5.0%
BEPL*	97,400	19,241	116,641	7.6%
OTO	10,000	1,600	11,600	0.8%
*GO	22,750	11,735	34,485	2.2%
ZOOM	-	2,184	2,184	0.1%
AOSPL	-	8,580	8,580	0.6%
QUALITY 1	-	3,000	3,000	0.2%
ZMOPL	-	2,900	2,900	0.2%
OILCO	-	27,250	27,250	1.8%
HORIZON	-	3,088	3,088	0.2%
PUMA	-	8,420	8,420	0.5%
Total	**951,193**	**584,316**	**1,535,509**	**100.0%**

**Capacity is inclusive of leased capacity*

Retail Network

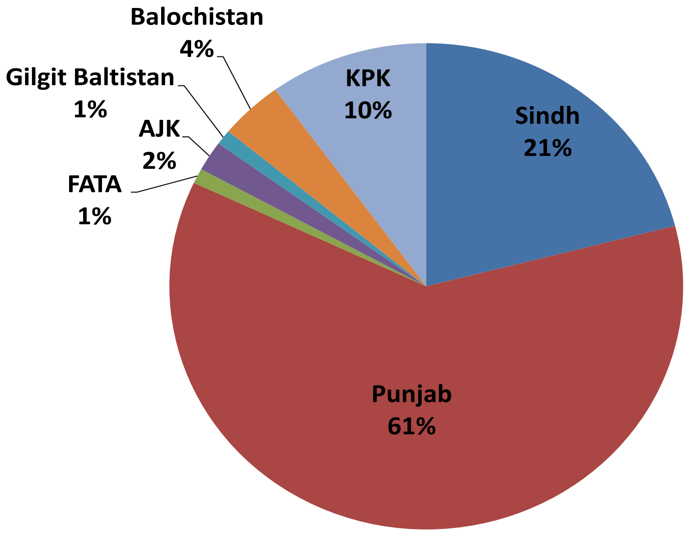
In terms of retail outlet dispersion, PSO continues to possess the largest retail footprint in the country with 44.3% of total outlets, followed by Shell, APL and Total with 9.9%, 7.7%, and 6.6% share, respectively. Hascol which has gained significant ground in terms of storage capacity expansion still lags other large players in terms of retail footprint expansion. Latest position of retail outlets of OMCs as available on the Company's website is as follows:

Figure 13: Retail outlets (latest position)

OMC	No. Of Retail Outlets
PSO	3546
Total Parco	858
Shell	780
APL	645
Hascol	571

4 Pakistan Oil Report 2016-17, OCAC

Figure 14: Province wise outlets distribution as per OCAC report in 2016-17



Financial Performance

Profitability:

Figure 15: Profitability Indicators

	PSO			Shell		
(Rs. in millions)	9MFY19	FY18	FY17	9MFY19	FY18	FY17
Net Sales	819,999	1,056,901	878,147	141,878	161,835	172,527
Gross Profit	23,884	39,636	37,136	10,259	15,429	15,150
Gross Margin	2.92%	3.75%	4.23%	7.23%	9.53%	8.78%
Operating Profit	17,387	31,870	34,662	(1,838)	2,473	5,584
Profit before Tax	10,693	27,160	29,347	(1,743)	4,182	6,219
	APL			Hascol		
(Rs. in millions)	9MFY19	FY18	FY17	9MFY19	FY18	FY17
Net Sales	164,448	216,360	172,081	162,349	217,942	133,743
Gross Profit	4,889	9,743	7,335	7,445	10,153	6,010
Gross Margin	2.97%	4.50%	4.26%	4.59%	4.66%	4.49%
Operating Profit	3,160	8,085	6,367	3,968	6,720	3,563
Profit before Tax	3,375	8,289	7,699	2	2,845	2,412

- Profitability for industry players has witnessed pressure during FY19 primarily on account of decline in oil sales, increase in finance cost and exchange losses.
- Financial performance of Hascol and Shell has been the most impacted during FY19 with exchange losses being the major dampener. Shell and Hascol incurred exchange losses of Rs. 5b and Rs. 3.9b, respectively during 2018.
- Profitability growth is expected to remain under pressure with limited increase expected in industry volumes, elevated finance cost and increase in tax burden. Overall profitability may depend upon quantum of exchange

losses and inventory gains/losses.

- Industry players are pursuing diversification initiatives (Lubricants, LPG, Specialized Fuels/Chemicals and LNG) in order to strengthen profitability profile.

Capitalization and Liquidity

Figure 16: Capitalization and Liquidity indicators

	PSO			Shell			APL		
(Rs. in millions)	9MFY19	FY18	FY17	9MFY19	FY18	FY17	9MFY19	FY18	FY17
Debt	101,990	89,847	130,499	11,852	-	-	-	-	-
Equity	114,742	110,452	102,850	6,610	9,982	10,452	17,736	18,417	16,294
Gearing	0.89	0.81	1.27	1.79	-	-	-	-	-

	Hascol		
(Rs. in millions)	9MFY19	FY18	FY17
Debt	23,946	11,653	8,590
Equity	8,832	9,794	4,756
Gearing	2.71	1.19	1.81

- Debt levels have increased on a timeline basis for most OMCs.
- Hascol reported the highest leverage within listed OMCs while APL has the strongest balance sheet.
- Shell’s equity base reduced significantly at end-March’2018 on account of losses incurred and dividends paid for the year 2018.
- Debt carried on PSO’s balance sheet is primarily to fund circular debt receivables.
- OMC sector generally benefits from a favorable working capital cycle because of sizeable cash sales, low inventory days and relatively high creditor days. However, funds generated from operations have depicted a decline and cash flow coverage of outstanding debt has declined.
- APL has the strongest liquidity profile amongst listed players.

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