Foundation Securities
REP-095

PAKISTAN

Oil Refineries

April 4, 2016

GRMs rise; postive developments on the horizon

Event

- On monthly basis domestic GRMs would show a moderate expansion in April, 2016 given relatively improved product spreads. Lower oil prices are helping to scale up the demand (international) of the end product which is reflecting in higher products' spread. As per our calculations, domestic GRMs would increase to US$7.5/bbl in April,2016 against US$5.5/bbl in previous month. Among the listed companies, ATRL margins are likely to outperform the industry (US$9.0/bbl), while NRL's GRM (ex-lube) to remain around US$4.5/bbl.

- Though we acknowledge the volatile nature of the GRM as a constraint on future predictability, the current oil market scenario along with modernization of local refineries should bode well for sector's dynamics. Hence, we are cautiously optimistic on the sector and recommend accumulation in ATRL and NRL.

Impact

- **Higher HSD margins instigating MoM increase:** The domestic GRMs for April, 2016 are calculated at US$7.5/bbl which is on a higher side compared to US$5.4/bbl (fine tuned with the actual crude oil price in March) in last month. The higher month on month increase in margins is primarily attributable to higher margins on HSD which accounts for ~37% of the product slate. The monthly margins are lower than 10MFY16 average GRMs of US$10/bbl (vs US$10.5/bbl in 10MFY15) due to current product prices catching up with the lower crude oil prices. We see this as a function of the cyclic nature of the GRM as highlighted in our previous report on GRM published last month

- **Plant shutdown may create deviation in ATRL's margins:** We estimate ATRL to outperform the industry; our calculation suggests GRMs of US$9.0/bbl in April against US$7.5/bbl in previous month. However, ATRL's throughput is relatively restricted due to on-going modernization of the plant and actual product slate may vary from our base case assumption (As per company's notice PMG production is expected to resume from mid-April which was shutdown from January 2016). Restricted ATRL throughput due to up-gradation work is likely to keep 2HFY16 earnings under pressure but from FY17 ATRL's GRMs are likely to improve that would reflect well on its bottom-line.

- On the other hand, NRL's GRMs for the month would stand around US$4.5/bbl, higher than previous month margins of US$3.5/bbl. However, NRL's higher margins of the lubricant segment would lift its overall GRMs.

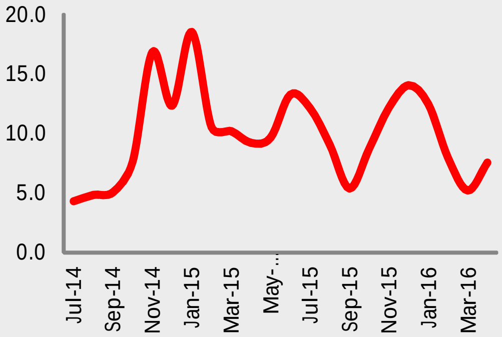
- **Modernization to further boost the margins:** Besides the prevailing robust patch of GRMs, we reiterate the modernization of refineries (Isomerization and desulphurization) is a material positive for the sector. The moderation is to improve the product slate via (1) conversion of Naphtha to higher margin Mogas and (2) Euro-II compliant HSD entitling them to higher deemed duty.

- Our back of the envelope calculation shows, the April 2016 margins would have expanded by another US$0.5-1/bbl given improved product slate after modernization.

Outlook

- Though the volatile nature of the crude oil prices and the derived petroleum prices result in lower predictability of GRMs, we believe continuation of prevailing oil dynamics is to keep product spread stretched. Hence, we have become cautiously positive on the sector.

Historical monthly GRMs (US$/bbl)



Source: Bloomberg, OGRA, Foundation Research, Apr 2016

Analyst

Nauman Khan nauman.khan@fs.com.pk
M. Arsalan Siddiqui arsalan.siddiqui@fs.com.pk
92 3215612290-94 Ext 311

Important disclosures:

Disclaimer: This report has been prepared by FSL. The information and opinions contained herein have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. Such information has not been independently verified and no guaranty, representation or warranty, express or implied is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. This document is for information purposes only. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete and this document is not, and should not be construed as, an offer, or solicitation of an offer, to buy or sell any securities or other financial instruments. FSL may, to the extent permissible by applicable law or regulation, use the above material, conclusions, research or analysis before such material is disseminated to its customers. Not all customers will receive the material at the same time. FSL, their respective directors, officers, representatives, employees, related persons may have a long or short position in any of the securities or other financial instruments mentioned or issuers described herein at any time and may make a purchase and/or sale, or offer to make a purchase and/or sale of any such securities or other financial instruments from time to time in the open market or otherwise, either as principal or agent. FSL may make markets in securities or other financial instruments described in this publication, in securities of issuers described herein or in securities underlying or related to such securities. FSL may have recently underwritten the securities of an issuer mentioned herein. This document may not be reproduced, distributed or published for any purposes.

Research Dissemination Policy: Foundation Securities (Pvt.) Ltd. endeavors to make all reasonable efforts to disseminate research to all eligible clients in a timely manner through either physical or electronic distribution such as mail, fax and/or email. Nevertheless, not all clients may receive the material at the same time.

Target price risk disclosures: Any inability to compete successfully in their markets may harm the business. This could be a result of many factors which may include geographic mix and introduction of improved products or service offerings by competitors. The results of operations may be materially affected by global economic conditions generally, including conditions in financial markets. The company is exposed to market risks, such as changes in interest rates, foreign exchange rates and input prices. From time to time, the company will enter into transactions, including transactions in derivative instruments, to manage certain of these exposures.

Analyst certification: The views expressed in this research accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the analyst(s) was, is, or will be directly or indirectly related to the inclusion of specific recommendations or views in this research. The analyst principally responsible for the preparation of this research receives compensation based on overall revenues of Foundation Securities and has taken reasonable care to achieve and maintain independence and objectivity in making any recommendations.

Recommendations definitions

If

Expected return >+10%	Outperform.
Expected return from -10% to +10%	Neutral.
Expected return <-10%	Underperform.