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Oil conundrum & Local E&Ps

- Oil prices have steeply dropped from $40/bbl since Dec 4, 2015 to nearly $26/bbl in the mid of February given frictions in OPEC and overall supply glut situation. This has thrown a great spanner on world markets as other commodity prices have also tumbled. This is ostensibly good for a developing country like Pakistan where overall oil import bill is likely to come down from last year.
- The reduction in oil prices is a bit positive for local explorers such as OGDC & POL yielding FY16 PE of 6.3x & 8.8x respectively as per our estimated earnings.

- Russia-Saudi Oil deal: A deal between Saudi Arabia and Russia to freeze oil output is a good omen; though we believe oil prices will go towards stability in coming months given ability of OPEC members to work with non-OPEC players. Saudi-Russia deal alongside OPEC - non OPEC cooperation will be crucial – however every major oil producer agrees that oil glut would remain their given Iran's quest to search for better market share. Iran is not going to do anything in terms of reducing the surplus. Iran will probably produce as much oil as it can to regain some market share.
- The Saudi Arabia-Russia deal to fix output at January levels alongside Qatar and Venezuela is the beginning of the good road. We believe clarity is coming since Russia, another major producer, is also kneeling down that could require "other steps to stabilize and improve the market.
- Saudi Arabia has so far resisted making any cuts in output given their fear of losing market share since it also sensing competition with Iran on the Gulf peninsula. Saudi Arabia produced 10.2mn barrels in January wherein Russia pumped 10.9mn. Iran on the other hand is negotiating with European countries for further drilling. In fact many European states are vying for stakes in Iranian oil companies – which is indeed not a good omen for oil prices. Some of the Latin American states such as Venezuela & Ecuador is asking to stop investment in oil wells at flashpoint places in order to bring stability into oil prices.
- China Factor: Economic recession in China is also one of the reasons in decrease in oil price. Chinese demand would ostensibly decline. The indications in China's economy in February signals the fact the overall slowdown in has not bottomed out.

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Recent news:

- **IEA sees oil market rebalancing in 2017; US production at record high by 2021:** Oil markets will begin to rebalance in 2017 thanks to falling U.S. production but that decline will prove short-lived as efficiency gains will push U.S. output to new records by the beginning of the next decade, the International Energy Agency said on Monday. (The News February 23, 2016)

- Pakistan factor: Oil prices may continue to range bound in coming days – wherein agreements between major players could keep prices stable around $30/bbl - $35/bbl. Pakistani Exploration & Production (E&P) companies would now have to live with these realizable prices and would have to boost local production from current levels in order to meet domestic demand. We are seeing positive beginnings for local E&Ps viz. OGDC & POL (our coverage companies) in terms of some rebound in quarterly earnings. However, local E&P production growth is a key factor for earnings growth.

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