

Day Break

Monday, 26 February 2018

COMPANY UPDATE

Pakistan State Oil Company Limited

Oil & Gas Marketing Companies

Recommendation	BUY
Target Price:	385.2
Last Closing: 23-Feb-18	293.5
Upside:	31.2
Valuation Methodology:	Discounted Cash Flow (DCF)

Time Horizon: Dec-18

Market Data

Bloomberg Tkr.	PSO PA
Shares (mn)	326.0
Free Float Shares (mn)	146.7
Free Float Shares (%)	45.0%
Market Cap (PKRbn USDmn)	95.7 865.1
Exchange	KSE 100
Price Info.	90D 06M 12M
Abs. Return	(13.9) (34.1) (35.6)
Lo	265.2 265.2 265.2
Hi	357.2 466.6 477.1

Key Company Financials

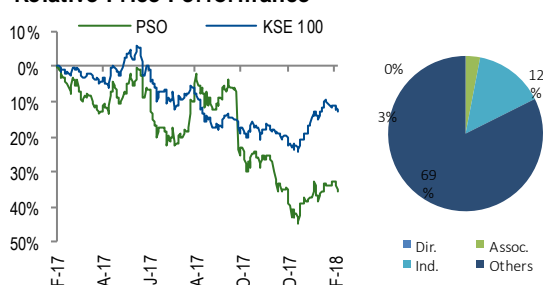
Period End: Jun

PKRbn	FY17A	FY18E	FY19F	FY20F
Total Revenue	878.1	779.7	807.7	892.3
Net Income	18.2	15.4	13.6	15.4
EPS (PKR)	55.9	47.4	41.7	47.2
DPS (PKR)	25.0	17.0	15.0	17.0
Total Assets	392.4	336.3	324.6	307.3
Total Equity	102.8	113.3	122.0	131.8

Key Financial Ratios

ROE (%)	17.7	13.6	11.1	11.7
P/E (x)	5.3	6.2	7.0	6.2
P/B (x)	0.9	0.8	0.8	0.7
DY (%)	8.5	5.8	5.1	5.8

Relative Price Performance



About the Company

Pakistan State Oil was incorporated in Pakistan in 1976. The principal activities of the Company are procurement, storage and marketing of petroleum and related products. It also blends and markets various kinds of lubricating oils.

Source: Bloomberg, PSX & IGI Research

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Oil & Gas – Marketing Companies

PSO: Analyst Briefing Takeaway 2QFY18

- Pakistan State Oil Company Limited (PSO) held its analyst briefing on 23rd Feb-18 to discuss financial result for 2QFY18 and future prospects of the company. The company reported earnings of PKR 3.49bn (EPS PKR 10.71) down by 38%YoY during 2QFY18 as compared to PKR 5.64bn (EPS PKR 17.30) in the same period last year;
- Gross profit declined by +17%YoY to PKR 9.54bn during 2QFY18 owing to inventory losses of PKR 0.73bn after tax. Operating costs increased by +19%YoY to PKR 7.05bn during 2QFY18 as compared to PKR 6.77bn in the corresponding period last year owing to exchange losses of PKR 0.75bn booked in Dec-17 as a result of 4.5% PKR depreciation.
- We maintain a 'BUY' call on PSO with Dec-18 TP of PKR 385/share offering an upside of +31% from its last close. The company is currently trading at FY18E P/E of 6.2x and dividend yield of 5.8%.

Earnings for 2QFY18 reported at PKR 10.71/share down by +38%YoY...

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...bringing 1HFY18 EPS to PKR 26.14, down by 15%YoY

As a result PSO's earnings for 1HFY18 stands at PKR 8.52bn (EPS PKR 26.14) during 2QFY18 down by 15%YoY primarily owing to a) inventory loss of PKR1.4bn, b) 53%YoY decline in other income in the absence of PIB income and lower penal interest income on receivables and, c) higher effective tax rate of 35%. However, core earnings excluding inventory losses stand at historic high of PKR 10.3bn for 1HFY18. The company restrained payout owing to cash constraints as circular debt piled up substantially.

Exhibit:

Financial Highlights

PKRmn	2QFY18	2QFY17	YoY	1HFY18	1HFY17	YoY
Net Sales	259,708	217,836	19%	518,353	411,348	26%
Gross Profit	9,540	8,186	17%	18,730	17,892	5%
Operating Costs	3,665	3,086	19%	7,050	6,766	4%
Other Op. Income	756	4,407	-83%	2,969	6,316	-53%
EBIT	6,631	9,506	-30%	14,649	17,441	-16%
Finance Cost	1,023	1,567	-35%	1,779	2,846	-37%
Profit Before Taxation	5,660	8,175	-31%	13,080	14,961	-13%
Profit After Taxation	3,493	5,639	-38%	8,522	10,015	-15%
EPS (PKR)	10.71	17.30		26.14	30.72	
DPS (PKR)	-	-		-	-	

Source: IGI Research, Company Financials

Shares mn: 326.02

Receivables Position for PSO

PKR'bn	Feb-18	Dec-17	Jun-17
Power Sector	205.5	203.1	176.2
LNG	20.6	16.5	14.0
PIA	13.1	13.3	13.3
PDC	9.6	9.6	9.6
Total	248.8	242.5	213.1
LPS	82.2	80.5	73.7
Total Including LPS	331.0	323.0	286.8

MS, HSD and FO Margins

PKR	Feb-18	1HFY18	1HFY17
MS (per Itr)	2.55	2.48	2.45
HSD (per Itr)	2.41	2.29	2.36
FO (per Mton)	1,636	1,190	1,097

Exhibit: White oil Market Share - Company wise (1HFY18)

1HFY17

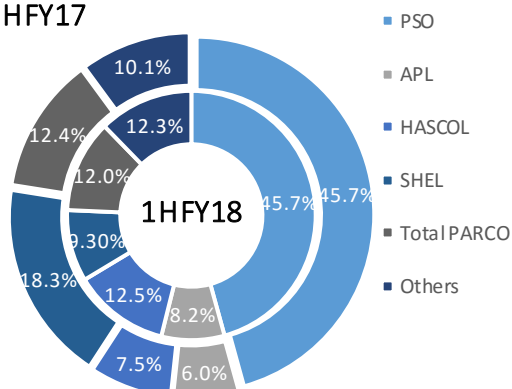
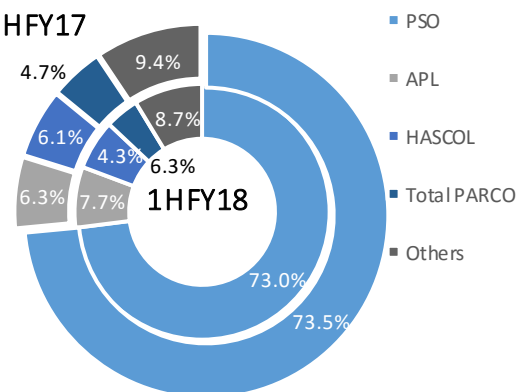


Exhibit: White oil Market Share - Company wise (1HFY18)

1HFY17



Source: Company Financials, IGI Research

Major highlights of analyst briefing as stated by the management

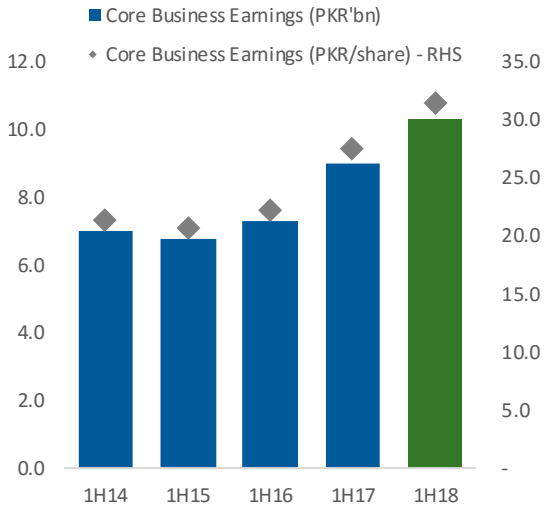
Key takeaway of the analyst briefing included:

- Exchange losses booked were lower than expected as the Company was able to partially pass forex losses on to customers through increase in FO prices as fuel component is pass through item for power sector and write off against previous un-booked exchange gains. Exchange loss was only incurred on MS and HSD during this quarter;
- Receivables dropped to PKR 65bn as at Sep-17 as PIB backed borrowing were paid off however as at Dec-17 short term borrowings have jumped up to PKR 118bn due to rising circular debt
- Despite increasing oil price in 2QFY18 the Company incurred PKR 0.73bn inventory loss as other OMCs withheld inventories to benefit from inventory gains and as a result PSO has to fulfill country's fuel requirement on GoP's directives so that pumps don't run dry leading to inventory losses as inventory levels drop significantly;
- Payout restrained owing to cash constraints during 2QFY18 as circular debt piled up significantly;
- The Company is currently offloading 3 shipments of FO ordered in Nov-17 which were deferred and company has not incurred heavy demurrage charges on it. The cost of fuel for these shipments will be priced based on cost incurred in Nov-17;
- Refinery procurement level stood at 39% in 1HFY18;

Management's business outlook included:

- Company is actively pursuing GoP and some of the outstanding receivables are expected to be settled in near term. If amount is settled the company may increase payout during 3QFY18/4QFY18.
- Management expects PSO's FO sales to remain at 2mn Mtons post FY19 owing to KE which is utilizing FO for power generation and other cash based customers, however summer demand will be key to monitor.
- HSD deregulation is yet to be implemented due to delays in notification and as a result OMC and dealer margins have not been increased.
- LNG business is likely to stay with PSO for some time until notified by GoP to switch to Pakistan LNG terminals.
- Cash flows are not expected to deteriorate drastically during summer.
- Management will not primarily focus on enhancing capacity of PRL but rather focus on up-gradation so that quantity of FO refined is reduced down to 7% from current 35-40% and enhance quantity of MS and HSD.
- Shell Pakistan Limited (SHEL) has been losing market share after oil tanker incident near Ahmedpur and other OMCs have captured SHEL's market share.

Highest ever core earnings in half year before inventory gain/losses, interest income & expenses



Outlook

The company further expects to increase its retail outlets to cater rising demand and under performance of company compared to industry growth. Furthermore, increase in average FO margin (up by +21%YoY in 1HFY18) is expected to lift profitability as margins are deregulated and linked with landed cost price. The Company is expected to increase its storage capacity by 250k Mton in the coming years which is expected to reduce PSO's vulnerability to heavy inventory loss/gain and ease storage concerns especially for MS. Furthermore, increased marketing and sales promotion for lubes should provide a healthy growth in the segment. Continuation of LNG business (1HFY18 volume up by +49%YoY in 1HFY18 to 2.22mn Mtons), increased volumes, lower financing cost on FE-25 loan and recovery of overdue Late Payment Surcharge (LPS) income to partially offset decline in other income.

Recommendation

We maintain a 'BUY' call on PSO with Dec-18 TP of PKR 385/share offering an upside of +31% from its last close. The company is currently trading at FY18E P/E of 6.2x and dividend yield of 5.8%.

Source: Company Financials, IGI Research

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Time Horizon: Dec – 2018

Valuation Methodology: The analyst(s) has used following valuation methodology to arrive at the target price of the said security (ies):

DCF (Discounted Cash Flow)

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