Day Break

Tuesday, 30 October 2018

COMPANY UPDATE

Pakistan State Oil Company Limited
Oil & Gas Marketing Companies

Recommendation	**BUY**
Target Price:	340.6
Last Closing: 29-Oct-18	278.2
Upside:	22.4
Valuation Methodology:	Discounted Cash Flow (DCF)
Time Horizon:	Jun-19

Market Data

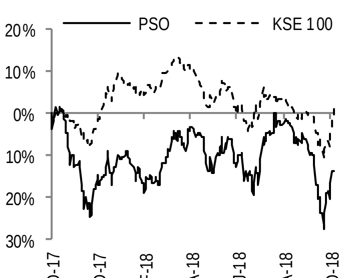
Bloomberg Tkr.		PSO PA
Shares (mn)		391.2
Free Float Shares (mn)		146.7
Free Float Shares (%)		37.5%
Market Cap (PKRbn | USDmn)	108.9	817.6
Exchange		KSE ALL

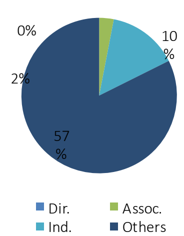
Price Info.	90D	06M	12M
Abs. Return	(5.7)	(10.9)	(13.8)
Lo	213.7	213.7	213.7
Hi	293.4	293.4	297.7

Key Company Financials
Period End: Jun

PKRbn	FY18A	FY19E	FY20F	FY21F
Total Revenue	1,056.9	1,336.6	1,138.5	1,194.2
Net Income	15.5	16.6	14.6	18.4
EPS (PKR)	39.5	42.5	37.2	47.1
DPS (PKR)	15.0	16.0	14.0	18.0
Total Assets	392.4	402.6	419.1	432.2
Total Equity	110.5	121.5	130.5	141.9
Key Financial Ratios				
ROE (%)	14.0	13.7	11.2	13.0
P/E (x)	7.0	6.6	7.5	5.9
P/B (x)	1.4	1.0	0.9	0.8
DY (%)	5.4	5.8	5.0	6.5

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

Abdullah Farhan
Senior Research Analyst
Tel: (+92-21) 111-234-234 Ext.: 912
Abdullah.farhan@igi.com.pk

Oil & Gas – Marketing Companies

PSO: Analyst Briefing Takeaway 1QFY19

- PSO held its analyst briefing on 29th Oct-18 to discuss financial result for 1QFY19 and future prospects of the company. The company reported earnings of PKR 4.18bn (EPS 12.82, Diluted @ 391.2mn EPS PKR 10.69) down by 17%YoY during 1QFY19 as compared to PKR 5.03bn (EPS PKR 15.43, Diluted @ 391.2mn EPS PKR 12.86),
- We attribute this decline in earnings to a) 77%/33%/14%YoY drop in FO/HSD/MS volumes, b) exchange loss of PKR 0.55bn and c) 56%YoY drop in other income due to lower penal interest income,
- On quarterly basis, profitability is up by +87%QoQ to PKR 4.18bn likely on the back of lower exchange losses, higher inventory gains on HSD, increased margins on MS/HSD/FO and lower effective tax rate of 36.6% compared to 67% in the same period last year,
- We maintain a **'BUY'** call on PSO with Jun-19 TP of PKR 340.6/share offering an upside of +22% from its last close. The company is currently trading at FY19E P/E of 6.6x and dividend yield of 5.8%.

Earnings for 1QFY19 reported at PKR 12.82/share down by 17%YoY…

PSO held its analyst briefing on 29th Oct-18 to discuss financial result for 1QFY19 and future prospects of the company. The company reported earnings of PKR 4.18bn (EPS 12.82, Diluted @ 391.2mn EPS PKR 10.69) down by 17%YoY during 1QFY19 as compared to PKR 5.03bn (EPS PKR 15.43, Diluted @ 391.2mn EPS PKR 12.86) in the same period last year. We attribute this decline in earnings to a) 77%/33%/14%YoY drop in FO/HSD/MS volumes, b) exchange loss of PKR 0.55bn and c) 56%YoY drop in other income due to lower penal interest income.

…however earnings are up by +87%QoQ

On quarterly basis, profitability is up by +87%QoQ to PKR 4.18bn likely on the back of lower exchange losses, higher inventory gains on HSD, increased margins on MS/HSD/FO and lower effective tax rate of 36.6% compared to 67% in the same period last year. However, earnings growth remained restricted due to lower other income in the absence of penal interest income and higher finance cost amid higher short term borrowings.

Exhibit:

Financial Highlights

PKRmn	1QFY19	1QFY18	YoY	4QFY18	QoQ
Net Sales	280,028	258,645	8%	312,261	-10%
Gross Profit	10,906	9,172	19%	10,742	2%
Operating Costs	3,581	3,368	6%	5,124	-30%
Other Income	970	2,213	-56%	2,416	-60%
EBIT	8,296	8,018	3%	8,035	3%
Finance Cost	1,826	756	142%	1,437	27%
Profit Before Taxation	6,590	7,420	-11%	6,745	-2%
Taxation	2,409	2,390	1%	4,491	-46%
Profit After Taxation	4,181	5,029	-17%	2,237	87%
EPS (PKR)	12.82	15.43		8.23	
EPS (PKR) – Diluted @ 391.2mn shares	10.69	12.86		5.72	
DPS (PKR)	-	-		-	

Source: IGI Research, Company Financials — *No of Shares: 391.23mn*

JamaPunji
http://www.jamapunji.pk

Receivables Position for PSO

PKR'bn	Oct-18	Sep-18	Jun-18
Power Sector	180.4	184.1	199.9
LNG	19.7	21.0	15.9
PIA	14.0	13.2	13.0
PDC	9.6	9.6	9.6
Exchange loss on FE-25	17.0	11.5	9.7
Total	**223.7**	**227.9**	**238.4**
LPS	92.7	93.2	87.2
Total Inclusing LPS	**316.4**	**321.1**	**325.6**

MS, HSD and FO Margins

PKR	Oct-18	1QFY19	1QFY18
MS (per ltr)	2.64	2.70	2.45
HSD (per ltr)	2.64	2.53	2.34
FO (per Mton)	2,362	2,251	1,090

Exhibit: White oil Market Share-Company wise (1QFY19)

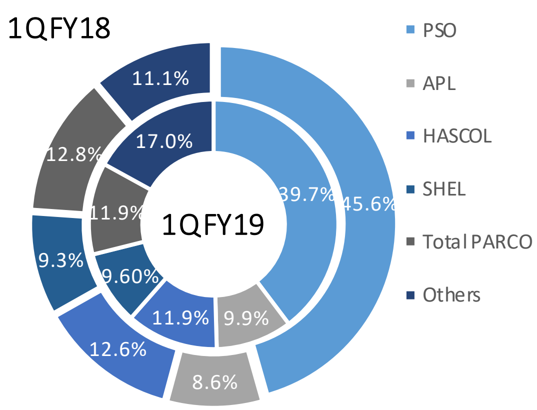
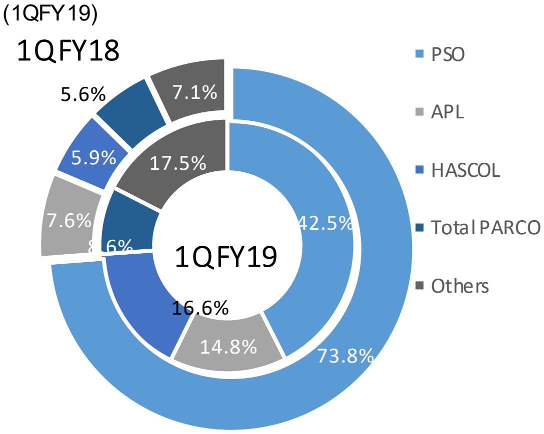


Exhibit: Black oil Market Share - Company wise (1QFY19)



Source: Company Financials, IGI Research

Major takeaways from analyst briefing as stated by the management

Key financial highlights:

- Effective tax rate stood at 36.6% during 1QFY19 compared to 32.3% reported in the corresponding period last year due to application of super tax and deferred tax in respect of difference between corporate tax rate in Finance Bill 2017-18 and 2018-19;
- PSO FE-25 borrowing cost stood at PKR 1.0bn, however the Company did not book any exchange loss on these borrowings in income statement as GoP has guaranteed the payment and subsequently PSO has recorded the amount as other receivables in balance sheet;
- PSO booked in inventory gain of PKR 1.23bn during the 1QFY19 which was mostly due to inventory gain of PKR 2.0bn on HSD. However the Company booked inventory loss on MS leading to net inventory gain of PKR 1.23bn as the company maintained inventory days of 12-15 days on MS while 30 days of inventory on HSD;
- Inventory loss on MS was due to lower inventory days as result of insufficient storage capacity for MS;
- Lubricant sales dropped due to supply chain issues which the Company can manufacturer and supply disruptions in base oil which is expected to be resolved in FY19;
- Other income was lower due to drop in penal interest income realized during quarter;
- Gross profit contribution from LNG increased to PKR 1.8bn during 1QFY19 owing to 6% rise in LNG sales and increase in LNG price.

Management's business outlook included:

- The Company's management is hopeful of positive reforms in power sector to resolve circular debt under the new Government;
- LNG business is likely to stay with PSO for some time until notified by GoP to switch to Pakistan LNG terminals;
- HSD smuggling has been on a rise since Dec-17 leading to overall drop in industry sales. Company is in talks with GoP to ensure resolution of the matter;
- Conversion of FO storage can only be done for HSD due to safety requirements;
- FO demand in the future will only be certain after 2 years once GoP fully realizes the demand and supply gap during the year. Thus for now FO plants are operating on as and when basis;
- PSO has increased its stake in PRL to 52.7% from 24.1% previously and will incur capex to improve efficiency in order for the refinery to remain viable. Setting up refinery in Gwadar will be undertaken as well however it is still in very initial stage;
- Shell Pakistan Limited (SHEL) lost its market share to other OMCs after Ahmedpur incident as SHEL pulled out to ensure all tanker met safety requirements. Post normalization of the matter PSO and other OMCs are likely to witness cut in market share;
- The Company expects to add further 70 new retail outlets in FY19 compared to 68 in FY18 along with revamping of old outlets in remote areas. And as a result of this PSO expects a 2-3% increase in market share in retail segment in FY19.

Outlook

The company further expects to increase its retail outlets by 70 outlet per year to cater rising demand and under performance of company compared to industry growth. Furthermore, increase in average FO margin (up by +2.1xYoY in 1QFY19) is expected to lift profitability as margins are deregulated and linked with landed cost price. The Company is expected to increase it storage capacity by 250k MTons in the coming years which is expected to reduce PSO's vulnerability to heavy inventory loss/gain and ease storage concerns especially for MS. PSO is also focusing on reducing operating cost especially administrative cost. Furthermore, with the incumbent Government focusing on reforming power sector, we believe the circular debt resolution may be eminent either through one off payment or measures to stop accumulation. This in turn would allow PSO's working capital to ease off whereas any lower FO sales would most likely keep a lid on accumulation of circular debt. We expect continuation of LNG business (1QFY19 volume up by +6%YoY to 1.17mn Mtons), increased volumes of JP-1 and MS, and recovery of overdue Late Payment Surcharge (LPS) income to partially offset decline in other income and reduced FO sales going forward.

Recommendation

We maintain a 'BUY' call on PSO with Jun-19 TP of PKR 340.6/share offering an upside of +22% from its last close. The company is currently trading at FY19E P/E of 6.6x and dividend yield of 5.8%.

Important Disclaimer and Disclosures

Research Analyst(s) Certification: The Research Analyst(s) hereby certify that the views about the company/companies and the security/securities discussed in this report accurately reflect his or her or their personal views and that he/she has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report. The analyst(s) is principally responsible for the preparation of this research report and that he/she or his/her close family/relative does not own 1% or more of a class of common equity securities of the following company/companies covered in this report.

Disclaimer: The information and opinions contained herein are prepared by IGI Finex Securities Limited and is for information purposes only. Whilst every effort has been made to ensure that all the information (including any recommendations or opinions expressed) contained in this document (the information) is not misleading or unreliable, IGI Finex Securities Limited makes no representation as to the accuracy or completeness of the information. Neither, IGI Finex Securities Limited nor any director, officer or employee of IGI Finex Securities Limited shall in any manner be liable or responsible for any loss that may be occasioned as consequence of a party relying on the information. This document takes no account of the investment objectives, financial situation and particular needs of investors, who shall seek further professional advice before making any investment decision. This document and the information may not be reproduced, distributed or published by any recipient for any purpose. This report is not directed or intended for distribution to, or use by any person or entity not a client of IGI Finex Securities Limited, else directed for distribution.

Rating system: IGI Finex Securities employs three tier ratings system, depending upon expected total return (return is defined as capital gain exclusive of tax) of the security in stated time period, as follows:

Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
Hold	If target price on aforementioned security(ies) is in between -10% and 10%, from its last closing price(s)
Sell	If target price on aforementioned security(ies) is less than -10%, from its last closing price(s)

Time Horizon: Jun – 2019

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

Risk: Investment in securities are subject to economic risk, market risk, interest rate risks, currency risks, and credit risks, political and geopolitical risks. The performance of company (ies) covered herein might unfavorably be affected by multiple factors including, business, economic, and political conditions. Hence, there is no assurance or guarantee that estimates, recommendation, opinion, etc. given about the security (ies)/company (ies) in the report will be achieved.

Basic Definitions and Terminologies used: Target Price: A price target is the projected price level of a financial security stated by an investment analyst or advisor. It represents a security's price that, if achieved, results in a trader recognizing the best possible outcome for his investment, Last Closing: Latest closing price, Market Cap.: Market capitalization is calculated by multiplying a company's shares outstanding by current trading price. EPS: Earnings per Share. DPS: Dividend per Share. ROE: Return on equity is the amount of net income returned as a percentage of shareholders' equity. P/E: Price to Earnings ratio of a company's share price to its per-share earnings. P/B: Price to Book ratio used to compare a stock's market value to its book value. DY: The dividend yield is dividend per share, divided by the price per share. CY/FY: Calendar/Fiscal/Financial Year. YoY/ QoQ/ MoM: Year-on-Year, Quarter-on-Quarter, Month-on-Month. Th /Mn /Bn /Tn: Thousands/Million/Billion/Trillion.

IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009

© Copyright 2018 IGI Finex Securities Limited

Contact Details

Research Team

Saad Khan	Head of Research	Tel: (+92-21) 111-234-234 Ext: 810	saad.khan@igi.com.pk
Abdullah Farhan	Senior Analyst	Tel: (+92-21) 111-234-234 Ext: 912	abdullah.farhan@igi.com.pk
Suleman Ashraf	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 957	suleman.ashraf@igi.com.pk
Muhammad Saad	Research Analyst	Tel: (+92-21) 111-234-234 Ext: 816	muhammad.saad@igi.com.pk
Umesh Solanki	Database Manager	Tel: (+92-21) 111-234-234 Ext: 974	umesh.solanki@igi.com.pk

Equity Sales

Faisal Jawed Khan	Head of Equities	Tel: (+92-21) 35301779	faisal.jawed@igi.com.pk
Zaeem Haider Khan	Regional Head (North)	Tel: (+92-42) 35777863-70	zaeem.haider@igi.com.pk
Muhammad Naveed	Regional Manager (Islamabad & Upper North)	Tel: (+92-51) 2604861-62	muhammad.naveed@igi.com.pk
Irfan Ali	Regional Manager (Faisalabad)	Tel: (+92-41) 2540843-45	irfan.ali@igi.com.pk
Asif Saleem	Branch Manager (RY Khan)	Tel: (+92-68) 5871652-56	asif.saleem@igi.com.pk
Mehtab Ali	Branch Manager (Multan)	Tel: (+92-61) 4512003	mahtab.ali@igi.com.pk
Zeeshan Kayani	Branch Manager (Abbottabad)	Tel: (+92-992) 408243-44	zeeshan.kayani@igi.com.pk
Ihsan Mohammad	Branch Manager (Peshawar)	Tel: (92-91) 5253035	ihsan.mohammad@igi.com.pk

IGI Finex Securities Limited
Trading Rights Entitlement Certificate (TREC) Holder of
Pakistan Stock Exchange Limited |
Corporate member of Pakistan Mercantile Exchange Limited

Head Office
Suite No 701-713, 7th Floor, The Forum, G-20,
Khayaban-e-Jami Block-09, Clifton, Karachi-75600
UAN: (+92-21) 111-444-001 | (+92-21) 111-234-234
Fax: (+92-21) 35309169, 35301780
Website: www.igisecurities.com.pk

Stock Exchange Office
Room # 134, 3rd Floor, PSX Building,
Stock Exchange Road, Karachi.
Tel: (+92-21) 32429613-4, 32462651-2 ,
Fax: (+92-21) 32429607

Lahore Office Shop # G-009, Ground Floor, Packages Mall Tel: (+92-42) 35777863-70, 35876075-76 Fax: (+92-42) 35763542	**Islamabad Office** Mezzanine Floor, Office 5, 6 & 7, Kashmir Plaza, Block- B, Jinnah Avenue, Blue Area Tel: (+92-51) 2604861-2, 2604864, 2273439 Fax: (+92-51) 2273861
Faisalabad Office Room #: 515-516, 5th Floor, State Life Building, 2- Liaqat Road Tel: (+92-41) 2540843-45 Fax: (+92-41) 2540815	**Rahim Yar Khan Office** Plot # 12, Basement of Khalid Market, Model Town, Town Hall Road Tel: (+92-68) 5871653-6, 5871652 Fax: (+92-68) 5871651
Multan Office Mezzanine Floor, Abdali Tower, Abdali Road Tel: (92-992) 408243 - 44	**Abbottabad Office** Ground Floor, Al Fatah Shoppinig Center , Opp. Radio Station, Mansehra Road Tel: (+92-99) 2408243 - 44
Peshawar Office 2nd Floor, The Mall Tower, 35 The Mall Peshawar Cantt. Tel: (92-91) 5253035, 5278448	**Sialkot Office** Suite No. 10 & 11, 1st Floor, Soni Square, Mubarik Pura Tel: (+92-52) 3258437, 3258762

IGI Finex Securities Limited
Research Analyst(s)
Research Identity Number: BRP009
© Copyright 2018 IGI Finex Securities Limited

JamaPunji
http://www.jammapunji.pk