Day Break

Thursday, 28 June 2018

Sector Update

OMC Sector

PKR/share	TP	Upside	P/E	D/Y
PSO	407.0	27.9%	6.0	6.0%
APL	740.3	26.4%	8.9	7.9%
HASCOL	379.7	25.6%	21.8	2.6%

PSO

PKR/share	FY18E	FY19F	FY20F	TP
Old EPS	50.8	50.7	47.2	385.2
Revised EPS	53.0	55.1	47.6	407.0
% change	*4%*	*9%*	*1%*	*6%*

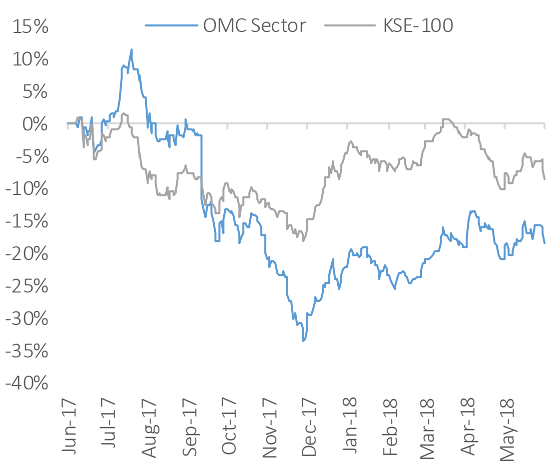
APL

PKR/share	FY18E	FY19F	FY20F	TP
Old EPS	64.2	64.8	68.3	677.0
Revised EPS	66.1	68.1	74.4	740.3
% change	*3%*	*5%*	*9%*	*9%*

HASCOL

PKR/share	CY18E	CY19F	CY20F	TP
Old EPS	8.7	12.9	19.1	327.9
Revised EPS	13.9	14.8	19.1	379.7
% change	*58%*	*14%*	*0%*	*16%*

Relative Performance to KSE 100



Source: Bloomberg, PSX & IGI Research

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Oil & Gas – Marketing Companies

OMC and dealer margins increased for MS and HSD in line with CPI inflation; rise in FO price and volume a further respite

- We have revised upwards our earnings estimates for Hascol Petroleum Limited (HASCOL), Attock Petroleum Limited (APL) and Pakistan State Oil (PSO) based on a) increase in Motor Spirit (MS) and High Speed Diesel (HSD) margins post notification by Petroleum Division (mainly HSD as margin increase was delayed throughout FY18 due to deregulation of margins), b) higher price of Furnace Oil (FO) and, c) improved volumes of FO during 4QFY18,
- The OMC margins have been augmented by PKR 0.09/ltr and PKR 0.23/ltr to PKR 2.64/ltr each for MS and HSD respectively,
- Based on the hike in OMC margins, we expect incremental earnings impact of +15%, +6% and +5% for HASCOL, APL and PSO respectively for CY18/FY19,
- The GoP imposed super tax of 3% in FY18 with a gradual reduction of 1% annually while simultaneously providing a gradual relief of 1% annual reduction in corporate tax rate to stand at 25% by FY23 from 30% in FY18,
- We maintain PSO as our top pick with our Dec-18 target price of PKR 407.0/share offering +27.9% upside from its last close. PSO is currently trading at P/E of 6.0x and offers a dividend yield of 6.0%. We have a **'BUY'** stance on APL and HASCOL with our Dec-18 target price of PKR 740.3/share and PKR 379.7/share, offering +26.4% and +25.6% upside respectively from last close.

Earning revised on account of hike in OMC margins for MS and HSD

We have revised upwards our earnings estimates for Hascol Petroleum Limited (HASCOL), Attock Petroleum Limited (APL) and Pakistan State Oil (PSO) based on a) increase in Motor Spirit (MS) and High Speed Diesel (HSD) margins post notification by Petroleum Division (mainly HSD as margin increase was delayed throughout FY18 due to deregulation of margins), b) higher price of Furnace Oil (FO) and, c) improved volumes of FO during 4QFY18. We have increased our earnings estimates for HASCOL, APL and PSO by 58%-14%, 3%-5% and 4%-9% for FY/CY18-19 and a 2%-9% increase on average for FY/CY20-23F to incorporate 1% gradual reduction in tax rate to 25% by FY/CY23. As a result, our target prices have been revised upwards by +16%, +9% and +6% to PKR 379.7/share, PKR 740.3/share and PKR 407.0/share for HASCOL, APL and PSO respectively.

OMC and dealer margins increased for MS and HSD

The Petroleum Division in its letter to Oil & Gas Regulatory Authority (OGRA) has conveyed a decision of the Economic Coordination Committee (ECC) taken on 30th May-18 regarding increase in OMC and dealer margins for MS and HSD. The OMC margins have been augmented by PKR 0.09/ltr and PKR 0.23/ltr to PKR 2.64/ltr each for MS and HSD respectively, while increasing the dealer margin by PKR 0.12/ltr and PKR 0.26/ltr. The aforementioned increase in margins would be effective from Jul-18, which would result in overall rise of PKR 0.21/ltr and PKR 0.49/ltr in MS and HSD price assuming all other pricing components remain unchanged.

Annual margin revision linked with CPI

To recall, GoP announced in 2016 that OMC margins for MS and HSD would be aligned annually as per CPI inflation of the preceding year as an incentive to OMCs. As a result OMC margins for MS and HSD, which cumulatively account for almost 59% of the total volumes of OMCs in Pakistan, were extended by PKR 2.55/ltr each in FY18 (up by +4.16%). However, since HSD margins were deregulated by GoP during 1HFY18 and due to delays in implementation of deregulated margins the increase in OMC margin was not implemented and stood at FY17 margin of PKR 2.41/ltr. Due to this reason, the effective increase in HSD margin is greater than MS to account for margin increment of FY17 and FY18 combined.

SHEL and HASCOL likely to be prime beneficiaries

We highlight SHEL and HASCOL to be prime beneficiaries of the margin increase as MS and HSD accounts for nearly 87% and 73% of its total sales volume compared to 45% and 67% for PSO and APL excluding non-energy products. Based on the hike in OMC margins, we expect incremental earnings impact of +15%, +6% and +5% for HASCOL, APL and PSO respectively for CY18/FY19.

Exhibit:
Historical OMC margins for MS and HSD

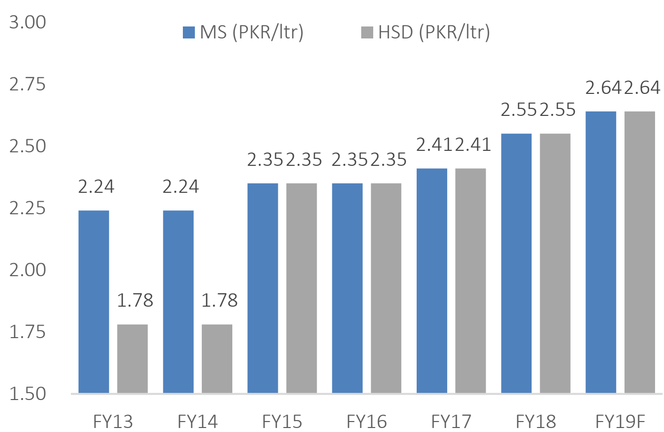
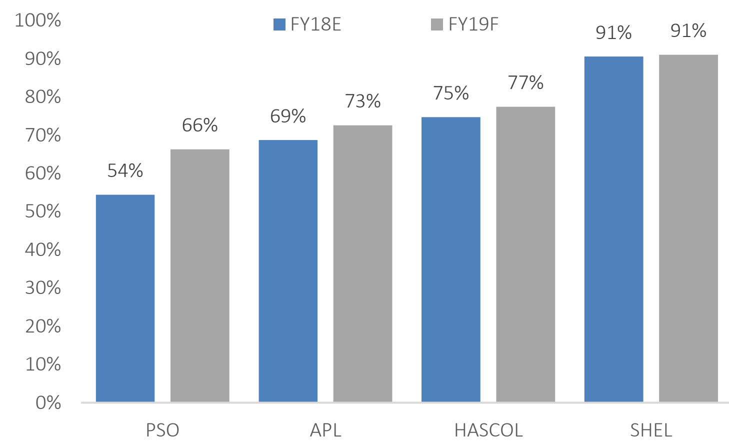


Exhibit:
MS and HSD contribution in total product mix for PSO, APL, SHEL and HASCOL



Source: IGI Research, OCAC, OGRA, PSO

Rise in FO price and gradual reduction of corporate tax imposed in Budget 2018-19

The GoP imposed super tax of 3% in FY18 with a gradual reduction of 1% annually while simultaneously providing a gradual relief of 1% annual reduction in corporate tax rate to stand at 25% by FY23 from 30% in FY18. As a result of these tax measures we estimate earnings attrition of 2%-5% for FY/CY18-19 for all PSO, APL and HASOCL while earnings accretion of 1%-7% is expected for FY/CY20-23. Furthermore, FO prices have increased by nearly ~59% in FY18TD on the back of PKR depreciation and rise in international oil prices. As a result, OMC margins have picked up substantially in FY18 and post imposition of ban on FO based power generation volumes have picked up substantially in 4QFY18 as power generation on FO has normalized amid lower Hydel generation and rise in demand. As a result we have raised our FO price assumption to PKR 57,000/Mton (up by +5%) for FY18 leading to 3%-5% increase in earnings for PSO, APL and HASCOL. We highlight, PSO to benefit most from rise in FO prices as FO is expected to contribute nearly 39% in FY18 compared to 29% and 25% for APL and HASCOL.

Recommendation

We maintain PSO as our top pick with our Dec-18 target price of PKR 407.0/share offering +27.9% upside from its last close. PSO is currently trading at P/E of 6.0x and offers a dividend yield of 6.0%. We have a **'BUY'** stance on APL and HASCOL with our Dec-18 target price of PKR 740.3/share and PKR 379.7/share, offering +26.4% and +25.6% upside respectively from last close.

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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):
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