Day Break

Tuesday, 24 April 2018

IGI Securities

COMPANY UPDATE

Pakistan State Oil Company Limited
Oil & Gas Marketing Companies

Recommendation		**BUY**
Target Price:		385.2
Last Closing:	23-Apr-18	327.8
Upside:		17.5
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)		106.9	923.5
Exchange			KSE 100
Price Info.	90D	06M	12M
Abs. Return	3.3	(8.5)	(26.1)
Lo	286.3	265.2	265.2
Hi	337.6	362.6	475.3

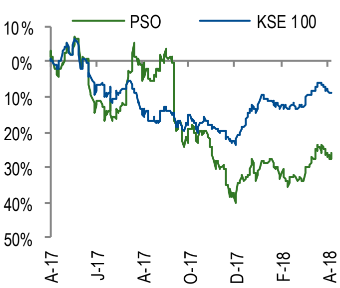
Key Company Financials
Period End: Jun

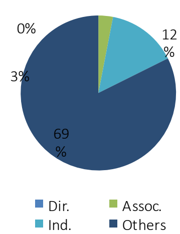
PKRbn	**FY17A**	**FY18E**	**FY19F**	**FY20F**
Total Revenue	878.1	779.7	807.7	892.3
Net Income	18.2	16.6	16.5	15.4
EPS (PKR)	55.9	50.8	50.7	47.2
DPS (PKR)	25.0	18.0	18.0	17.0
Total Assets	392.4	337.1	327.4	310.1
Total Equity	102.8	114.1	124.8	134.6

Key Financial Ratios

ROE (%)	17.7	14.5	13.3	11.4
P/E (x)	5.9	6.5	6.5	6.9
P/B (x)	1.2	1.0	0.9	0.9
DY (%)	7.6	5.5	5.5	5.2

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 3QFY18

- We have revised upwards our earnings estimates for Pakistan State Oil Company Limited (PSO) by 8%/24% for FY18/19 after incorporating 3QFY18 result. We have revised our earnings based on a) higher inventory gain on FO of PKR 1.71bn during 3QFY18 and, b) continuation of LNG business in FY19;
- PSO held its analyst briefing on 23rd Apr-18 to discuss financial result for 3QFY18 and future prospects of the company. The company reported earnings of PKR 4.70bn (EPS PKR 14.42) up by +14%YoY during 3QFY18 as compared to PKR 4.14bn (EPS PKR 12.70) in the same period last year.
- With circular debt payments of PKR 100-200bn expected to be released in May-18 along with PKR 70-80bn already injected in to the power sector to ensure smooth operations, we expect PSO's working capital to ease off whereas any lower FO sales would most likely keep a lid on accumulation of circular debt
- We maintain a **'BUY'** call on PSO with Dec-18 TP of PKR 385/share offering an upside of +18% from its last close. The company is currently trading at FY18E P/E of 6.5x and dividend yield of 5.5%.

Estimates revised by 8%/24% for FY18/19 post 3QFY18 result

We have revised upwards our earnings estimates for Pakistan State Oil Company Limited (PSO) by 8%/24% for FY18/19 after incorporating 3QFY18 result. We have revised our earnings based on a) higher inventory gain on FO of PKR 1.71bn during 3QFY18 and, b) continuation of LNG business in FY19. However we have increased our finance cost given that the Company has incurred exchange loss due to nearly 10% PKR depreciation in FY18TD. As a result, we have kept our TP intact at PKR 385/share.

Earnings for 3QFY18 reported at PKR 14.42/share up by +14%YoY…

PSO held its analyst briefing on 23rd Apr-18 to discuss financial result for 3QFY18 and future prospects of the company. The company reported earnings of PKR 4.70bn (EPS PKR 14.42) up by +14%YoY during 3QFY18 as compared to PKR 4.14bn (EPS PKR 12.70) in the same period last year. We attribute this incline in earnings to a) inventory gains of PKR 1.71bn primarily on FO, b) lower exchange loss of PKR 130mn as PSO passed on the impact of exchange rate on the IPPs and c) +1%/+7%YoY increase in MS/JP-1 sales. Effective tax rate increased to 36% during 3QFY18 compared to 38% in the same period last year.

…bringing 9MFY18 EPS to PKR 40.56, down by 7%YoY

As a result, PSO's earnings for 9MFY18 stands at PKR 13.23bn (EPS PKR 40.56) down by 7%YoY primarily owing to a) inventory loss of PKR 0.23bn, b) 29%YoY decline in FO sales and, c) higher effective tax rate of 35%. The company paid out cash dividend of PKR 10.0/share owing to receipt of cash from IPPs as GoP injected PKR 70-80bn during 3QFY18 to ease rising circular debt.

Exhibit:
Financial Highlights

PKRmn	3QFY18	3QFY17	YoY	9MFY18	9MFY17	YoY
Net Sales	226,286	218,160	4%	744,639	629,508	18%
Gross Profit	10,182	9,232	10%	28,912	27,123	7%
Operating Costs	3,089	2,904	6%	10,139	9,670	5%
Other Income	2,112	1,703	24%	5,081	8,019	-37%
EBIT	9,204	8,031	15%	23,853	25,472	-6%
Finance Cost	1,907	1,485	28%	3,686	4,331	-15%
PBT	7,353	6,716	9%	20,433	21,677	-6%
PAT	4,703	4,141	14%	13,225	14,156	-7%
EPS (PKR)	14.42	12.70		40.56	43.42	
DPS (PKR)	10.00	10.00		10.00	10.00	

Source: IGI Research, Company Financials *No of Shares: 326.02mn*

Receivables Position for PSO

PKR'bn	Apr-18	Mar-18	Jun-17
Power Sector	179.7	185.6	176.2
LNG	22.4	21.6	14.0
PIA	13.2	13.1	13.3
PDC	9.6	9.6	9.6
Total	**224.9**	**229.9**	**213.1**
LPS	83.9	83.9	73.7
Total Inclusing LPS	**308.8**	**313.8**	**286.8**

MS, HSD and FO Margins

PKR	Apr-18	9MFY18	9MFY17
MS (per ltr)	2.55	2.57	2.40
HSD (per ltr)	2.41	2.24	2.31
FO (per Mton)	1,712	1,308	1,020

Exhibit: White oil Market Share - Company wise (9MFY18)

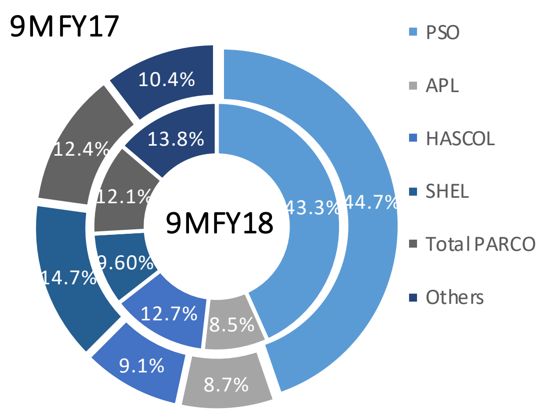
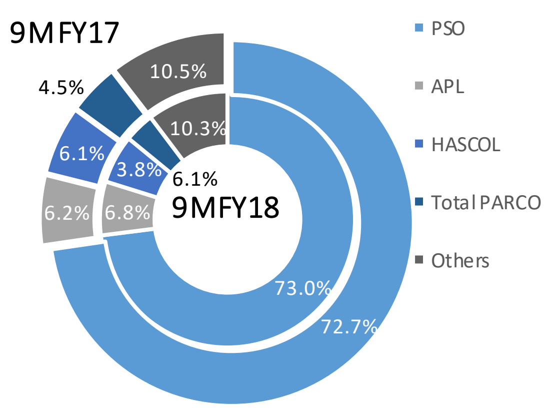


Exhibit: White oil Market Share - Company wise (1HFY18)



Source: Company Financials, IGI Research

Major highlights of analyst briefing as stated by the management

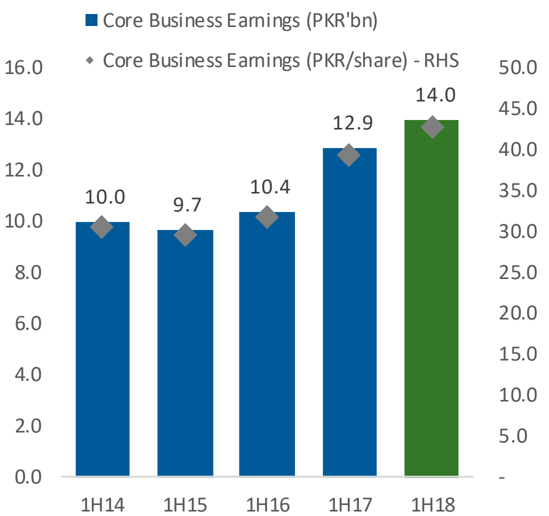
Key takeaway of the analyst briefing included:

- 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 which was low as refinery procurement level was high and PSO had minimal LCs;
- PSO FE-25 borrowing currently stands at USD 850mn, 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;
- The Company was able to announce cash dividend of PKR 10/share owing to receipt of nearly PKR 50-80bn from GoP to ensure smooth operation of energy sector during summer time;
- Refinery procurement level stood at 40% however white oil procurement was above 60% while black oil (mostly FO) was below 30%;
- PSO booked in inventory gain of PKR 1.71bn during the 3QFY18 which was mostly on FO as the shipments ordered and stuck at port since Nov-17 were offloaded in Feb-18 and Mar-18 during which time FO prices jumped up by +46% to PKR 67,052/Mton in Feb-18;
- The Company currently maintains 20 days of inventory for HSD (excluding pipeline), 14 days on MS and 10 days on FO.

Management's business outlook included:

- Company is actively pursuing GoP and some of the outstanding receivables are expected to be settled in near term. The estimated amount to be injected in to power sector by May-18 which will ultimately come to PSO may vary in the range of PKR 100-200bn, however it will only clear the outstanding receivables amount and not the overdue penal interest income which is recorded in the income statement;
- LNG business is likely to stay with PSO for some time until notified by GoP to switch to Pakistan LNG terminals;
- HSD deregulation is yet to be implemented due to delays in notification and as a result OMC and dealer margins have not been increased;
- PSO is currently pursuing ECC to resolve the double taxation on LNG and enhance Company's margin as well;
- For the summer season PSO has currently received order of 15,000MTPD of FO from GoP;
- PSO will incur capex on PRL to upgrade the refinery rather than enhance capacity and is targeting on reducing the FO quantity to ~7% from currently ~40% and establish a coker unit to convert FO into 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



Source: Company Financials, IGI Research

Outlook

The company further expects to increase its retail outlets by 60 outlet per year 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 it 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. PSO is also focusing on reducing operating cost especially administrative cost to . Furthermore, with circular debt payments of PKR 100-200bn expected to be released in May-18 along with PKR 70-80bn already injected in to the power sector to ensure smooth operations, we expect 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 (9MFY18 volume up by +34%YoY to 3.33mn 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 Dec-18 TP of PKR 385/share offering an upside of +18% from its last close. The company is currently trading at FY18E P/E of 6.5x and dividend yield of 5.5%.

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Recommendation	Rating System
Buy	If target price on aforementioned security(ies) is more than 10%, from its last closing price(s)
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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):
(Discounted Cash Flow)

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