Day Break

Wednesday, 15 August 2018

IGI Securities

COMPANY UPDATE

Pakistan State Oil Company Limited
Oil & Gas Marketing Companies

Recommendation	NEUTRAL
Target Price:	383.5
Last Closing: 13-Aug-18	352.1
Upside:	8.9
Valuation Methodology:	Discounted Cash Flow (DCF)
Time Horizon:	Dec-18

Market Data

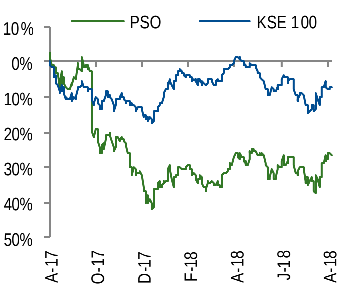
Bloomberg Tkr.		PSO PA
Shares (mn)		326.0
Free Float Shares (mn)		146.7
Free Float Shares (%)		45.0%
Market Cap (PKRbn | USDmn)	114.8	931.8
Exchange		KSE 100

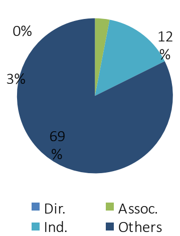
Price Info.	90D	06M	12M
Abs. Return	(0.5)	7.4	(26.6)
Lo	284.7	284.7	265.2
Hi	337.6	341.1	466.6

Key Company Financials
Period End: Jun

PKRbn	FY18A	FY19E	FY20F	FY21F
Total Revenue	1,056.9	1,143.6	933.6	1,002.4
Net Income	15.5	18.6	16.3	18.6
EPS (PKR)	47.4	57.2	49.9	57.1
DPS (PKR)	15.0	21.0	18.0	21.0
Total Assets	392.4	360.2	353.6	324.0
Total Equity	113.8	125.6	136.1	147.8
Key Financial Ratios				
ROE (%)	13.6	14.8	12.0	12.6
P/E (x)	7.4	6.2	7.1	6.2
P/B (x)	1.8	1.0	0.9	0.8
DY (%)	4.3	6.0	5.1	6.0

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 FY18

- PSO held its analyst briefing on 13th Aug-18 to discuss financial result for 4QFY18 and future prospects of the company. The company reported earnings of PKR 2.24bn (EPS PKR 6.86) down by 45%YoY during 4QFY18 as compared to PKR 4.07bn (EPS PKR 12.48) in the same period last year,
- We attribute this decline in earnings to a) higher effective tax rate of 67% due to super tax and deferred tax liability, b) exchange loss of PKR 215mn and c) 33%/6% drop in FO/HSD sales. The company announced cash dividend of PKR 5.0/share taking total cash payout for FY18 to PKR 15.0/share along with a bonus issue of 20%,
- 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 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%.

Earnings for 4QFY18 reported at PKR 6.86/share down by 45%YoY…

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…bringing FY18 EPS to PKR 47.42, down by 15%YoY

As a result, PSO's earnings for FY18 stands at PKR 15.46bn (EPS PKR 47.42) down by 15%YoY primarily owing to a) exchange loss of PKR 1.0bn, b) 30%YoY decline in FO sales, c) 30%YoY drop in other income in the absence of PIB income and, d) higher effective tax rate of 43%. The Company also reported a 30%YoY drop in FO sales, however +27%YoY and +11%YoY rise in LNG and JP-1 sales offset the impact of lower FO volumes.

Exhibit:

PSO Financial Highlights

PKRmn	4QFY18	4QFY17	YoY	FY18	FY17	YoY
Net Sales	312,261	248,638	26%	1,056,901	878,147	20%
Gross Profit	10,724	10,075	6%	39,636	37,199	7%
Operating Costs	5,124	3,612	42%	15,263	13,282	15%
Other Income	2,416	2,726	-11%	7,497	10,745	-30%
EBIT	8,017	9,189	-13%	31,870	34,662	-8%
Finance Cost	1,437	1,592	-10%	5,123	5,923	-14%
PBT	6,727	7,670	-12%	27,160	29,347	-7%
PAT	2,237	4,069	-45%	15,461	18,226	-15%
EPS (PKR)	6.86	12.48		47.42	55.9	
EPS (PKR) Bonus Adjusted	5.72	10.4		39.52	46.59	
DPS (PKR)	5.00	15.00		15.00	25.00	
Bonus	20%	20%		20%	20%	

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

JamaPunji
http://www.jamapunji.pk

Receivables Position for PSO

PKR'bn	Aug-18	Jun-18	Jun-17
Power Sector	196.0	199.9	176.2
LNG	19.7	15.9	14.0
PIA	13.7	13.0	13.3
PDC	9.6	9.6	9.6
Total	**239.0**	**238.4**	**213.1**
LPS	91.7	87.2	73.7
Total Inclusing LPS	**308.8**	**325.6**	**286.8**

MS, HSD and FO Margins

PKR	Aug-18	FY18	FY17
MS (per ltr)	2.64	2.59	2.36
HSD (per ltr)	2.64	2.23	2.30
FO (per Mton)	2,311	1,415	1,117

Exhibit: White oil Market Share - Company w ise (FY18)

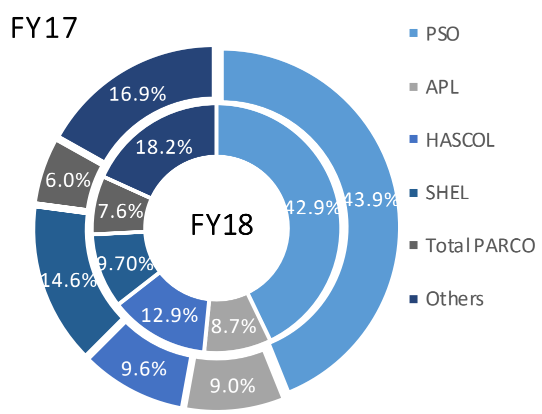
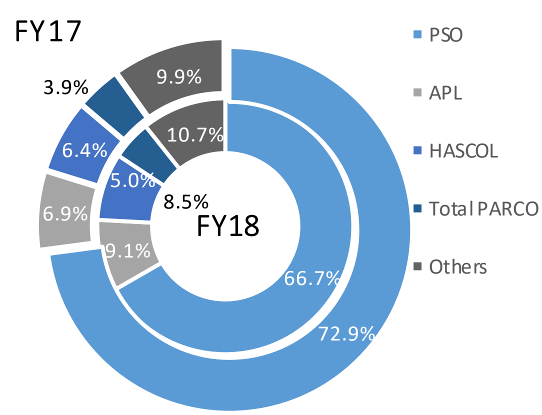


Exhibit: Black oil Market Share - Company w ise (FY18)



Source: Company Financials, IGI Research

Major takeaways from analyst briefing as stated by the management

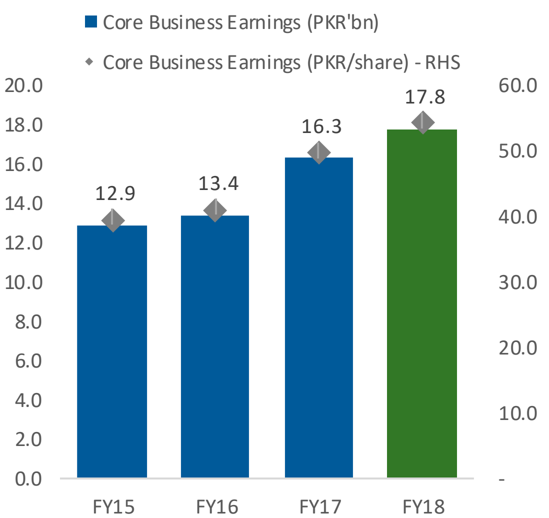
Key financial highlights:

- Effective tax rate stood at 67% during 4QFY18 compared to 47% 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 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;
- Current short term borrowings stand at PKR 130bn and total receivables stand at PKR 331bn which are up by PKR 44bn since FY17;
- PSO booked in inventory gain of PKR 0.62bn during the 4QFY18 which was mostly due to inventory gain of PKR 1.39bn, PKR 0.63bn and PKR 0.59bn on FO, HSD and JP-1/JP-8. However the Company booked heavy inventory loss of PKR 2.06bn on MS leading to net inventory gain of PKR 0.62bn;
- Inventory loss on MS was due to lower inventory days as result of insufficient storage capacity for MS;
- Lubricant volumetric growth was slow due to supply chain issues which the Company expects to be resolved in FY19.

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 deregulation is yet to be implemented due to delays in notification;
- ECC has approved hike in LNG margins for PSO, but formal notification from OGRA is pending;
- PSO is currently supplying FO to cash based customers such as KEL and AES Lalpir. PSO will keep on supplying FO to efficient plants on cash basis which rank higher on merit order list while demand from other plants will emanate on as and when basis when electricity demand peaks during summer season. Management foresees a sustainable demand of 2.5-3.0mn tons in the short-medium term;
- 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. It is estimated to cost around PKR 1.0bn and will take around 4-5 years to complete;
- Shell Pakistan Limited (SHEL) has been losing market share after oil tanker incident near Ahmedpur which led to dumping of fuel by other OMCs at SHEL retail outlets. However, once SHEL resumes normal operations other OMCs may witness slow-down in growth momentum while PSO shall remained unaffected;
- 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.

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 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 +27%YoY in FY18) 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 (FY18 volume up by +27%YoY to 4.49mn 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 **'HOLD'** call on PSO with Dec-18 TP of PKR 383.5/share offering an upside of +9% from its last close. The company is currently trading at FY19E P/E of 6.2x and dividend yield of 6.0%.

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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)
Hold	If target price on aforementioned security(ies) is in between -10% and 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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