Day Break

Tuesday, 03 October 2017

COMPANY UPDATE

PAKISTAN STATE OIL COMPANY LIMITED
OIL & GAS MARKETING COMPANIES

Recommendation		BUY
Target Price:		511.1
Last Closing:	2-Oct-17	442.8
Upside:		15.4
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		Jun-18

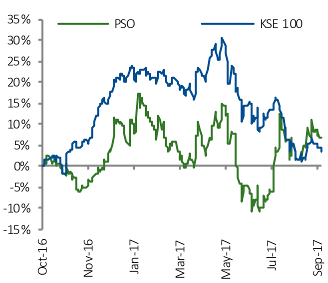
Market Data

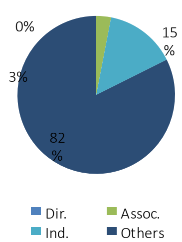
Bloomberg Tkr.			PSO PA
Shares (mn)			271.7
Free Float Shares (mn)			122.3
Free Float Shares (%)			45.0%
Market Cap (PKRbn | USDmn)		120.3	1,141.3
Exchange			KSE 100
Price Info.	90D	180D	365D
Abs. Return	15.9	7.5	6.9
Lo	368.4	368.4	368.4
Hi	466.6	475.3	486.1

Key Company Financials
Period End: Jun

PKRbn	FY16A	FY17A	FY18E	FY19F
Total Revenue	678.0	878.1	885.1	982.3
Net Income	10.27	18.2	17.7	17.7
EPS (PKR)	37.8	67.1	65.0	65.2
DPS (PKR)	12.5	25.0	20.0	20.0
Total Assets	342.3	392.4	318.9	340.6
Total Equity	91.6	102.8	115.1	127.4
Key Financial Ratios				
ROE (%)	11.2	17.7	15.4	13.9
P/E (x)	11.7	6.6	6.8	6.8
P/B (x)	1.3	1.2	1.0	0.9
DY (%)	2.8	5.6	4.5	4.5

Relative Price Performance & Shareholding





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 Gearing Steam to Sprint Again; Earnings revised with 'BUY' Intact

- We provide a detailed review of the full year performance of Pakistan State Oil Company Limited (PSO) based on FY17 financial statements. We have also revised our earnings estimated going forward and target price.
- PSO reported earnings of PKR 18.23bn (EPS PKR 67.08) up by +77%YoY during FY17 as compared to PKR 10.27bn (EPS PKR 37.81) in the same period last year.
- We have revised down our earnings estimates for PSO by 9%-20% from FY18F-20F on the back of a) discontinuation of PIB income owing to maturity in Jul-17 against our assumption of rollover at lower rate and, b) increased selling and distribution expense on the back higher sales promotion expense.
- Based on downward revision in earnings while improved cash flows as a result of cash proceeds from PIBs, we have marginally revised down our Target Price for PSO while maintaining **'BUY'** stance on the scrip with our revised and rolled over Jun-18 TP of PKR 511/share. The stock offers +15% upside from its last closing and is currently trading at FY18E P/E of 6.8x and dividend yield of 4.5%.

PSO: Earnings Revised based on full year financial reports

We provide a detailed review of the full year performance of Pakistan State Oil Company Limited (PSO) based on FY17 financial statements. We have also revised our earnings estimated going forward and target price.

Earnings for FY17 reported at PKR 67.08/share up by +77%YoY

PSO reported earnings of PKR 18.23bn (EPS PKR 67.08) up by +77%YoY during FY17 as compared to PKR 10.27bn (EPS PKR 37.81) in the same period last year. Earnings during FY17 were primarily driven by a) after tax inventory gains of PKR 1.06bn (PKR 3.9/share) as compared to an inventory loss of PKR 5.29bn (PKR 19.5/share) in the same period last year, b) +5%/+10%YoY rise in white/black oil sales led by +9%/+18%/+11%YoY rise in MS/Jet Fuel/FO volumes, c) increase in FO margin by +7%YoY to PKR 1,021/Mton and, d) +28%YoY jump in lubricant sales to 35.4Ktons.

To highlight, PSO reported highest ever core earnings before inventory gain/losses, interest income and expenses of PKR 16.2bn (~PKR 59.6/share) in FY17. The company announced higher than expected cash dividend of PKR 15.0/share along with the result (total FY17 cash dividend of PKR 25/share), accompanied by a surprise bonus share of 20%.

4QFY17 earnings down by 28%YoY to PKR 14.98/share

On quarterly basis, earnings clocked in at PKR 4.07bn (EPS PKR 14.98) during 4QFY17 as compared to PKR 5.68bn (EPS PKR 20.90) in the same period last year. This drop in earnings is primarily attributable to a) after tax inventory gains of PKR 591mn, b) 54%YoY decline in other income owing to lower Late Payment Surcharge (LPS) income and, c) 46.9% effective tax rate during 4QFY17 (4QFY16: 40.6%).

Exhibit:

Financial Highlights

PKRmn	4QFY17	4QFY16	YoY	QoQ	FY17	FY16	YoY
Net Sales	248,649	189,380	31%	14%	878,147	677,967	30%
Gross Profit	10,158	9,222	10%	10%	37,199	22,863	63%
Operating Costs	3,694	3,399	9%	27%	13,282	12,835	3%
Other Op. Income	2,726	5,870	-54%	60%	10,745	12,798	-16%
Finance Cost	1,592	2,135	-25%	7%	5,923	7,150	-17%
PBT	7,670	9,558	-20%	14%	29,347	16,289	80%
PAT	4,069	5,680	-28%	-2%	18,226	10,273	77%
EPS (PKR)	**14.98**	**20.90**			**67.08**	**37.81**	
DPS (PKR)	15.00	7.50			20.00	12.50	
Bonus	20%	-			-	-	

Source: IGI Research, Company Financials *Shares mn: 271.69 mn*

Volumes up by +8%YoY to 14.1mn ton in FY17

PSO's total volumes jumped up by +8%YoY to 14.1mn ton on the back of +9%/+11%/+18%YoY jump in MS/FO/Jet fuel sales. FO sales increased on the back of higher demand from FO based power plants such as HUBC which resumed operations post overhauling of boilers. Jet fuel sales increased as PSO recaptured business of AACO (including Air Arabia, Saudi Airline, Gulf Air, Kuwait Air & Oman Air) in Karachi & Islamabad and won business of Thai Air in Islamabad. Volumetric growth was further corroborated by +28%YoY rise in lubricant sales owing aggressive marketing leading to signing of supply contract with Pakistan Railways.

Market share down to 54.8% in FY17

The company's overall market share dropped to 54.8% in FY17 from 55.9% last year owing to loss of market share in MS and HSD to 39.6% and 44.4%, respectively. The loss of market share occured as a result of addition of new OMCs creating higher competition and lack of aggressive expansion on company's part. However, PSO regained its market share in FO to 73.1% in FY17 from 70.5% last year while further gaining traction in lubricant market through aggressive sales promotion leading to market share of 9.2%. The company was also able to increase its market share in JP-1 to 73.5% from 66.3% last year by attaining foreign airline contracts and increasing number of cash customers.

Exhibit:

Product-wise sales for last 3 years (mnTons)

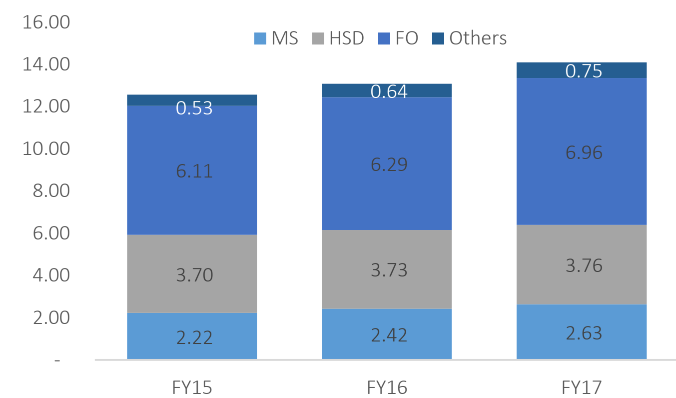
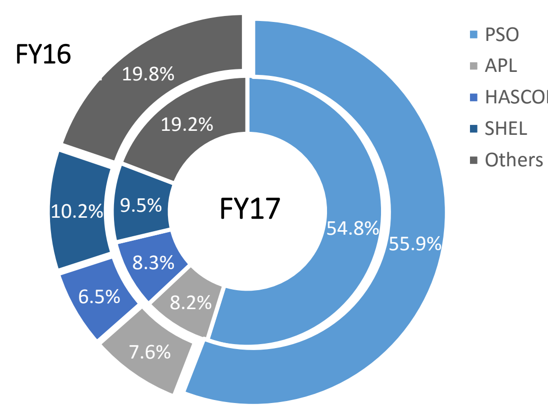


Exhibit:

Market Share - Company wise (FY17)



Source: IGI Research, Company Financials,

Receivables accumulated to PKR 213bn increasing by +19%YoY in FY17

The company's receivables piled up to PKR 213bn by +19%YoY in FY17 compared to 179bn reported last year. The increase was primarily led by +21%YoY rise in receivables from WAPDA, HUBC and KAPCO amounting to PKR 176bn in FY17 as compared to 146bn last year. The total receivables amount currently stands at nearly 24% of the company's net sales which stood at 15% in FY14. However, in FY18TD the overall receivables have come down to PKR 210bn owing to LNG payments received while power sector receivables have further piled up to PKR 184bn.

Exhibit:

Receivables Position for PSO

PKR'bn	Aug-17	FY17	FY16
Power Sector	184.2	176.1	146.5
LNG	2.7	14.0	11.0
PIA	13.6	13.3	12.3
PDC	9.6	9.6	9.6
Total	**210.1**	**213.0**	**179.4**

Source: IGI Research, Company Financials

Over 60 new retail outlets added in FY17

PSO increased its retail presence in FY17 by adding over 60 new retail outlets during the year to stand at 3,489 retail outlets across Pakistan. The company plans to achieve a target of adding 100 retail outlets per annum in order to sustain its market share which has been declining over the last few years on the back of addition of new OMCs and aggressive expansion by HASCOL.

Earnings Estimates Revised with 'BUY' call Intact

Earnings revised down by 9%-20% for FY18F-20F

We have revised down our earnings estimates for PSO by 9%-20% from FY18F-20F on the back of a) discontinuation of PIB income owing to maturity in Jul-17 against our assumption of rollover at lower rate and, b) increased selling and distribution expense on the back of higher sales promotion expense. As a result we have marginally revised down our Jun-18 target price for PSO by 3% to PKR 511/share, maintaining a **'BUY''** call on the scrip with +15% upside from last closing.

Earnings to post 5Yr CAGR of 7%

We expect PSO to register a 5Yr earnings CAGR of 7% on the back of a) 3 year expansion plan to increase storage capacity to sustain market share amid rising competition, b) increase in JP-1 and lubricant sales to lift earnings, c) rise in international FO prices leading to higher profit contribution from FO sales, d) cash proceeds from PIB to improve liquidity and provide opportunity for availability of cash for expansion and, e) 10%-13% and 5%-8% growth in MS and HSD sales respectively over the period FY18-22F on the back of increasing demand. As a result we still have a **'BUY'** call on PSO with our revised and rolled over Jun-18 TP of PKR 511/share offering +15% upside from last close.

Exhibit:

Financial Highlight for PSO

	FY15	FY16	FY17	FY18E	FY19F	FY20F
Key Financials (PKR/share)						
EPS	25.53	37.81	67.08	65.03	65.19	74.97
EPS - (Bonus Adjusted)	21.28	31.51	55.90	54.19	54.33	62.47
DPS	10.00	12.50	25.00	20.00	20.00	22.00
BV	302.96	337.09	378.56	423.59	468.78	521.75
Key Ratios						
P/E (x)	17.34	11.71	6.60	6.81	6.79	5.91
D/Y (%)	2.26	2.82	5.65	4.52	4.52	4.97
P/B (x)	1.46	1.31	1.17	1.05	0.94	0.85
ROE (%)	8.62	11.82	18.75	16.21	14.61	15.14

Source: IGI Research, Company Financials, PSX

Cash proceeds from PIB to provide liquidity for expansion

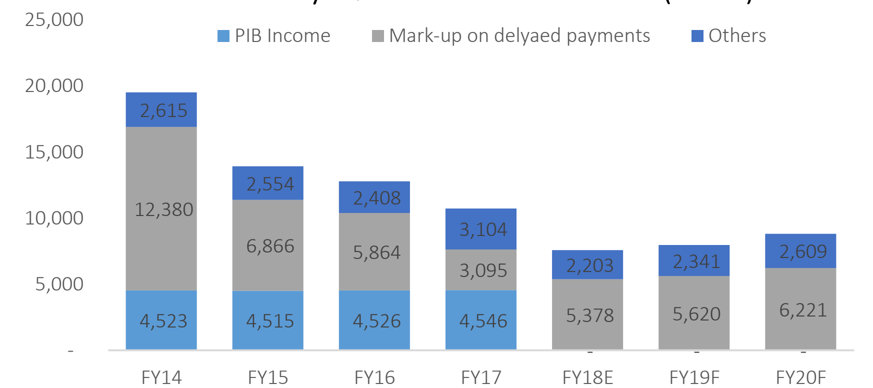
The company received nearly PKR 44bn in Jul-17 through proceeds from maturity of PIBs issued by Government of Pakistan (GoP). The company intends to pay off its short term borrowings to improve liquidity through the cash proceeds received. We believe, as a result of easing cash flow constraints the management will be able to pursue its objective to invest PKR 40bn over the next 3yrs to increase its storage capacity which in turn is likely to provide support in sustaining market share amid rising competition from addition of new OMCs. Nevertheless, we have incorporated a total capex of PKR 30bn over the next 4 years for expansion in to storage capacity as we believe some of the proceeds from PIBs will be injected in to working capital to ease cash constraints.

However resulting in loss of other income from PIBs

As the GoP has made full payment in respect of the PIBs, PSO's other income is expected to come down nearly 30%YoY in FY18 which amounted to PKR 4.5-4.6bn. As a result of loss of other income from PIBs we expect PSO's earnings to post a decline of 3%YoY in FY18 to PKR 65.03/share. However, we expect loss of PIB income to be mitigated through on a) improved profit contribution from FO owing to rise in FO prices, b) increase in OMC margins for MS and HSD, c) continuation of LNG income and increase in quantity imported from 400mmcfd to 600mmcfd, and d) outstanding LPS income to keep slightly negate decline in other income through loss of PIB income.

Exhibit:

PIB income contributed nearly 42% of the total other income - (PKRmn)



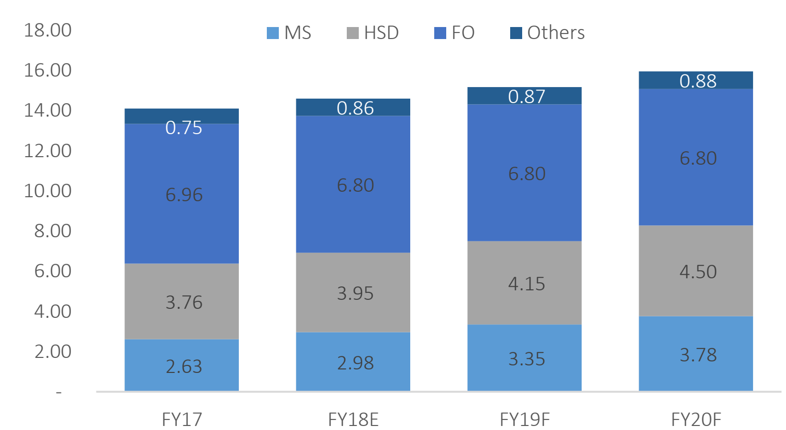
Source: IGI Research, Company Financials

Volumes to post 5Yr CAGR of 4.1% during FY18-20F

We expect PSO's volumes to grow by +4-5% over the period FY18-20F led by a) 5Yr CAGR of 12% and 5% in MS and HSD volumes respectively over the next five years, as company expands in to storage facilities and retail outlets. Nevertheless, we believe this growth despite being above industry, will only enable PSO to sustain its market share which it has been losing to new OMCs over the past few years. Regaining lost market share remains a remote possibility for now owing to high competition through addition of new OMCs.

Exhibit:

Total Volumes to grow at a 5Yr CAGR of 4.1% (mn Tons)



Source: IGI Research, Company Financials

Other key catalyst include:

- The company is now receiving 6 shipment of LNG per month with an increase in quantity imported from 400mmcfd to 600mmfd from Feb-17 onwards;
- Even after LNG supply arrangement is shifted from PSO to Pakistan LNG, the company plans to remain in LNG marketing business;
- Case against PSO withdrawn in the Supreme Court for increasing its shareholding in PRL; the company intends to incur Capex to double the refining capacity;
- The company plans to open retail outlets close to Gwadar city but remains hesitant to extend its presence inside the city owing to availability of cheaper and lower quality fuel. However, if Government takes action against this, PSO will target Gwadar city to expand its retail network;
- Although annual revision of MS/HSD OMC margin with CPI remains intact, PSO's management pointed out strong pursuance with concerned ministries to ensure it is being granted persistently in the coming years;
- PSO to focus more on LPG and lubricant business expansion and targets to become 1st and 2nd largest by 2020, respectively.

Outlook

The company further plans to increase its retail outlets to cater rising demand and company under performance compared to industry growth. Furthermore, FO profit contribution (up by +7%YoY in FY17) is expected to further lift profitability as margins are de regulated and linked with price. PSO is expected to increase it storage capacity by 300k 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. Moreover, shelter to heavy inventory losses is expected to emanate from fortnightly revision in POL prices which was previously done on monthly basis. Furthermore, increased marketing and sales promotion for lubes should provide a healthy growth in the segment. Continuation of LNG business and increased volumes to partially offset decline in other income.

Recommendation

Based on downward revision in earnings while improved cash flows as a result of cash proceeds from PIBs, we have marginally revised down our Target Price for PSO while still maintaining **'BUY'** stance on the scrip with our revised and rolled over Jun-18 TP of PKR 511/share. The stock offers +15% upside from its last closing and is currently trading at FY18E P/E of 6.8x and dividend yield of 4.5%.

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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)
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 – 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)

Risk: Investment in securities are subject to economic risk, market risk, interest rate risks, currency risks, credit risks, political and geopolitical risks. The performance of company(ies) covered herein mightunfavorably 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.

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