Day Break

Monday, 30 September 2019

COMPANY UPDATE

Pakistan State Oil Company Limited

Oil & Gas Marketing Companies

Recommendation		**BUY**
Target Price:	Dec/20	198.5
Last Closing:	27-Sep-19	156.5
Upside:		26.8
Valuation Methodology:		Discounted Cash Flow (DCF)
Time Horizon:		14M

Market Data

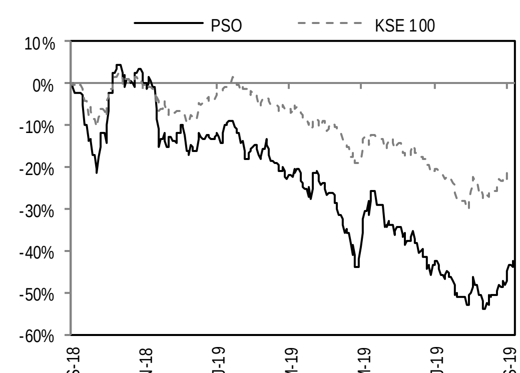
Bloomberg Tkr.			PSO PA
Shares (mn)			391.2
Free Float Shares (mn)			176.1
Free Float Shares (%)			45.0%
Market Cap (PKRbn | USDmn)		61.2	390.5
Exchange			KSE ALL
Price Info.	90D	06M	12M
Abs. Return	(9.6)	(26.6)	(42.5)
Lo	124.5	124.5	124.5
Hi	175.9	216.2	283.7

Key Company Financials

Period End: Jun

PKRbn	**FY18A**	**FY19A**	**FY20F**	**FY21F**
Total Revenue	1,056.9	1,154.3	1,159.0	881.2
Net Income	15.5	10.6	11.2	8.6
EPS (PKR)	39.5	27.1	28.6	21.9
DPS (PKR)	15.0	10.0	11.0	8.0
Total Assets	402.6	377.5	350.1	350.5
Total Equity	110.5	115.9	122.7	128.2
Key Financial Ratios				
ROE (%)	14.5	9.4	9.4	6.8
P/E (x)	4.0	5.8	5.5	7.1
P/B (x)	0.6	0.5	0.5	0.5
DY (%)	9.6	6.4	7.0	5.1

Relative Price Performance



Source: Bloomberg, PSX & IGI Research

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Oil & Gas – Marketing Companies

PSO: Maintaining Buy Stance Post Management Meeting; Earnings Marginally Revised Down

- We have revised our earnings estimate for Pakistan State Oil Company Limited (PSO) by an average of 5-8% for FY20-24. As a result our rolled over Dec-20 target price has been revised down by 5% to PKR 198.5/share,
- PSO held its analyst briefing on 27th Sep-19 to discuss financial result for 4QFY19 and future prospects of the company. The company reported earnings of PKR 4.66bn (EPS 11.91) up by +2.1xYoY during 4QFY19,
- We attribute this growth in earnings to a) PKR 3.4bn inventory gain led by HSD, b) PKR 2.6bn Late Payment Surcharge (LPS) income and, c) lower effective tax rate of 31.3%. On quarterly basis, profitability was up by +2.8xQoQ during 4QFY19 on the back of hefty inventory gains and lower effective tax rate of 31.3% compared to 52.1% in the last quarter,
- We maintain a **'BUY'** call on PSO with our rolled over Dec-20 TP of PKR 198.5/share offering an upside of +27% from its last close. The company is currently trading at FY20F P/E of 5.5x and dividend yield of 7.0%.

Earnings revised post FY19 result and Analyst Briefing

We have revised our earnings estimate for Pakistan State Oil Company Limited (PSO) by an average of 5-8% for FY20-24 on account of rise in interest rates and lower volumes due to slow down in economy and substantial price differential between smuggled and local fuel. As a result our rolled over Dec-20 target price has been revised down by 5% to PKR 198.5/share.

Profitability for 4QFY19 reported at PKR 11.91/share up by +2.1xYoY

PSO held its analyst briefing on 27th Sep-19 to discuss financial result for 4QFY19 and future prospects of the company. The company reported earnings of PKR 4.66bn (EPS 11.91) up by +2.1xYoY during 4QFY19 as compared to PKR 2.24bn (EPS: PKR 5.72) in the same period last year. We attribute this growth in earnings to a) PKR 3.4bn inventory gain led by HSD, b) PKR 2.6bn Late Payment Surcharge (LPS) income and, c) lower effective tax rate of 31.3%. This brings total earnings for FY19 to PKR 10.59bn (EPS: PKR 27.06) down by 32%YoY compared to PKR 15.46bn (EPS PKR 39.52) in the same period last year.

Earnings are up by +2.8xQoQ

On quarterly basis, profitability was up by +2.8xQoQ during 4QFY19 on the back of hefty inventory gains and lower effective tax rate of 31.3% compared to 52.1% in the last quarter. However, earnings growth remained restricted due to higher exchange loss of PKR 2.3bn. PSO announced cash dividend of PKR 5.0/share for 4QFY19 along with bonus of 20% taking total cash payout to PKR 10/share for FY19.

Exhibit:

PSO Financial Highlights (Un-Consolidated)

PKRmn	4QFY19	4QFY18	YoY	3QFY19	QoQ	FY19	FY18	YoY
Net Sales	335,790	312,261	8%	246,656	36%	1,153,453	1,056,901	9%
Gross Profit	12,133	10,742	13%	7,887	54%	35,094	39,636	-11%
Operating Cost	7,024	5,124	37%	2,557	175%	17,113	15,263	12%
Other Income	3,713	2,416	54%	942	294%	7,305	7,497	-3%
Finance Cost	2,163	1,437	51%	2,920	-26%	8,939	5,123	74%
Profit Before Taxation	6,784	6,745	1%	3,500	94%	17,477	27,160	-36%
Profit After Taxation	4,660	2,237	108%	1,677	178%	10,587	15,461	-32%
EPS (PKR)	11.91	5.72		4.29		27.06	39.52	
DPS (PKR)	5.00	5.00		-		10.00	15.00	
Bonus Issue	20%	20%		-		20%	20%	

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

Receivables Position for PSO

PKR'bn	Jun-18	Jun-19	Sep-19
Power Sector	199.9	115.9	107.1
LNG	15.9	64.7	62.6
PIA	13.0	13.3	13.9
PDC	9.6	9.6	9.6
Exchange loss on FE-25	9.7	30.2	28.0
Total	**248.1**	**233.7**	**221.2**
LPS	87.2	113.2	117.9
Total Inclusing LPS	**335.3**	**346.9**	**339.1**

Exhibit: White oil Market Share-Company w ise (FY19)

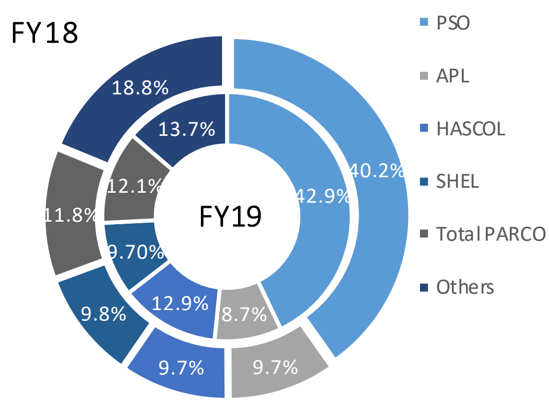
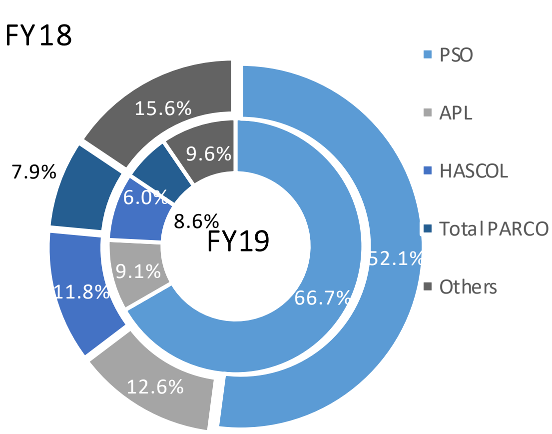


Exhibit: Black oil Market Share - Company w ise (FY19)



Source: Company Financials, IGI Research

Major takeaways from analyst briefing as stated by the management

Key financial highlights:

- The result included the consolidation of Pakistan Refinery Limited (PRL) in to PSO post acquisition of further stake in Dec-18 which brought total stake in PRL to 52.7%. The major difference between consolidated and unconsolidated account was the higher other income (Consolidated) which was due to accounting treatment of LPS income by PRL;
- Effective tax rate stood at 31.3% during 4QFY19 compared to 66.6% reported in the corresponding period last year;
- PSO booked in inventory gain of PKR 3.42bn during the 4QFY19 which was mostly due to inventory gain of PKR 3.10bn on HSD. However the Company booked inventory loss on MS of PKR 1.02bn leading to net inventory gain of PKR 3.42bn. Total inventory gain stood at PKR 194mn for FY19 compared to PKR 294mn in FY18;
- Other income was lower due to PKR 2.7bn penal interest income realized during the quarter;
- Finance cost increased owing to higher mark up on FE-25 and running finance taken due to rise in interest rates while other expenses were higher due to PKR 2.3bn exchange loss booked during the quarter;
- LNG receivables from SNGP have increased to PKR 63bn as at 26th Sep-19 compared to PKR 15.9bn as at Jun-18. However, power sector receivables are down to PKR 107bn as at 26th Sep-19 compared to PKR 200bn as at Jun-18 owing to receipt of PKR 60bn through Sukuk issue by GoP;
- PSO's market share in white oil products has dropped to 40% in FY19 as compared to 42.9% in FY18.

Management's business outlook included:

- The next tranche of PKR 200bn Sukuk is still pending with SBP due to certain issues and for now there is no certain timeline of when it will be issued;
- PSO expects LNG receivables to not pile up substantially going forward. Management expects to see a spike in receivables at certain point which may likely come down and hover around at current levels;
- PSO expect to convert 250,000 tonnes of FO storage in to MS and HSD in the next 2.5yrs with 50,000 tonnes of FO to be converted in to MS by end of 2019;
- OMC margin increase is likely to be taken up in the next ECC meeting and margins increase approval is likely to be given which is currently with the Ministry of Finance;
- The Company will plan its investment post transition phase in PRL with first phase focusing on upgradation of refinery in deep conversion and then second phase focusing on capacity enhancement. However, the amount of investment will only be quantified once plan is approved by the Board of Directors. Furthermore, post transition phase PSO will likely uplift higher percentage of products from PRL;
- PSO plans to increase its storage capacity in Punjab as it has been facing issues of retail outlet expansion due to restriction placed by OGRA on account of storage;
- FE 25 borrowing is down to USD 200mn which will mature in the next two months and the Company does not expect to utilize the facility further owing to build up of receivables of exchange losses on these loans;
- Local refinery uplift currently stands at 45%.

Outlook

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 costs especially administrative cost. Furthermore, resolution of circular debt through expected 3 tranches of PKR 200bn each (1 already issued) would ease cash starved companies in Pakistan energy chain. 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. However, key concern remains, accumulation of circular debt on LNG through SNGP which by contractual agreement terms is on take or pay basis, and cash requirement for PSO in this regard is fixed. Thus PSO's working capital concerns are likely to ease but not eliminate as retail fuel segment has been on a downturn in terms of demand and to a certain extent hit by grey market.

On volumes front total industry volumes dropped by 25%YoY in FY19. This was reflective of 20%YoY and 58%YoY drop in HSD and FO sales in FY19. Drop in HSD sales in FY19 was due to high price differential between smuggled and local fuel leading to hit from grey market sales and economic slowdown. HSD being directly correlated to GDP growth is likely to post 2.5%-3.0% growth post FY20 while FO is likely to maintain 2.2-2.6mn tons. MS sales are likely to post only 5-10%YoY growth in FY20 with 8-10% growth there onwards.

Recommendation

We maintain a **'BUY'** call on PSO with our rolled over Dec-20 TP of PKR 198.5/share offering an upside of +27% from its last close. The company is currently trading at FY20F P/E of 5.5x and dividend yield of 7.0%.

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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 – 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)

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