

Day Break

Monday, 16 May 2016

Company Update

Pakistan State Oil Co. Ltd.

Oil & Gas Marketing Companies

Recommendation	BUY
Target Price	448.4
Last Closing	377.0
Upside	19%

Market Data

Bloomberg Tkr.	PSO PA
Shares (mn)	271.7
Market Cap (PKRbn USDmn)	102.4 978.6
Exchange	KSE 100

Price Info.	90D	180D	365D
Abs. Return	14.0	11.5	2.4
Low	315.5	306.7	287.0
High	378.8	378.8	404.1

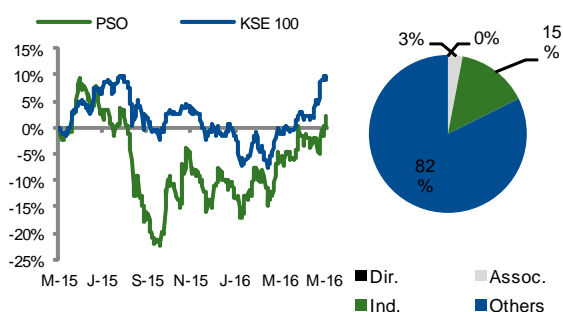
Key Company Financials

PKRbn	FY15A	FY16E	FY17F	FY18F
Total Revenue	913.1	637.7	770.0	860.7
Net Income	6.9	8.6	15.4	17.3
EPS (PKR)	25.5	31.8	56.8	63.6
DPS (PKR)	10.0	10.0	11.0	13.0
Total Assets	341.3	334.0	362.1	382.3
Total Equity	82.3	88.2	100.7	114.4

Key Financial Ratios

	8%	10%	15%	15%
ROE (%)				
P/E (x)	14.8	11.9	6.6	5.9
P/B (x)	1.2	1.2	1.0	0.9
DY (%)	2.7	2.7	2.9	3.4

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, KSE 100 & IGI Research

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Pakistan State Oil

Earnings Take a Hit Owing to Heavy Inventory Losses

- Pakistan State Oil Company (PSO) posted a loss of PKR 2.1bn (LPS PKR 7.85) in 3QFY16 compared to a loss of PKR 1.0bn (LPS PKR 3.83) in the same period last year.
- PSO booked pre-tax inventory loss of PKR 7.6bn during 3QFY16 (PKR 7.9bn in 9MFY16), which was primarily due to PKR 7.0bn loss on HSD (PKR 11.1bn in 9MFY16) as the company had to maintain 59 days of inventory due to distribution of HSD through pipelines.
- We currently have a “BUY” call on PSO with our Dec-16 TP of PKR 448/share, offering +19% upside from its last closing of PKR 377/share. PSO is currently trading at a FY16 P/E of 11.6x.

PSO Reported a loss of PKR 7.85/share in 3QFY16

Pakistan State Oil Company (PSO) posted a loss of PKR 2.1bn (LPS PKR 7.85) in 3QFY16 compared to a loss of PKR 1.0bn (LPS PKR 3.83) in the same period last year, primarily owing to total pre-tax inventory loss of PKR 7.8bn (PKR 28.6/share). Cumulative earnings for 9MFY16 clocked in at PKR 4.6bn (EPS PKR 16.71) depicting a growth of +42%YoY compared to PKR 3.2bn (EPS PKR 11.94) in the corresponding period.

MS & HSD Volumes Declined while FO Volumes remained upbeat

MS and HSD volumes plummeted by 7%YoY each in 3QFY16 to 0.6mnTon and 0.8mnTon, respectively, owing to lack of sufficient storage capacity for MS and loss of market share to other OMCs due to lesser focus on retail products. FO volumes picked up dramatically by +11%YoY to 1.5mnTon in 3QFY16 owing to higher demand as Pakgen and Hub Plant came online during the quarter.

Exhibit: PSO Volumes

000'tons	3QFY16	3QFY15	YoY	9MFY16	9MFY15	YoY
MS	556.4	598.7	-7%	1,767.7	1,561.7	13%
HSD	800.1	864.0	-7%	2,510.5	2,546.8	-1%
FO	1,532.7	1,385.7	11%	4,446.3	4,379.8	2%
Total	3,055.9	2,981.8	2%	9,204.4	8,893.5	3%

Source: IGI Research and Company Financials

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Loss in 3QFY16 driven by Heavy Inventory Loss on HSD and Lower FO prices

PSO booked pre-tax inventory loss of PKR 7.6bn during 3QFY16 (PKR 7.9bn in 9MFY16), which was primarily due to PKR 7.0bn loss on HSD (PKR 11.1bn in 9MFY16) as the company had to maintain 59 days of inventory due to distribution of HSD through pipelines. Company also booked an inventory loss of PKR 0.6bn on FO in 3QFY16 (gain of PKR 1.0bn in 9MFY16), however inventory gain of PKR 59mn on MS was recorded in 3QFY16 (PKR 2.1bn in 9MFY16) owing to lower inventory levels. Furthermore, FO prices were down by 42%YoY in 3QFY16 resulting in lower FO margin of PKR 848/ton from PKR 1,465/ton in the same period last year, in our view. For 9MFY16, FO margins plunged by 83%YoY to PKR 958/ton.

Receivables Pile up as Company seeks Payment Plan from Government

PSO's receivables have increased to PKR 177bn as of Apr-16, as compared to PKR 137bn at Dec-15 owing to build up in receivables from power sector (PKR 137bn at Dec-15 versus PKR 144bn at Apr-16). LNG receivables have further accumulated to PKR 12bn as of Apr-16 as compared to PKR 9bn in Mar-16. As per news report PSO receivables now stand at PKR 201bn for which the company seeks a payment plan with an immediate payment of PKR 11bn under 7-day credit arrangement. The company plans to utilize this cash for maintaining sufficient inventories of POL products to meet additional demand.

Exhibit: PSO Receivables

PKR bn	Apr-16	Mar-16	Dec-15
Power sector	144	144	137
LNG (SNGP)	12	9	11
Price Diff claims from GoP	10	10	9
PIA	12	13	13
Total	177	175	170

Source: IGI Research and Company Financials

Outlook

We expect the company to post healthy profits during 4QFY16 owing to a) 19% increase in FO prices in 4Q16TD, b) rebound in ex-refinery prices for HSD resulting in inventory gains, and c) higher demand for MS and HSD expected. Going forward, major triggers for improved profitability are likely to be a) company's plan to convert FO storage capacity at Keamari and FOTCO terminal to enhance storage capacity for MS (expected to be completed by Jun/Jul-16), b) LNG supply of 1.5-3.0mn tons expected to boost after tax earnings in the range of PKR 2.93/share-PKR 5.86/share in FY17, c) mutual consensus between company and government for receivables payment plan, and d) upward margin revision of PKR 0.06 for MS and HSD expected to increase earnings by PKR 1.34/share in FY17.

Recommendation

We currently have a "BUY" call on PSO with our Dec-16 TP of PKR 448/share, offering +19% upside from its last closing of PKR 377/share. PSO is currently trading at a FY16 P/E of 11.6x.

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Exhibit: Financial Highlights

PKRmn	3QFY16	3QFY15	YoY	9MFY16	9MFY15	YoY
Gross Sales	187,378	219,125	-14%	650,748	823,695	-21%
Net Sales	134,622	173,930	-23%	488,587	682,217	-28%
Gross Profit	(520)	1,644	-132%	13,641	14,152	-4%
Operating Expenses	3,179	2,954	8%	9,298	10,381	-10%
Other Income	1,624	2,590	-37%	6,928	9,312	-26%
EBIT	(2,076)	1,123	N/M	11,133	12,569	-11%
Finance Cost	1,414	2,741	-48%	5,015	8,683	-42%
Profit Before Taxation	(3,265)	(1,640)	N/M	6,731	3,888	73%
Profit After Taxation	(2,132)	(1,041)	N/M	4,594	3,242	42%
EPS (PKR)	(7.85)	(3.83)		16.91	11.93	
DPS (PKR)	-	6.00		5.00	6.00	

Source: IGI Research and Company Financials

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Recommendation	Rating System
Buy	If return on aforementioned security(ies) is more than 10%, from its last closing price(s)
Hold	If return on aforementioned security(ies) is in between -10% and 10%, from its last closing price(s)
Sell	If return on aforementioned security(ies) is more than -10%, from its last closing price(s)

Valuation Methodology

The analyst[^] has used following valuation methodology to arrive at the target price of the said security (ies):

- Discounted Cash Flow (DCF)

Time Horizon

- Dec-16

Risk

- Changes in State Bank of Pakistan Policy Rate
- Change in Circular Debt quantum
- Changes in USD/PKR
- Change in Oil price

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