

Day Break

Tuesday, 23 April 2019

COMPANY UPDATE

Pakistan State Oil Company Limited

Oil & Gas Marketing Companies

Recommendation		BUY
Target Price:	31-Dec-19	250.2
Last Closing:	22-Apr-19	202.9
Upside:		23.3
Valuation Methodology:	Discounted Cash Flow (DCF)	

Time Horizon: 8M

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)	79.4	560.6	
Exchange	KSE ALL		
Price Info.	90D	06M	12M
Abs. Return	(14.7)	(15.1)	(24.3)
Lo	196.9	196.9	196.9
Hi	247.7	283.7	293.4

Key Company Financials

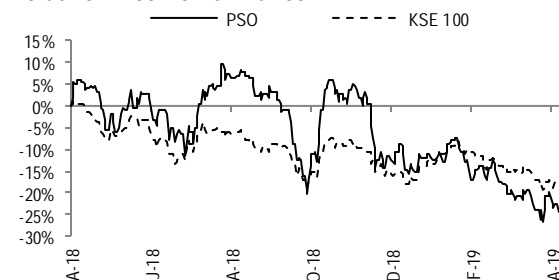
Period End: Jun

PKRbn	FY18A	FY19E	FY20F	FY21F
Total Revenue	1,056.9	1,117.7	842.8	909.0
Net Income	15.5	8.8	11.8	9.5
EPS (PKR)	39.5	22.5	30.2	24.3
DPS (PKR)	15.0	9.0	11.0	9.0
Total Assets	392	403	376	353
Total Equity	110	116	124	130

Key Financial Ratios

ROE (%)	14.0	7.6	9.5	7.3
P/E (x)	5.1	9.0	6.7	8.4
P/B (x)	1.0	0.7	0.7	0.6
DY (%)	7.4	4.4	5.4	4.4

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: Earnings revised down incorporating management meeting and weakening sector fundamentals

- We have revised our earnings estimate for Pakistan State Oil Company Limited (PSO) by an average of 22-35% for FY19-22. As a result our Dec-19 target price has been revised down by 17% to PKR 250.2/share,
- PSO held its analyst briefing on 22nd Apr-19 to discuss financial result for 3QFY19 and future prospects of the company. The company reported earnings of PKR 1.68bn (EPS 4.29) down by 64%YoY during 3QFY19,
- We attribute this decline in earnings to a) 29%/17%/34%YoY drop in FO/HSD/JP-1 volumes, b) inventory loss of PKR 0.11bn, c) higher effective tax rate of 52.1% and d) 55%YoY drop in other income. On quarterly basis, profitability is up by +24.61xQoQ to PKR 1.68bn likely on the back of lower exchange losses, lower inventory losses due to gains made on HSD, and lower effective tax rate of 52.1%.
- We maintain a 'BUY' call on PSO with Dec-19 TP of PKR 250.2/share offering an upside of +23% from its last close. The company is currently trading at FY19/20F P/E of 9.0/6.7x and dividend yield of 4.4%/5.4%.

Earnings revised post 9MFY19 result

We have revised our earnings estimate for Pakistan State Oil Company Limited (PSO) by an average of 22-35% for FY19-22 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 Dec-19 target price has been revised down by 17% to PKR 250.2/share.

Profitability for 3QFY19 reported at PKR 4.29/share down by 64%YoY...

PSO held its analyst briefing on 22nd Apr-19 to discuss financial result for 3QFY19 and future prospects of the company. The company reported earnings of PKR 1.68bn (EPS 4.29) down by 64%YoY during 3QFY19 as compared to PKR 4.70bn (EPS PKR 12.02) in the same period last year. We attribute this decline in earnings to a) 29%/17%/34%YoY drop in FO/HSD/JP-1 volumes, b) inventory loss of PKR 0.11bn, c) higher effective tax rate of 52.1%, and d) 55%YoY drop in other income due to lower penal interest income. This brings total earnings for 9MFY19 to PKR 5.93bn (EPS PKR 15.15) down by 55%YoY compared to PKR 13.23bn (EPS PKR 33.80) in the same period last year.

...however earnings are up by +24.6xQoQ

On quarterly basis, profitability is up by +24.61xQoQ to PKR 1.68bn on the back of lower exchange losses, lower inventory losses due to gains made on HSD and lower effective tax rate of 52.1% compared to 88.7% in the same period last year. However, earnings growth remained restricted due to lower other income and higher finance cost amid rise in interest rate. PSO announced cash dividend of PKR 5.0/share for 3QFY19.

Exhibit:

PSO Financial Highlights

PKRmn	3QFY19	3QFY18	YoY	2QFY19	QoQ	9MFY19	9MFY18	YoY
Net Sales	246,656	226,286	9%	291,825	-15%	818,508	744,639	10%
Gross Profit	7,887	10,182	-23%	5,090	55%	23,884	28,894	-17%
Operating Cost	2,557	3,089	-17%	3,951	-35%	10,089	10,139	0%
Other Income	942	2,112	-55%	1,680	-44%	3,592	5,081	-29%
Finance Cost	2,920	1,907	53%	2,029	44%	6,776	3,686	84%
PBT	3,500	7,353	-52%	604	5.80x	10,693	20,416	-48%
PAT	1,677	4,703	-64%	68	24.61x	5,926	13,225	-55%
EPS (PKR)	4.29	12.02		0.17		15.15	33.80	
DPS (PKR)	5.00	10.00		-		5.00	10.00	

Source: IGI Research, Company Financials

No of Shares: 391.23mn

Receivables Position for PSO

PKR'bn	Jun-18	Mar-19	Apr-19
Power Sector	199.9	107.7	110.3
LNG	15.9	55.4	60.0
PIA	13.0	13.2	14.1
PDC	9.6	9.6	9.6
Exchange loss on FE-25	9.7	21.3	21.3
Total	248.1	207.2	215.3
LPS	87.2	103.0	103.0
Total Including LPS	335.3	310.2	318.3

Exhibit: White oil Market Share-Company wise (9MFY19)

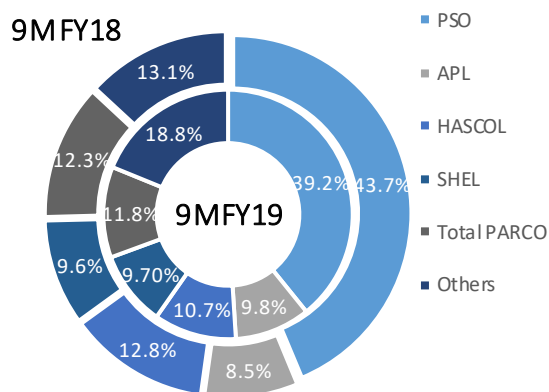
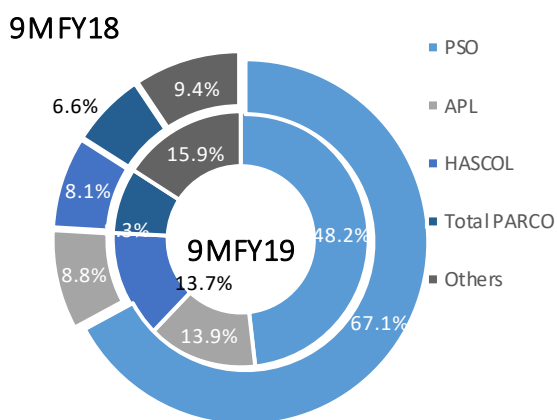


Exhibit: Black oil Market Share - Company wise (9MFY19)



Major takeaways from analyst briefing as stated by the management

Key financial highlights:

- Effective tax rate stood at 52.1% during 3QFY19 compared to 36.0% reported in the corresponding period last year due higher tax on LNG as LNG volumes have increased;
- PSO booked in inventory loss of PKR 0.11bn during the 3QFY19 which was mostly due to inventory gain of PKR 2.0bn on FO. However the Company booked inventory loss on MS of PKR 2.30bn leading to net inventory loss of PKR 0.11bn. HSD reported modest inventory gain of PKR 0.01bn;
- Inventory loss on MS was due to lower inventory days as result of insufficient storage capacity for MS;
- Lubricant sales improved but remained flat on yearly basis;
- Other income was lower due to drop in penal interest income realized during quarter;
- Finance cost increased owing to 42%YoY and 2.5xYoY rise in markup on FE-25 loan and running finance respectively owing to substantial rise in interest rates;
- Gross profit contribution from LNG increased to PKR 1.6bn during 3QFY19 owing to rise in LNG sales and increase in LNG price;
- LNG receivables from SNGP have increased to PKR 60bn as at 21st April-19 compared to PKR 15.9bn as at Jun-18, however power sector receivables are down to PKR 110bn as at 21st April-19 compared to PKR 200bn as at Jun-18 owing to receipt of PKR 60bn through Sukuk issue by GoP;
- PSO received PKR 60bn on account of PKR 200bn Sukuk issued by GoP to ease circular debt pile up;
- PSO's market share in white oil products has dropped to 39% in 9MFY19 as compared to 44% in 9MFY18.

Management's business outlook included:

- PSO will import 6 cargoes of FO for which the tender has been placed and PSO expects timely recovery for the supply of these cargoes;
- The Company expects three tranches to resolve circular debt pile up of which one tranche of PKR 200bn has already been issued while second tranche is in process however amount to be received by PSO is still not confirmed;
- PSO expects recoveries under LNG supply to SNGP are expected to improve in summer season as recoveries of SNGP stand at nearly 15 days during summer compared to 45 days in winter when gas is supplied on preference to domestic consumer;
- 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;
- MS and HSD price differential stands at around PKR 25-35/ltr which is hurting local sales. The Company expects MS and HSD sales to remain depressed due to smuggled fuel price differential and lower GDP growth. Furthermore, with increased competition and discounts offered by smaller OMCs have also hurt the market share;
- The Company will firstly upgrade PRL to reduce FO level and then will increase the capacity of the refinery similar to what PARCO is doing.

Source: Company Financials, IGI Research

Outlook

The Company is expected to increase its 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, 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 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 we expect total industry volumes to drop by 23%YoY in FY19 and post modest 5% growth in FY20. This is reflective of 17%YoY and 57%YoY drop in HSD and FO sales in FY19. Drop in HSD sales in FY19 is 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 FY19 while FO is likely to maintain 2.8-3.0mn tons. MS sales are likely to post only +4%YoY growth in FY19 with a 8-10% growth thereonwards.

Recommendation

We maintain a '**BUY**' call on PSO with Dec-19 TP of PKR 250.2/share offering an upside of +23% from its last close. The company is currently trading at FY19/20F P/E of 9.0/6.7x and dividend yield of 4.4%/5.4%.

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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 – 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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