

June 09, 2010

Pakistan Market

OMCs: May volumes remain downbeat

MORNING BRIEFING



KSE100 Index: Closing 9763.17 ↓ (-28.47)

High Speed Diesel (HSD) and Motor Gasoline (MOGAS) sales remained depressed during May 2010 driven by an anticipated fall in local oil prices on Jun 1. However, Furnace Oil (FO) continued to witness robust sales (up 12%MoM) on the back of heightened demand from the power generation sector. As a result, 11MFY10 total oil consumption arrived at 18.4mn tons, up 9%YoY. Given the raise in the minimum turnover tax to 1% from 0.5%, we highlight concerns over PSO's future profitability (earnings erosion by 25%-31%). However, the company's management remains confident about the restoration of the original tax requirement. Though we retain our valuation for now, it is important to note that after incorporation of the increase in turnover tax, the scrip still trades at a 15% discount to its target price and offers an FY11F dividend yield of 7%.

Volumes fall in May on expected decline in prices

With consumers expecting a 4-5% decline in local oil prices on Jun 1, sales for HSD declined by 17%MoM to 584k tons, whereas MOGAS volumes remained flat at 171k tons. Traditionally, May has been a strong month for oil consumption, given it being a Rabi harvesting period. Other regulated products such as Kerosene Oil (SKO) and Light Diesel Oil (LDO) sales also suffered, sliding 12%MoM and 14%MoM, respectively, Jet Fuel (JP) being the sole exception (up 4%MoM) on the back of higher export sales to Afghanistan. Our discussions with the oil companies' managements have revealed a sharp pick up in volumes for June, in response to the expected decrease in local oil prices on Jun 1.

FO sales continued to rise (up 12%MoM) on growing demand from the power generation sector. Shell Pakistan FO sales recorded a supernormal growth of 587%MoM, which we believe is due to the initiation of fuel supply to Nishat Power's plant - expected to go operational today. Cumulatively, total oil consumption for the month of May was down 1%MoM to 1.8mn tons.

FO sales dominant in 11MFY10

Rising demand for FO (up 13%YoY) drove total oil consumption up by 9%YoY to 18.4mn tons during 11MFY10. MOGAS sales also recorded an impressive growth of 29%YoY given a reduced price differential with CNG, and gas load management within the country. However, HSD sales remained downbeat owing to subdued economic activity. Rising demand for JP from Afghanistan boosted volumes by 37%YoY during the period.

Oil Product sales (in 000 tons)

	11MFY10				YoY-Growth			
	Industry	PSO	Shell	APL	Industry	PSO	Shell	APL
HSD	6,818	3,914	1,189	434	-1%	-7%	-11%	70%
FO	8,357	7,439	106	371	13%	16%	44%	-16%
Mogas	1,762	804	425	88	29%	22%	29%	101%
SKO	149	90	8	14	-9%	-4%	-53%	-16%
LDO	68	15	-	36	-16%	-43%	NM	-24%
JP	1,257	677	434	62	37%	34%	33%	1%
Total	18,411	12,938	2,162	1,006	9%	9%	3%	16%

Source: JS Research, * excludes Non-Energy products & local JP8

Outlook: Tax concerns over PSO profitability

The raise in minimum turnover tax to 1% from 0.5% by the government in the Budget FY11 has caused major concerns over PSO's future profitability. Our estimates suggest 25%-31% earnings erosion for the company. However, the management confidently expects the tax structure to be reverted back to the original 0.5%, as it feels the company will be wrongly penalized for increasing sales when margins are thin and regulated. Until clarity on the issue emerges, we maintain our valuation for the scrip. Further, even after incorporating the increase in minimum turnover tax, the scrip still trades at a discount of 15% to our consequent target price of Rs310 and offers a dividend yield of 7% for FY11, thereby meeting our criteria for a 'Buy' stance.

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Earnings sensitivity to change in turnover tax

	EPS			Target	FY11	
	FY11F	FY12F	FY13F	Price	PE(x)	Div.Yield
0.5% turnover tax	60.8	62.8	57.4	390	4.4	9%
1% turnover tax	45.9	46.7	39.6	310	5.9	7%

Source: JS Research

Also in focus

ECC considering duty reduction on PTA

The ECC in its meeting yesterday has decided to consider withdrawing the SRO 1045(1)/2008 and 1299(1)/2009 regarding the monetization of duty on PTA under which the PSF and PET manufacturers would get refunds of the duty protection amount. To recall, there has been a news flow regarding the reduction of PTA duty protection from the current level of 7.5%, however the decision is yet to be considered and would be reviewed in the next ECC meeting. We believe, a 1% duty reduction would bring down the company's EPS by Rs0.16 and Rs0.17 in 2010 and 2011 respectively.

EPS sensitivity to duty reduction

Duty	EPS 2010E	EPS 2011F
7.5%	1.96	1.76
6.5%	1.80	1.59
5.5%	1.65	1.43
4.5%	1.49	1.26
3.5%	1.33	1.10

Source: JS Research

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