JS Research

February 15, 2010

Pakistan Market

MORNING BRIEFING

PSO: 1HFY10 EPS expected at Rs24.2 / 'Buy'

KSE100 Index: Closing 9805.87 ↑ (+3.07)

Pakistan State Oil (PSO) is scheduled to announce its half year result on Feb 17, 2010, where it is expected to post earnings of Rs24.2 per share in 1HFY10, compared to a loss per share of Rs58.6 in the corresponding period last year. Absence of inventory and exchange losses this year will be key factors behind the turnaround in the fortunes of the company. Moreover, the company is expected to post an EPS of Rs13 in 2QFY10, up 17%QoQ. With the management confirming receipt of Rs500mn from PIA, we have incorporated a Rs250mn reversal in the provision for the said. We also expect a second interim cash dividend of Rs4-5/share, taking the cumulative dividend to Rs7-8/share in the 1HFY10. With the scrip trading at a FY10E PE of 6.6x, we reiterate our 'Buy' stance on the scrip.

Higher FO sales to propel revenues

Rise in demand from the power generation sector has driven PSO's furnace oil (FO) sales up by 27%YoY in 1HFY10, pushing up total oil sales by 14.8%. As a result, the company has improved its market share in FO sales to 88.8% from 86.8% earlier. Hence, revenues for the company are likely to propel to Rs351bn in 1HFY10, compared to Rs335bn in the corresponding period last year – up 5%. PSO has already posted net sales of Rs169bn in 1QFY10.

Inventory gains to turnaround margins

PSO which posted inventory gains of Rs950mn in 1QFY10 is expected to benefit a further Rs768mn in 2QFY10 owing to the rising trend in oil prices. On the contrary, inventory losses last year eroded earnings for the company. Hence, we expect a gross profit of Rs12.7bn (gross margin: 3.6%) in the 1HFY10 as against a gross loss of Rs7.7bn (gross margin: -2.3%) in 1HFY09.

Lower operating costs to cushion earnings

A lower operating cost by 29% due to absence of exchange losses is likely to provide support to earnings hampered by high finance costs. With the persisting circular debt, PSO is likely to post finance costs of Rs3.2bn – up 9% from last year. Other income (operating, non-operating and share of profit of associates) too is expected to post a decline of 13%YoY. As a result, we expect earnings of Rs4.1bn (EPS of Rs24.2) as against a net loss of Rs10.05bn (loss per share of Rs58.6) in the corresponding period last year.

Table: PSO 1HFY10 earnings estimates

(Rs mn)	1HFY10E	1HFY09A	Δ%
Net Sales	351,477	334,663	5%
Cost of products sold	338,776	342,387	-1%
Gross profit / (loss)	12,701	(7,724)	NM
Other operating income	781	701	11%
Operating costs	4,814	6,803	-29%
Other income	118	496	-76%
Profit / (loss) from operations	8,787	(13,330)	NM
Finance costs	3,194	2,926	9%
Share of profit of associates	336	222	52%
Profit / (loss) before tax	5,929	(16,034)	NM
Taxation	1,786	(5,985)	NM
Profit / (loss) after tax	4,143	(10,049)	NM
EPS / (LPS)	24.2	(58.6)	NM

Source: JS Research and Company accounts

Recommendation: 'Buy' maintained

With rising demand for furnace oil (up 22%YoY in 7MFY10) from the power generation sector, PSO is expected to be the major beneficiary, given its vast handling and distribution capacity. PSO's FO sales are expected to grow at a 4 year (FY09-13) CAGR of 9%. However, despite recent hikes in power tariff, inter-corporate debt remains a concern for PSO. Nonetheless, we remain bullish on PSO which trades at a FY10E and FY11F PE of 6.6x and 5.1x, respectively.

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Pakistan State Oil

Market Price: Rs300.91	**Kats Code:** PSO
Market Cap: Rs51.6bn (US$608mn)	**Bloomberg Code:** PSO PA
1-yrs Avg. Daily Volume: 1.6mn shares, Rs407mn (US$4.8mn)	**Reuters Code:** PSO.KA
1-year High/Low: Rs342.95/124.29	

Also in focus

IMF review to begin today

IMF and Pakistan's financial officials are expected to meet today to discuss the country's economic performance and decide on the release of IMF's fifth tranche worth US$1.2bn. According to the Finance Minister, quarterly targets have been met and it is expected that the amount will be received by next month. To recall, Pakistan has received a cumulative US$6.5bn to date from a total of US$11.2bn Stand By agreement with IMF.

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