

October 26, 2009

Pakistan Market

PSO: Result review + analyst briefing update

MORNING BRIEFING



KSE100 Index: Closing 9150.85 ↓ (-3.15)

After exchange and inventory losses had severely dented Pakistan State Oil (PSO) profitability during 1QFY09, the company posted strong earnings during the corresponding period this year (1QFY10) on the back of upbeat furnace oil sales and inventory gains. PSO reported profit of Rs1.9bn (EPS of Rs11.1) in 1QFY10 as against a loss of Rs8.4bn (loss per share of Rs48.9) last year. However, reported earnings were slightly below expectations as the company provisioned approx. Rs600mn of the Rs2.3bn owed by Pakistan International Airlines (PIA) in accordance with their credit policy. Moreover, the company has declared a cash dividend of Rs3 per share with the result.

Trading at FY10E and FY11F PE of 6.3x and 3.6x, respectively, we maintain our 'Buy' stance on PSO.

Furnace oil sales – earnings driver

The company witnessed a substantial growth of 30% in Black oil (FO) business mainly due to strong demand of furnace oil from the power generation sector. Mogas and Jet fuel sales increased 27% and 4%, respectively while HSD sales declined by 13% at the back of slow economic activity during the period. Resultantly, company's market share in Black oil increased to 89% from 86% while its overall market share stood at 72%. Despite the strong growth in volumetric sales, net sales declined to Rs169bn, down 10%YoY primarily due to reduction in oil prices.

Moreover, the company recorded inventory gains of Rs950mn as oil prices moved across a band of US\$60/barrel to US\$73/barrel. This is in sharp contrast to 1QFY09 where the company incurred inventory losses of Rs14.6bn due to sharp fall in international oil prices. Resultantly, gross profit arrived at Rs6.4bn in 1QFY10 as against a gross loss of Rs7.4bn in the corresponding period last year. Excluding inventory gains/losses for both the years, PSO has reported an EPS of Rs7.8 in 1QFY10 as against Rs7.2 in 1QFY09, up 8.2%YoY. Going forward, company expects magnitude of inventory

gains and losses to reduce due to monthly price revision as compared to quarterly revisions earlier.

Financial charges continues to dent earnings

Financial charges continue to dent earnings for PSO as they increased to Rs1.6bn, up 47% mainly on account of circular debt issue which had crossed Rs100bn during the reported period. PSO had received Rs41.3bn (Hubco Rs26.9bn, KAPCO Rs14.4bn) from Rs82.4bn TFCs issued and subsequently made payments of Rs24.7bn to refineries (Parco Rs17.6bn, ATRL Rs3.7bn, NRL Rs1.1bn and Rs1.0bn to PRL).

Meanwhile, other operating income from handling, storage and commission stood strong at Rs371mn, up 20%YoY. With the absence of exchange losses this year, operating expenses declined to Rs2.7bn, down 44%YoY. However, an amount of approx. Rs600mn (after-tax impact of approx. Rs2.3/share) was provisioned for Rs2.3bn owed by PIA in accordance with their credit policy which resulted in the company posting slightly below than expected result.

Outlook: 'Buy' maintained

In analyst briefing, PSO disclosed that it has signed a Fuel Supply Agreements (FSA) with the Northern Power Generation Company (NGPCL), for which it will be the sole supplier of FO to RPPs. This should increase PSO's market share in FO business segment. The company is also looking to start a major marketing drive for its high margin lube business. Furthermore, the recent increase in power tariff is likely to ensure timely payments by Wapda which owes PSO approx. Rs34bn.

Key risks:

- On the flip side, energy companies still owe approximately Rs68bn to PSO due to increase in supply of furnace oil off late to IPPs. This will continue to drag financial charges for the company in the coming quarter.

- With international oil prices hovering around US\$80/barrel, there remains a risk of margin reduction on regulated products. OMCs are currently getting 4% margin on Petrol, Kerosene and LDO subject to oil prices hovering in the band of US\$40-80/barrel.

With the scrip trading at FY10E and FY11F PE of 6.3x and 3.6x, respectively and offering an attractive dividend yield of 9.5% and 13.9%, we maintain our 'Buy' stance on PSO.

Table: Financial Highlights

(Rs mn)	1QFY10A	1QFY09A	Δ%
Net Sales	169,268	188,980	-10%
Cost of products sold	162,875	196,384	-17%
Gross profit	6,394	(7,404)	NM
Other operating income	371	309	20%
Operating expenses	2,689	4,781	-44%
Other Income	69	256	-73%
Finance Cost	1,573	1,072	47%
Share of profit	156	89	76%
PBT	2,727	(12,603)	NM
PAT	1,906	(8,383)	NM
EPS	11.1	(48.9)	NM

Source: Company announcements

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