we invest in relationships™

WE Detailed Report

March 2015

Pakistan State Oil

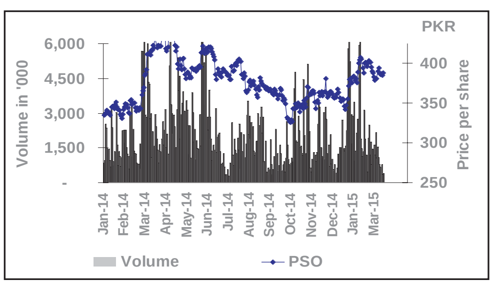
PSO: Eyes beyond FY15

We carry on our coverage for Pakistan State Oil with 'BUY' advice of December 2015 target price of Rs 510/share, currently offering an upside of 38%. Our positive view on the stock has basis from higher volumetric growth at 3-year CAGR of 5.6% led by MS & furnace oil (FO) sales and better margin on regulated product i.e. HSD & MS. We admit that company is in hot waters due to liquidity crunch because of lower expectation of dividend, but company offers huge discount to valuation provide decent opportunity. Furthermore, government is likely to inject another dose of liquidity while quantum has not been finalized yet. We expect any stopgap would be more beneficial for the company comparing June 2013; mainly due to lower furnace oil prices and consistent increase in electricity tariff. Trading at FY16E and FY17E PE of 6.9x and 6.4x, respectively, stock is available at a huge discount of 20% versus market's PE of 8.3x. The key risks to our view include lower International Oil prices, PKR depreciation, lingering circular debt, increase in receivables and surge in discount rate.

KEY DATA

KATS Code	PSO
Reuters Code	PSO.KA
Current Price (Rs)	370.19
Year High, Low (Rs)	415.40 , 340.50
Market Cap (Rs' bn)	105
Market Cap (US$ mn)	1,033
Shares Outstanding (mn)	271.69
Free Float (%)	46%

Source: KSE, Reuters & WE Research



Source: KSE & WE Research

PSO Financial Snapshot

	FY14A	**FY15F**	**FY16F**	**FY17F**
Net Sales (Rs mn)	1,187,639	1,039,330	1,063,645	1,110,878
Gross Profit (Rs mn)	36,824	24,675	28,991	29,968
Profit after Taxation (Rs mn)	21,818	10,636	14,534	15,664
EPS (Rs)	80.31	39.15	53.50	57.66
Book Value (Rs/share)	289.38	319.80	362.63	409.69
DPS (Rs)	8.00	10.00	12.00	12.00
P/E (x)	4.61	9.45	6.92	6.42
P/BV(x)	1.28	1.16	1.02	0.90
Dividend Yield (%)	2.3	3.0	3.2	3.2
Payout (%)	10.0	25.5	22.4	20.8
ROE (%)	27.8	12.2	14.8	14.1
ROA (%)	5.9	2.7	3.6	3.7

Source: Company Reports & WE Research

we invest in relationships™

Valuation: BUY with a Target Price of Rs 510

We have estimated a target price of Rs 510/share for PSO using DCF based valuation method. A discount rate of 17.1%, comprised of 10% risk free rate, 6.5% equity risk premium and a beta of 1.1 is used. The risk free rate is based on the secondary market yield on 10 year PIBs. PSO provides an upside of 38% to our DCF based December end 15 target price worth of Rs 510/share. Buy!

PSO provides an upside of 38% to our DCF based December end 15 target price worth of Rs 510/share.

DCF based value of PSO

Rs in million	FY15E	FY16F	FY17F
Net Income	10,636	14,534	15,664
Non- Cash expenses	1,186	1,264	1,351
Change in working cap	23,934	738	414
Capex	(1,187)	(1,256)	(1,330)
Free Cash Flow to Equity	34,568	15,281	16,100
Discounted Free Cash Flow	34,568	13,048	11,739
Terminal Value	108,666		
PV Terminal Value	79,230		
Shares Outstanding	271.69		
Target Price Dec'15 (Rs)	**510**		

Source: WE Estimates

Oil price drop not as dire as deemed

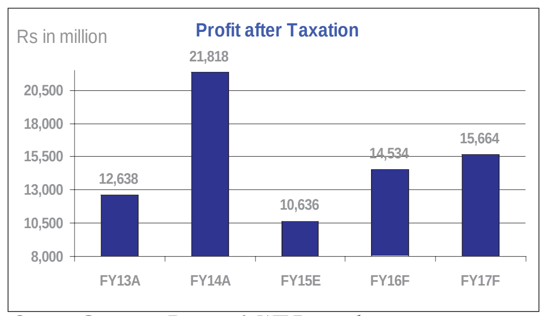
As oil prices slipped down by massive 54%, we squeezed our estimates by 14% for FY16-17 as furnace oil impart around 25% in net sales against previous input of 37% in FY14. We have lower assumption as PSO enjoys margin of 3.5% on FO. However, lower product prices would increase petroleum product sales and that is not a concern for the company like E&P companies which were badly hit by lower oil prices. Moreover, we guesstimate lower furnace oil prices of around Rs 48,000/ton would be positive for the company as it would require less borrowing which eventually pushed higher sales in the future.

we invest in relationships™

We expect company profitability to surge at a 3-year CAGR of 21.4% (FY15-17) as company to show profit after taxation of Rs 15,664 million (EPS: Rs 57.66) in FY17 against Rs 10,636 million (EPS: Rs 39.15) in FY15.

Earnings growth likely post-FY15

Though 2QFY15 remained gloomy for oil & gas sector due to sharp decline in crude oil prices by 54%, We expect company to make after-tax profit of Rs 10,636 million (EPS: Rs 39.15) in FY15 compared with an earning of Rs 21,818 million (EPS: Rs 80.31) in FY14. The main reason behind this massive decline is record inventory losses of around Rs 2.7 billion, exchange losses and decline in furnace oil margin. We expect company profitability to surge at a 3-year CAGR of 21.4% (FY15-17) as company to show profit after taxation of Rs 15,664 million (EPS: Rs 57.66) in FY17 against Rs 10,636 million (EPS: Rs 39.15) in FY15. This better performance is expected due to lower base effect of FY15, higher volumetric sales and better margin.



Source: Company Reports & WE Research

Other income likely to hike at a 3-year CAGR of 10.2% (FY15-17) as it would reach at Rs 22,254 million in FY17 against Rs 18,319 million in FY15 due higher penal interest income form IPPs and interest income from investments in PIBs.

Other income to lend support

Other income likely to hike at a 3-year CAGR of 10.2% (FY15-17) as it would reach to Rs 22,254 million in FY17 against Rs 18,319 million in FY15 due to higher penal interest income form IPPs and interest income from investments in PIBs, on the contrary financing cost to stabilize around Rs 14,428 million in FY15; thus gulf of other income and financing cost to remain positive. Furthermore, company has unbooked net interest income worth of Rs 35 billion (after tax impact of Rs 83.74/share) which would actualize later once payment received.

We expect exchange losses to minimize from here as current account to remain marginal surplus from here and foreign exchange reserves to further enhance from current $16 billion mark.

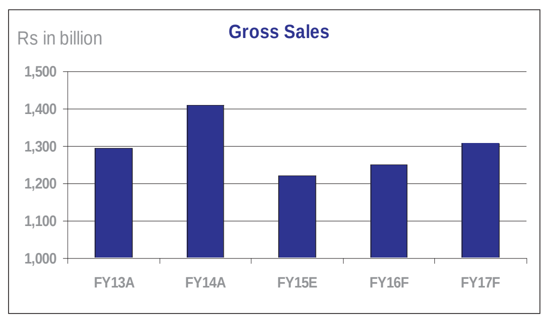
We expect the top line of the company to surge by 3.4% CAGR (FY15-17) to Rs 1,307 billion in FY17 against Rs 1,223 billion in FY15 on the back of 5.6% rise in volumetric sales.

No more huge exchange losses likely

PSO imports 90% of the petroleum product in the country, which poses significant perils to exchange rate owing to volatile PKR rate against US$. We expect exchange losses to lessen from here, as current account to stay marginal surplus, and foreign exchange kitty to further fatten from current $16 billion mark.

Higher volumes to crutch top line

Gross sales of the company to decline by 13% to Rs 1,223 billion versus Rs 1,410 billion in FY14 due to drop in product prices by 34% during the period. However volumetric sales to remain stable which would provide support to top line. We expect the top line of the company to surge by 3.4% CAGR (FY15-17) to Rs 1,307 billion in FY17 against Rs 1,223 billion in FY15 on the back of 5.6% rise in volumetric sales. We expect the gross profit of the company to escalate at 3 years CAGR (FY15-17) of 10.2% to Rs 29,968 million in FY17 against Rs 24,675 million in FY15 due to lower base effect and better volumetric sales.



Source: WE Research

Healthy positioned to cater additional demand

We anticipate volumetric sales to soar at a 3-year CAGR of 5.6% to 14 million tons in CY17 against 12.56 million tons in FY15 primarily due to hike in motor sprit, high speed diesel and furnace oil on increasing demand. We foresee lower oil prices would give boost to demand of petroleum product and we expect PSO would be beneficiary as company handles 90% of the country oil products imports with having large storage network and highest number of retail outlets.

we invest in relationships™

Low petrol prices to lift volumetric growth

It is expected that growth in PSO sales volume is mainly attribute to the surge of 11% in Mogas consumption to reach at 2.09 million tons in during the year FY15 against 1.88 million tons in FY14. This is mainly due to the CNG crisis as a transport fuel and now from lower Mogas prices by around 34%. During 8MFY15, the overall PSO sales of MS increased by 12% YoY to 1.37 million tons in 8MFY15 against 1.22 million tons in 8MFY14. We believe MS sales to increase by 3-year volume CAGR of 7.5% as country is facing huge shortage of gas which would increase the usage of gasoline in domestic generators to cope with power shortages.

We believe MS sales to increase by 3-year volume CAGR of 7.5% as country is facing huge shortage of gas which would increase the usage of gasoline in domestic generators to cope with power shortages.

FO sales likely to perk up

With growing energy needs in the country, reliance on thermal power generation has been on the consistent rise. With a low level of water in dams and non availability of gas for multi-fired power generation, demand for furnace oil (FO) has been up for the last two years. Going forward, we expect Independent Power Producers (IPPs) to continue to operate at higher load factor which ultimately result in growth in furnace oil. Furthermore, lower furnace oil prices by Rs 48,000/ton would increase further demand. We anticipate that PSO is set to be a primary beneficiary of the expected increase in FO demand mainly on the back of its substantial market share, stable supply contracts and efficient inventory management. However in medium term, we expect demand to remain flat due to commencement of new coal base power plant.

We anticipate that PSO is set to be a primary beneficiary of the expected increase in FO demand mainly on the back of its substantial market share, stable supply contracts and efficient inventory management. However in medium term, we expect demand to remain flat due to commencement of new coal base power plant.

Receivables top Rs200 billion

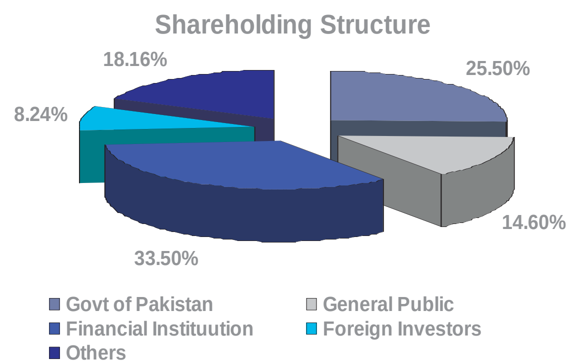
PSO receivables increased by 16% HoH to Rs 203 billion against Rs 175 billion at June 30, 2014 owing to significant receivables from power sector. Furthermore, company is finding difficulties to open further LCs with banks. As per industry channel, government is likely to inject another dose of liquidity but quantum has not been finalized yet. We expect any relief would be more favorable for the company comparing June 2013 mainly due to lower furnace oil prices and consistent increase in electricity tariff.

Company Introduction

Pakistan State Oil is a public quoted company incorporated in Pakistan under the Companies Act, 1913 now Companies Ordinance, 1984) and is listed at all stock exchange of Pakistan. 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.

The primary shareholder of PSO is the government of Pakistan with 25.5% direct shareholding and 54% aggregate shareholding after adding the block shares in PICIC growth and Investment funds. The general public has 14.6% of shares and financial institutions own 33.50% while foreign investors have 8.24% of total shares.

.



Source: Company Report

we invest in relationships™

PSO - Financial Highlights

Valuation

	FY14A	FY15F	FY16F	FY17F
EPS (Rs)	80.31	39.15	53.50	57.66
Book Value (Rs/share)	289.38	319.80	362.63	409.69
DPS (Rs)	8.00	10.00	12.00	12.00
P/E (x)	4.61	9.45	6.92	6.42
P/BV(x)	1.28	1.16	1.02	0.90
Dividend Yield (%)	2.3	3.0	3.2	3.2
Payout (%)	10.0	25.5	22.4	20.8

Source: Company Reports & WE Research

Key Ratio Analysis

	FY14A	FY15F	FY16F	FY17F
Current Ratio (x)	1.09	1.13	1.17	1.21
ROE (%)	27.8	12.2	14.8	14.1
ROA (%)	5.9	2.7	3.6	3.7
Gross Margin (%)	3.10	2.37	2.73	2.70
Net Margin (%)	1.84	1.02	1.37	1.41
Sales Growth (%)	7.96	-12.5	2.34	4.4
PAT Growth (%)	72.6	-51.3	36.7	7.8

Source: Company Reports & WE Research

Income Statement

Rs in million	FY14A	FY15F	FY16F	FY17F
Net Sales	1,187,639	1,039,330	1,063,645	1,110,878
Cost of Products Sold	1,150,815	1,014,655	1,034,654	1,080,910
Gross Profit	36,824	24,675	28,991	29,968
Other Income	19,518	18,319	21,289	22,254
Operating Expenses	14,370	13,535	14,241	14,615
Profit from operations	41,972	29,459	36,039	37,607
Finance Costs	9,544	13,864	14,548	14,428
Share of Profit of Associates	542	569	597	627
Profit before Taxation	32,969	16,164	22,088	23,806
Taxation	11,151	5,528	7,554	8,142
Profit for the Period	21,818	10,636	14,534	15,664

Source: Company Reports & WE Research

Balance Sheet

Rs in million	FY14A	FY15F	FY16F	FY17F
Share Capital	2,717	2,717	2,717	2,717
Shareholder Equity	78,621	86,885	98,522	111,306
Non Current Liabilities	5,184	6,923	7,269	7,632
Current Liabilities	288,346	293,633	300,740	309,703
Total Liabilities	293,530	300,556	308,009	317,335
Non Current Assets	58,637	56,449	54,370	52,391
Current Assets	313,514	330,992	352,161	376,250
Total Assets	372,151	387,441	406,531	428,642

Source: Company Reports & WE Research

Cash Flow Statement

Rs in million	FY14A	FY15F	FY16F	FY17F
Cash from Operations	20,405	35,756	16,537	17,430
Cash from Investing activities	(2,098)	1,002	814	627
Cash from Financing	(2,927)	(632)	(2,552)	(2,516)
Net change in Cash	15,379	36,125	14,800	15,541
Beginning Cash balance	5,227	20,607	56,732	71,531
Ending Cash balance	20,607	56,732	71,531	87,072

Source: Company Reports & WE Research

we invest in relationships™

WE Financial Services

Corporate Office
506, Fifth Floor,
Karachi Stock Exchange Building,
Stock Exchange Road,
Karachi - 74000,
Pakistan
URL: www.we.com.pk