Alfa Adhi Securities
REN # REP-004

AKSEER RESEARCH
REN # REP-400R

Pakistan State Oil (PSO):
Market leader trading at a discount

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Prices as of 7th October, 2021

Maintain 'BUY' with PT of PKR 319/share

- We revise our earnings estimates upward for Pakistan State Oil (PSO) after incorporating latest FY21 financials. Our new EPS for FY22/23 now comes at PKR 39/40, compared to previous estimates of PKR 38/36 (up 2.6%/11.1%).
- Our rolled forward June-22 PT stands at PKR 319, offering an upside of 60%, along with a dividend yield of 6%.
- Our liking for PSO is based on:
  - Economic growth driving surge in retail fuels (HSD/MS) volumetric sales.
  - Expected increase in OMCs margins in 2HFY22, in line with national CPI.
  - PSO regaining its lost market share through storage and retail network enhancement.
  - Significant decline in short term borrowings over the last 2 years, boding well in rising interest rate scenario.
  - Attractive valuations along with sound fundamentals warrant attention. Trading at a trailing PBV of 0.7x, 56% and 46% discount to its 8 years mean PBV and APL's trailing PBV, respectively.
- The key downside risk to our investment call is rising overdue receivables due to circular debt; however, the ongoing developments will improve the situation.
- We reiterate 'BUY' on PSO. The stock is trading at FY22 PE and PBV of 5.1x and 0.6x, respectively.

Key Data	
PSX Ticker	PSO
Bloomberg Ticker	PSO:PA
Reuters Ticker	PSO:KA
Target Price (PKR)	319
Current Price (PKR)	199
Upside/(Downside) (%)	60%
Dividend Yield (%)	6%
Total Return (%)	66%
12-month High (PKR)	262
12-month Low (PKR)	184
Outstanding Shares (mn)	469
Market Cap (PKR mn)	93,193
Year End	June

Key Ratios	FY19A	FY20A	FY21A	FY22E	FY23F	FY24F
EPS	22.6	-13.8	62.1	39.0	40.2	44.3
EPS Growth	-32%	NM	NM	-37%	3%	10%
DPS	10.0	0.0	15.0	11.0	12.0	15.0
PER	8.8	NM	3.2	5.1	4.9	4.5
Div. Yield	5.0%	0.0%	7.6%	5.5%	6.0%	7.6%
EV/EBITDA	7.1	NM	3.7	4.3	3.0	2.3
PBV	0.8	0.8	0.7	0.6	0.6	0.5
ROE	9.2%	-5.6%	23.0%	12.5%	11.8%	12.0%

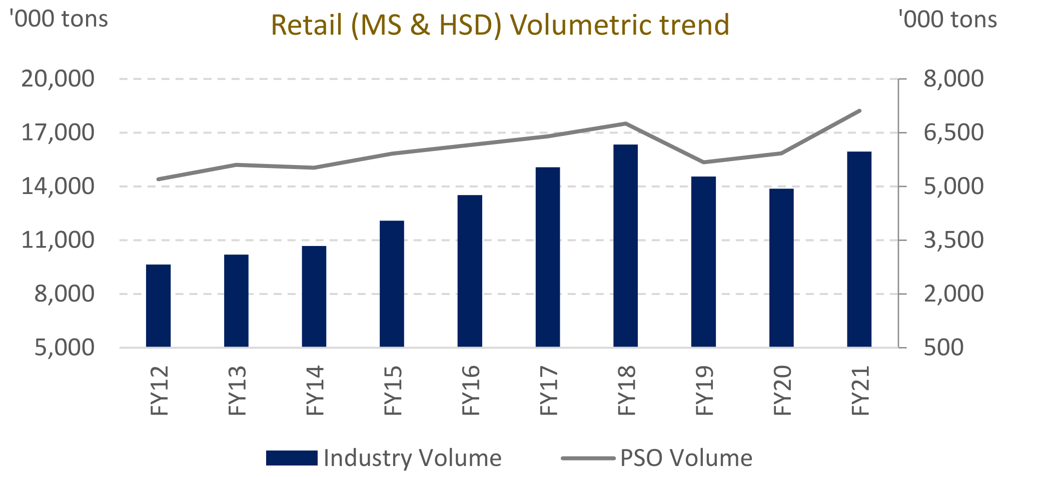
Higher volumetric sales and upward revision in margins to support earnings growth

Earnings revised up by 2.6%/11.1%

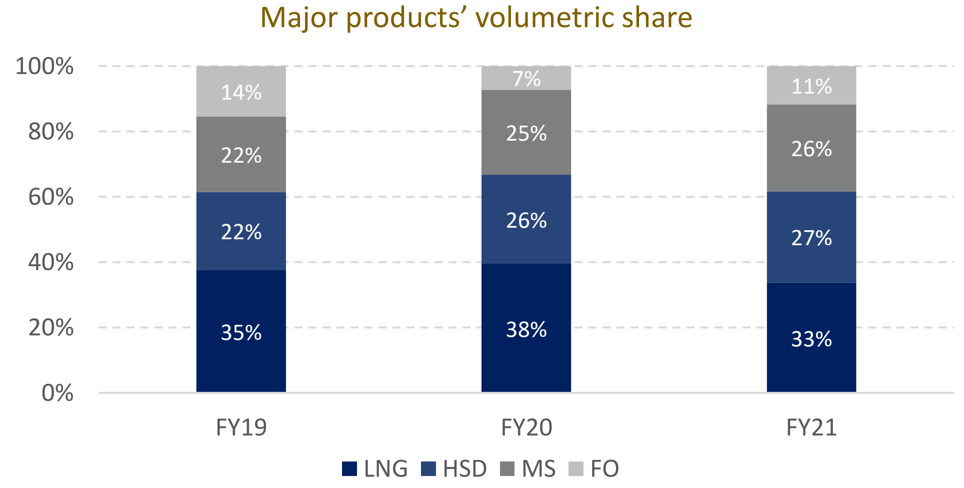
- We have revised upward our earnings estimates for PSO on the back of significant recovery in the volumetric sales and the company recapturing the lost market share in retail fuel segments over last year.
- PSO's overall volumes grew 22% YoY during FY21 due to economic recovery based demand post lockdowns. The major uptick was witnessed in FO, HSD and MS, up 53%, 21% and 21% YoY, respectively, also surpassing the industry growth.
- We expect HSD and MS volumes to witness a CAGR of 3% over FY22-27 driven by positive economic growth leading to higher demand. Increase in transportation and agriculture activity is expected to boost HSD sales, whereas the MS demand will emanate from surge in automobile sales. FO sales are expected to remain intact at 0.5mn tons per annum during next few years due to power sector's consumption.

OMCs margins to grow at 8% CAGR

- OMCs' margins, linked with national CPI, are expected to increase annually in line with the CPI surge. For FY22 we have assumed OMC margins to increase to PKR 3.1/liter. Going forward, we expect OMCs margins to grow at a CAGR of 8% in next 5 years further supporting net earnings growth.



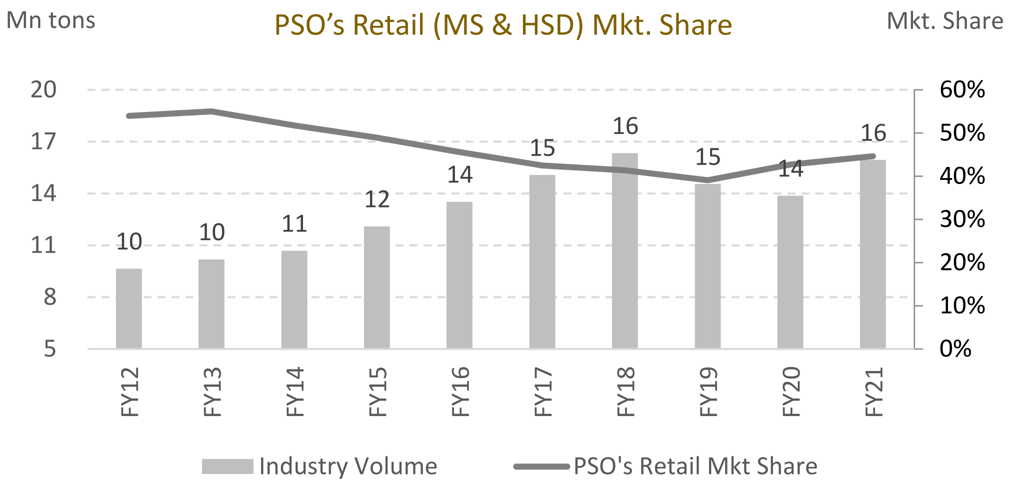
Source: Akseer Research



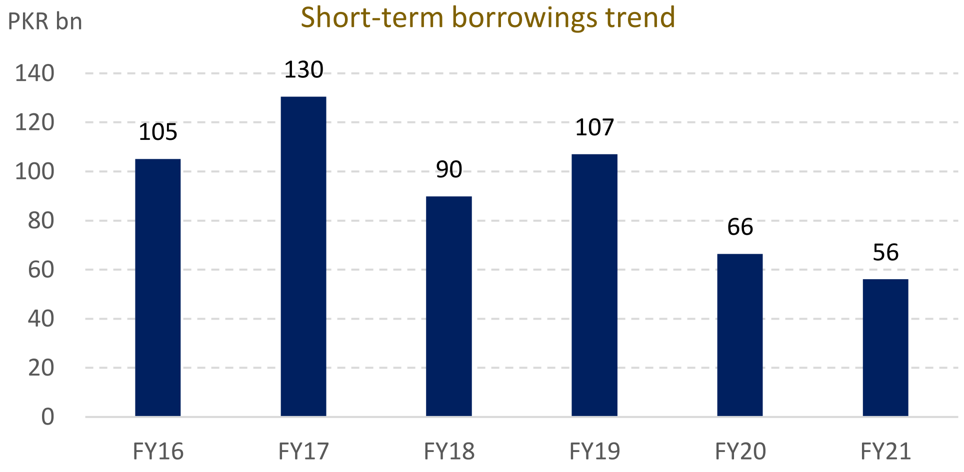
Source: Company Accounts & Akseer Research

Storage capacity expanding; borrowing costs declining

- **Additional/rehabilitated storage coupled with largest retail capacity to keep market share intact**
  - During FY21, PSO rehabilitated 131,000 tons of storage capacity out of 164,000 tons planned, at Kemari and ZOT (Zulfiqarabad Oil Terminal). Similarly, the company has started storage tanks construction project with total capacity of 198,000 tons out of which 43,000 tons capacity has already been completed at Shikarpur, Faisalabad and Tarru Jabba depots. This project is expected to be completed by the end of Dec-21.
  - Additionally, PSO added 71 new retail outlets during the year, taking the cumulative outlets capacity to ~3,600, the largest in Pakistan.
  - Resultantly, the company managed to recapture its lost market share in retail fuel segment, up ~2% to 45%. Going forward, the additional capacity will also help meet the growing demand in the country.
- **Declining short-term borrowings to result in lower finance cost**
  - PSO rely on short term borrowings to meet its working capital needs given the ongoing circular debt issue has ballooned its receivables. However, during FY21, the company managed to reduce its short term borrowings by PKR 10bn to PKR 56bn, lowest in 8 years, also resulting in 24% YoY decline in the finance cost.
  - With the resumption of overdue receivables payments, we expect borrowing quantum to remain in the same vicinity going forward which will bode well in the rising interest rate scenario.



Source: Company Accounts & Akseer Research



Source: Company Accounts & Akseer Research

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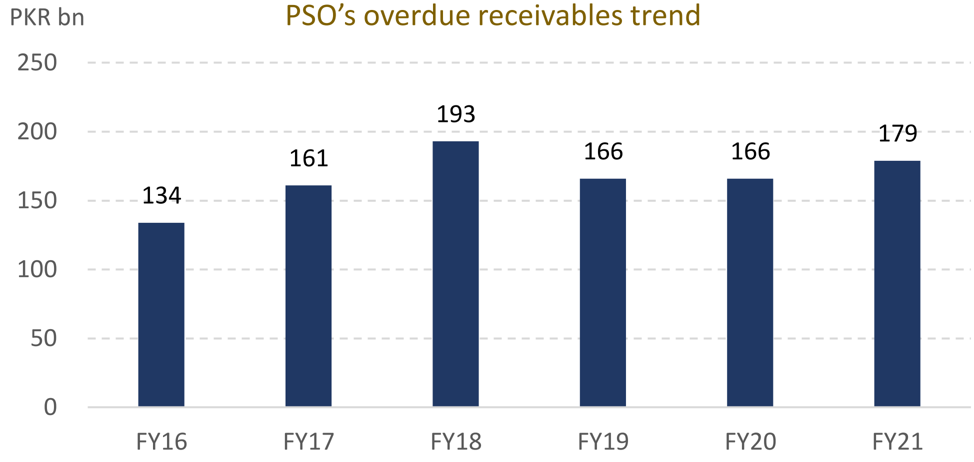
Circular debt remains a concern; however, developments underway

- PSO's overdue receivables grew at a CAGR of 6% during the last 5 years from PKR 134bn in FY16 to PKR 179bn at the end of FY21. However, after peaking at PKR 193bn in FY18, the receivables declined to PKR 166bn the following year as PSO received payment out of government's PKR 200bn energy Sukuk.
- Despite PKR 10bn decline in power sector receivables, PSO's total overdue receivables again swell by PKR 12bn during FY21. This is mainly due to steep rise in the emerging gas sector overdue receivables, growing by PKR ~25bn during the year to PKR 94bn.
- We expect this situation to deteriorate further with the approaching winter season when LNG is diverted to domestic sector and collection of dues is poor resulting in pileup of gas sector circular debt.
- However, the management has submitted various proposals to the government to contain further elevation in receivables including debt to equity swap in Guddu and Nandipur power projects.

PSO's overdue receivables trend



Source: Company Accounts & Akseer Research

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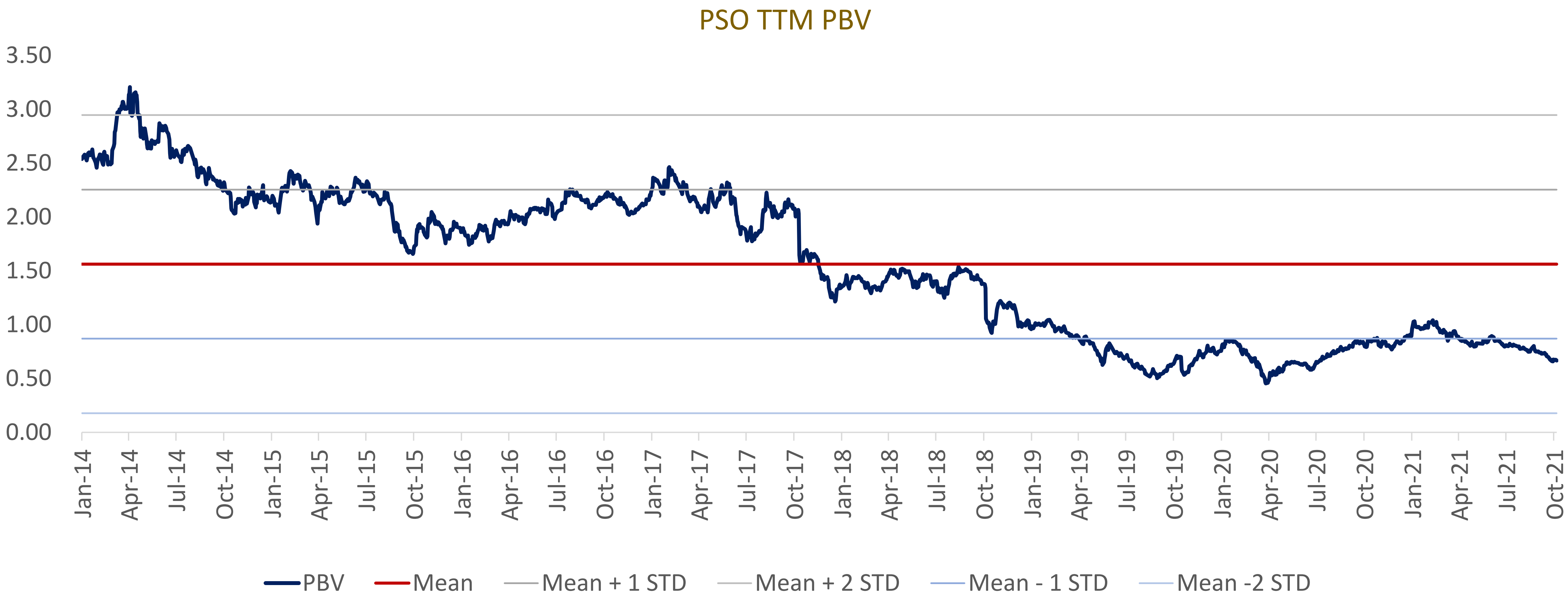
Available at a 56% discount to its mean PBV and 46% to APL's PBV



- Currently PSO is trading at trailing PBV of 0.7x which is at a 56% discount to its mean PBV of 1.6x during the last 8 years.
- Interestingly, PSO is also at a 46% discount compared to APL which is trading at trailing PBV of 1.3x.

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Risk - Return Profile

- **Valuation Basis**
  - Our PT for Pakistan State Oil (PSO) has been computed using Free cash flow to equity (FCFE) method. We have used a risk free rate of 11%, beta of 1.0 & market risk premium of 6% to arrive at cost of equity of 17.0%.
- **Investment Thesis**
  - Our investment case on PSO is based on:

1) Increase in volumetric sales owing to uptick in demand post pandemic,
2) Improving market share,
3) Decline in borrowings resulting in lower finance cost

- **Risks**
  - Key risks to our investment thesis are

1) Sharp decline in oil prices,
2) Loss of market share to other industry players,
3) Decline in OMC volumes due to economic slowdown,
4) Delay in margin revision, and
5) Influx of smuggled POL products.

Relative Performance

Source: PSX & Akseer Research

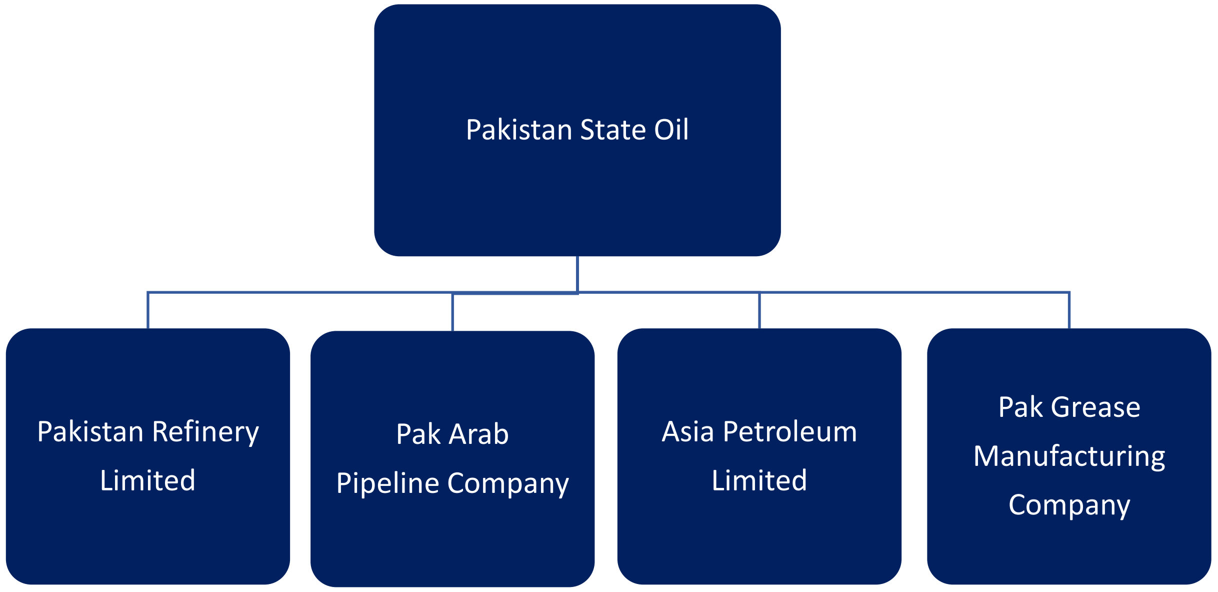
Comparative Ratios (FY21)	PSO	APL	SHEL*
Market share (Retail)	45%	7%	9%
EPS	62.1	49.4	22.1
DPS	15.0	27.0	-
Dividend yield	7.6%	9%	-
Gross margin	4.5%	5.3%	8.2%
Net Margin	2.4%	2.6%	2.0%
PER	3.2	6.1	6.2
PBV	0.7	1.3	2.2

Source: Company Accounts & Akseer Research
** Annualized EPS*

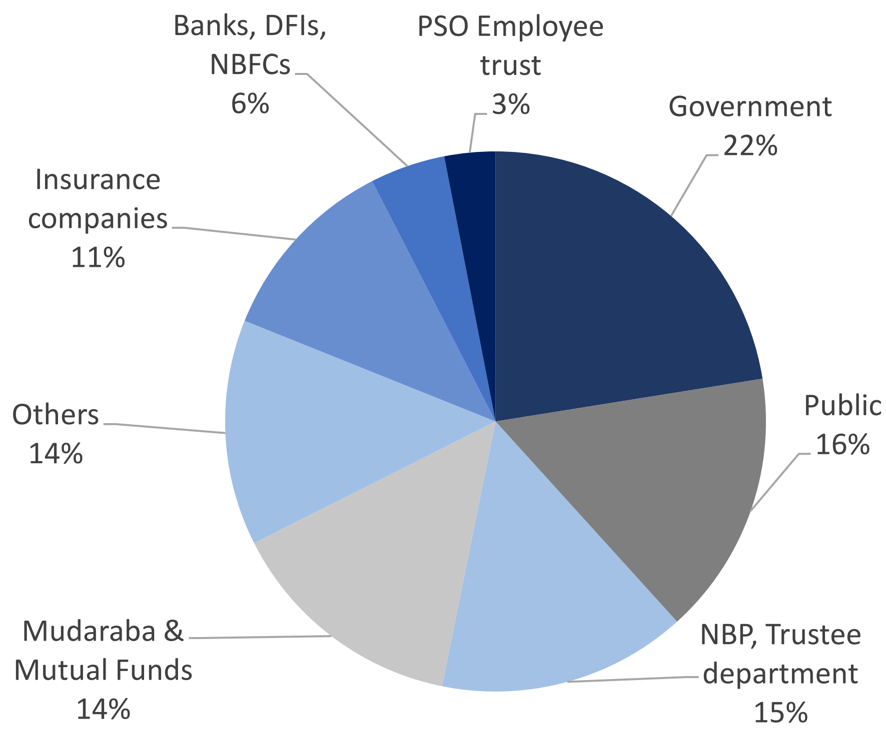
Company Overview

- Pakistan State Oil Company Limited, a state-owned entity, was incorporated in 1976 and is primarily engaged in the procurement, storage, distribution, and marketing of petroleum and related products in Pakistan. PSO offers motor gasoline, furnace oil, jet fuel, kerosene, compressed natural gas (CNG), and liquefied petroleum gas. The company has the largest network comprising of 3,500+ retail outlets, 9 installations, 23 depots, refueling facilities at 10 airports, with two state-of-the-art lubricant manufacturing facilities and LPG storage & bottling facilities.

- **Strategic Investments**



Shareholding Pattern



Financial Highlights

Income Statement (PKR mn)	FY19A	FY20A	FY21A	FY22E	FY23F	FY24F
Gross sales	1,340,978	1,302,037	1,424,249	1,555,825	1,637,846	1,757,096
Discounts/taxes	186,680	193,679	220,002	238,337	250,202	267,256
Net sales	**1,154,298**	**1,108,358**	**1,204,247**	**1,317,488**	**1,387,645**	**1,489,840**
Cost of Sales	1,118,281	1,096,131	1,149,638	1,271,937	1,339,934	1,437,137
Gross profit	**36,017**	**12,227**	**54,609**	**45,552**	**47,710**	**52,703**
Operating expenses	12,137	14,290	14,337	18,115	19,080	20,485
Other expenses	3,535	3,723	3,997	4,223	4,511	4,998
Other operating Income	3,151	2,909	5,130	3,458	3,642	3,911
Other income	4,202	7,301	13,696	7,569	7,650	7,748
EBITDA	26,257	7,749	53,717	34,509	35,737	39,371
EBIT	**25,141**	**6,557**	**52,439**	**33,245**	**34,256**	**37,662**
Financial Charges	8,987	13,427	10,242	5,920	6,236	6,695
Profit Before Tax	**17,477**	**(5,134)**	**44,056**	**29,169**	**30,083**	**33,257**
Taxation	6,890	1,332	14,917	10,858	11,222	12,474
Profit After Tax	**10,587**	**(6,466)**	**29,139**	**18,311**	**18,860**	**20,783**
Ratios						
EPS	22.55	(13.77)	62.07	39.00	40.17	44.27
DPS	10.00	-	15.00	11.00	12.00	15.00
Payout Ratio	44%	-	24%	28%	30%	34%

Source: Company Accounts & Akseer Research

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Financial Highlights

Balance Sheet (PKR mn)	FY19A	FY20A	FY21A	FY22E	FY23F	FY24F
Trade debts	219,586	197,117	220,196	183,404	182,194	183,696
Other working capital assets	160,046	92,236	104,865	114,706	120,799	129,672
Cash	4,593	3,909	2,902	57,903	74,214	91,032
Current assets	**384,225**	**293,261**	**327,962**	**356,013**	**377,207**	**404,401**
Fixed Assets	7,113	11,522	13,166	16,161	19,306	22,608
Long term Investments	11,440	16,191	16,267	17,893	19,682	21,651
Other non current assets	14,301	21,898	21,865	18,858	19,236	19,647
Total assets	**417,080**	**342,872**	**379,260**	**408,926**	**435,432**	**468,306**
Creditors	104,967	65,099	76,784	84,004	88,477	94,994
Short term borrowing	106,977	66,433	56,043	61,313	64,578	69,334
Other liabilities	78,427	85,819	94,216	103,153	108,547	116,259
Current liabilities	**290,371**	**217,350**	**227,043**	**248,470**	**261,602**	**280,586**
Deferred liabilities	7,528	6,787	7,186	7,330	7,477	7,626
Total liabilities	**297,899**	**229,811**	**239,281**	**255,800**	**269,079**	**288,212**
Retained earnings	115,268	108,366	135,283	148,431	161,658	175,399
Shareholders' equity	119,181	113,061	139,978	153,126	166,353	180,094
Total equity and liabilities	**417,080**	**342,872**	**379,260**	**408,925**	**435,432**	**468,306**
Ratios						
BVPS	253.88	240.84	298.18	326.19	354.36	383.64
ROCE	3.23%	0.48%	8.48%	4.89%	4.72%	4.84%
ROA	2.58%	-1.70%	8.07%	4.65%	4.47%	4.60%
ROE	9.22%	-5.57%	23.03%	12.49%	11.81%	12.00%

Source: Company Accounts & Akseer Research

Financial Highlights

Cashflow Statement (PKR mn)	FY19A	FY20A	FY21A	FY22F	FY23F	FY24F
Net Income	10,587	(6,466)	29,139	18,311	18,860	20,783
Depreciation	1,116	1,191	1,278	1,263	1,481	1,709
Working capital	(20,192)	57,566	(15,431)	43,842	4,967	3,827
CFO	**(8,490)**	**52,292**	**14,986**	**63,417**	**25,308**	**26,319**
Fixed Capital Expenditure	(2,008)	(7,764)	(5,991)	(1,032)	(4,761)	(5,156)
Chg in Long term investments	(6,656)	(4,751)	(76)	(1,627)	(1,789)	(1,968)
Chg in other Long term assets	(745)	(5,433)	3,103	(220)	(242)	(266)
FCFF	**(12,498)**	**50,920**	**18,750**	**64,210**	**22,379**	**23,068**
Interest	(5,401)	(16,576)	(6,728)	(3,672)	(3,864)	(4,139)
FCFE	**1,815**	**(1,067)**	**490**	**60,927**	**21,945**	**23,860**
Changes in equity	(1,858)	346	(2,222)	(5,164)	(5,633)	(7,042)
Changes in cashflow	(43)	(722)	(1,732)	55,764	16,311	16,818
Ending Cash	**4,593**	**3,872**	**2,139**	**57,903**	**74,214**	**91,032**

Source: Company Accounts & Akseer Research

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Disclosures and Disclaimer

Valuation Methodology

To arrive at our 12-months Price Target, the JV uses different valuation methods which include: 1). DCF methodology, 2). Relative valuation methodology, and 3). Asset-based valuation methodology.

Ratings Criteria

JV employs a three-tier ratings system to rate a stock, as mentioned below, which is based upon the level of expected return for a specific stock. The rating is based on the following with time horizon of 12-months.

Rating	Expected Total Return
Buy	Greater than or equal to +15%
Hold	Between -5% and +15%
Sell	Less than or equal to -5%

Ratings are updated to account for any development impacting the economy/sector/company, changes in analysts’ assumptions or a combination of these factors.

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