

# Pakistan Equity | Oil & Marketing | Earnings Revision

March 25, 2022

REP-057

## Pakistan State Oil (PSO) Earnings revised up, Buy maintained



Best Local Brokerage  
House 2015-16, FY2020

**ASIAMONEY**

Best Local Brokerage House  
Brokers Poll 2011-14, 2016-21



Best Brokerage  
House 2018,19-20



Best Research  
House 2019-20



Best Brokerage  
House 2019-21

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# Earnings revised upwards due to huge inventory gains

## "Buy" Rated

|                           |                      |
|---------------------------|----------------------|
| KATS Code                 | PSO                  |
| Bloomberg Code            | PSO PA               |
| Reuters Code              | PSO.KA               |
| Market Price              | Rs157.51             |
| Market Cap                | Rs73.9bn/US\$407mn   |
| Free float Market Cap     | Rs33.3bn/US\$183.1mn |
| 1-Yr Avg. Daily Vol. (mn) | 0.9                  |
| 1-Yr Avg. Daily Val. (mn) | Rs182.82/US\$1.1     |
| 1-Yr High/ Low            | Rs243.17/156.2       |
| Estimated free float      | 45%                  |
| Share outstanding (mn)    | 469.47               |
| Index weight              | 1.89%                |

## PSO: EPS Revision

| Rs  | New   |       |       | Earlier |       |       | Change |       |       |
|-----|-------|-------|-------|---------|-------|-------|--------|-------|-------|
|     | FY21A | FY22E | FY23F | FY21A   | FY22E | FY23F | FY21A  | FY22E | FY23F |
| PSO | 62    | 119   | 74    | 62      | 45    | 50    | 0%     | 165%  | 47%   |

## PSO: Key Numbers

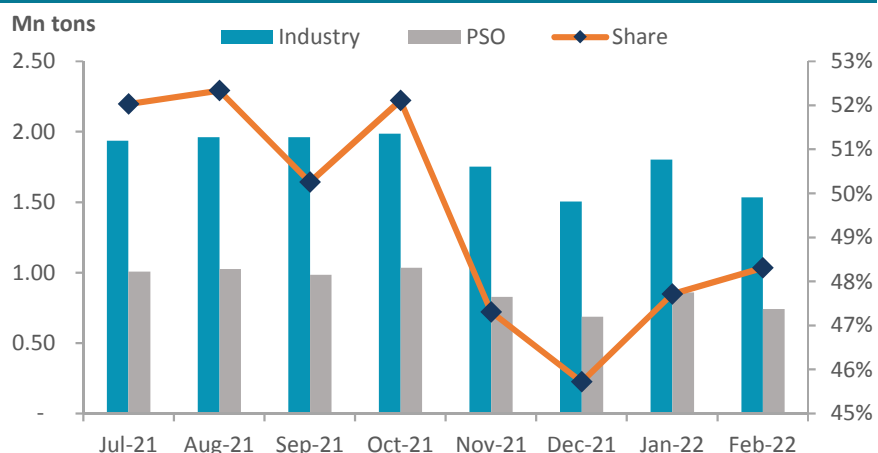
|                 | FY19A | FY20A | FY21A | FY22E | FY23F |
|-----------------|-------|-------|-------|-------|-------|
| EPS (Rs)        | 21.9  | -13.8 | 62.1  | 119.2 | 73.5  |
| Earnings Growth | -34%  | NM    | NM    | 92%   | -38%  |
| PE @ Rs158 (x)  | 7.19  | NM    | 2.54  | 1.32  | 2.14  |
| Dividend Yield  | 6%    | 0%    | 10%   | 13%   | 10%   |
| ROE             | 9%    | NM    | 21%   | 29%   | 16%   |
| PBV (x)         | 0.6   | 0.7   | 0.5   | 0.4   | 0.3   |

Source: Company Accounts, Topline Research

- We are revising up our earnings estimates for Pakistan State Oil (PSO) for FY22E and FY23F to Rs119/sh and Rs74/sh vs. our previous estimate of Rs45/sh and Rs50/sh, respectively. This revision is primarily driven by (i) significant inventory gains during 1HFY22 led by sharp rally in global oil prices, (ii) higher other income on the back of payment by IPPs, and (iii) higher than expected volumetric sales. We maintain our 'Buy' stance on the company with a Target Price of Rs224/share for Dec-22, having potential upside of 42%.
- **Higher oil prices to drive inventory gains:** During 1HFY22, PSO's earnings witnessed a significant growth of 2.4x YoY to clock in at Rs32bn (EPS: Rs68) led by higher than expected inventory gains which is estimated at ~Rs20bn (Rs42/share) due to rally in international oil prices as Arab light crude oil prices on average increased by 77%. As a result, gross margins of PSO in 1HFY22 clocked in at 4.96% vs. 3.61% in 1HFY21.
- Excluding inventory gains earnings are estimated at Rs26/sh.
- We though expect inventory gains to continue in 3QFY22 as Arab light crude oil prices on average have increased by 25% till Mar 24, 2022 from 2QFY22 average.
- Our back of the envelope working indicates that with every US\$10 change in Arab light oil prices is estimated to have an annual earnings impact of 10-20% on PSO's earnings, depending upon the inventory days held for each product.
- **Other income to support bottom line:** The company's other income in 1HFY22 clocked in at Rs10.7bn as compared to Rs4.4bn in 1HFY21, mainly due to payment received from power companies (HUBCO, KAPCO etc.) on account of Late Payment Surcharge. This occurred after government approved and disbursed Rs135bn as the 2<sup>nd</sup> installment to IPPs in Dec 2021, aimed at reducing the circular debt.

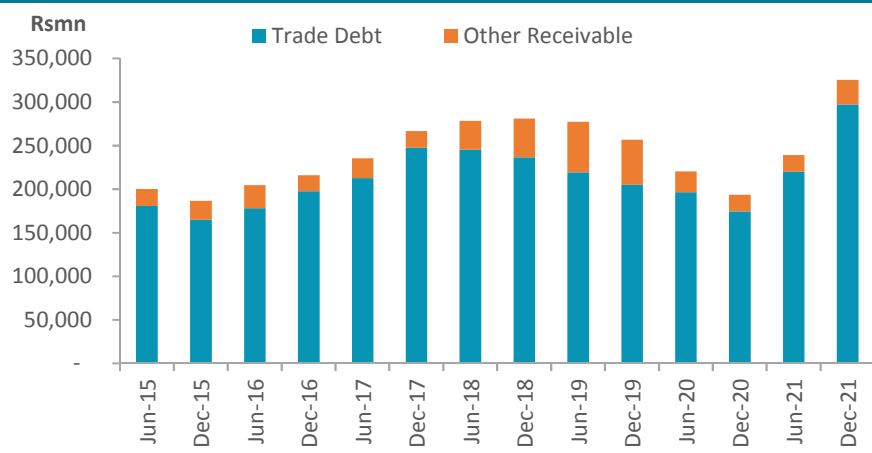
# PSO continue to face liquidity issues amid rising receivables

PSO Vs Industry Sales Trend



Source: Company Accounts, Topline Research

PSO: Total Receivables Trend



Source: Company Accounts, Topline Research

- Improvement in Volumetric Sales:** As of 8MFY22, PSO's volumetric sales witnessed a 23% YoY growth to clock in at 7.1mn tons, mainly led by uptick in High Speed Diesel (HSD) volumetric sales (+24% YoY) followed by MOGAS (+16% YoY) and Furnace Oil (+29% YoY). Going forward, we expect the company to record 17% YoY growth in FY22E to reach ~10.5mn tons. Uptick in OMC sales is driven by rising car/bike sales and increased FO demand from power sector.
- Exposure to Circular Debt:** The company has continued to witness sharp rise in total receivables amounting to Rs325bn as of Dec 2021 vs. Rs239bn in Jun 2021. The company's receivables from power companies stands at Rs259bn in Dec 2021 as compared to Rs183bn in Jun 2021, indicating rising trend in gas circular debt. This has led to sharp liquidity crunch for the company and the company had to rely on short term borrowings for the same. Despite payment to IPPs, this issue continue to impact PSO's balance sheet.
- Price Differential Claim:** Despite a steep rise in global oil prices, PM Imran Khan on Feb 28, 2022 announced a cut in petrol & diesel prices and froze them at Rs149.86/ltr and RS144.15/ltr, respectively till the upcoming budget. Petroleum levy and Sales tax has also been waived off. Due to this, Price Differential Claim (PDC) of ~Rs23/ltr on petrol emerged, which Government will be releasing to OMCs with in a week. However, any delay in payments can further impact the liquidity position for the company. Every Rs10/ltr of PDC results in receivables of Rs3.76bn per month.
- Valuation:** We have used discounted free cash flow method to value PSO with a risk rate of 12% and risk premium of 6% to arrive at a Target Price of Rs224/share, offering a 42% upside from last day closing price of Rs158/share.

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|---------|--|
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| Neutral | Stock will perform in line with the average total return of stocks in universe |
| Sell    | Stock will underperform the average total return of stocks in universe         |

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|---------------|---------------------------------------|
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| Market Weight | = Weight in KSE-100 Index             |
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