Equity Research Report NIGERIA

FSDH
FSDH SECURITIES LIMITED

MRS Oil Plc: *Interim Results – Q3, September 2010*

December 06, 2010 | **BUY** | **Fair Value: NG₦ 80.85** | **Current Price: NG₦73.74**

Valuation/Analyst Recommendation

In arriving at a fair value for the ordinary shares of MRS, we used two valuation methods which are Discounted Future Earnings Method (DFE) and Discounted Free Cash Flow Method (DCF). We project Turnover, Earnings Before Interest and Tax (EBIT), Earnings Before Interest Tax Depreciation and Amortization (EBITDA) and Profit After Tax (PAT) for the periods ending December 2010, 2011, 2012, 2013 and 2014. We estimate the **Turnover** of **N101.46bn**, **N121.75bn**, **N146.10bn**, **N157.79bn** and **N170.41bn** for 2010, 2011, 2012, 2013 and 2014, respectively. We estimate **EBIT** of **N2.33bn**, **N2.82bn**, **N3.42bn**, **N3.70bn** and **N3.99bn** for the same period, based on EBIT Margin of 2.30% for 2010, 2.32% for 2011 and 2.34% for 2012-2014. We estimate **EBITDA** of **N3.01bn**, **N3.59bn**, **N4.26bn**, **N4.62bn** and **N4.99bn** for the same period. Looking at our estimate of the capital expenditure of the company within the forecast period and the notional tax on EBIT for the same period and adjusting for the net working capital, we arrived at **Free Cash Flow (FCF)** of **N1.76bn**, **N2.27bn**, **N2.71bn**, **N3.13bn** and **N3.40bn**.The forecast PAT of **N2.18bn**, **N2.56bn**, **N3.07bn**, **N3.31bn** and **N3.58bn** is based on PAT margin of 2.15% for 2010, and 2.10% for 2011-2014. Using a dividend payout of 85% for the period we arrived at **Dividend Payment** of **N1.85bn**, **N2.17bn**, **N2.61bn**, **N2.82bn** and **N3.04bn**. We applied a terminal growth rate of **7.69%**. We used a beta value of 1; risk free rate of **9.90%** and a **market risk premium** of **10.04%**. Applying the foregoing parameters on the Capital Asset Pricing Model (**CAPM**), the cost of equity generates **19.94%**, which is our cost of capital. The company had no long term interest bearing debt in its capital structure as at the last audited account. Using **253.99mn** shares in issue, the **DFE** Model generates **N84.36** per share and the **DCF** Model generates **N77.99** per share. Applying a weight of 45% to the DFE and 55% to the DCF, we arrive at a value of **N80.85** per share, which is our fair value. Buying the stock at the current market price of **N73.74** and and holding to our fair value of **N80.85** and adding the present value of the 5-year forecast dividends, investors will earn a total return of **49.37%.** Relating this return to the cost of Equity at **19.94%,** investment in MRS shares at the current market price will record a positive alpha return of **29.43%.** The 2010 forward earnings yield based on our fair value generates **10.62%**, while the 2010 forward Dividend Yield based on **N7.30** Dividend Per Share at our fair value generates **9.03%**. The earnings yield at current market price is 5.62%. We therefore place a **BUY** on MRS shares at the current market price.

Business Description

MRS engages in the business of marketing and distribution of refined petroleum products.

Ticker	MRS
Sector	Petroleum Marketing
Date of Incorporation	1969
Date of Listing	December 8,1978
Year End	December
No of Ordinary Shares	253,988,000
Capitalisation (₦)	43,535,868,086.20
% of Market Capitalisation	0.55
52-Week High(₦)	91.35
52-Week Low (₦)	66.47
YTD Return (%)	7.45
52-Week Avg. Trade	24,713
Beta Value	0.13
Current EPS (₦)	4.15
Current PE(x)	17.79

Growing Retail Outlets:

The unaudited Q3, 2010 result of **MRS Oil Plc (MRS)** for the period ended September 30, 2010 showed that its Turnover (TO) increased by **8.45%** to **N58.95bn**, compared with N54.35bn in the corresponding period of 2009. The increase in costs, which may be linked to the expansion of retail outlets, did not allow the growth in turnover to trickle down to the bottom line. The Profit Before Tax (PBT) increased marginally by **0.21%** to **N1.933bn** in 2010 from N1.929bn in the corresponding period of 2009. The tax provision also increased marginally by **0.17%** from N617.59mn in 2009 to N618.66mn in 2010 leading to a Profit After Tax (PAT) of **N1.314bn** in Q3 2010 from N1.05bn in 2009, representing a marginal increase of **0.15%.**

The company's profit margins decreased marginally in Q3 2010 over Q3 2009, but increased over the FY December, 2009. The PBT margin decreased to 3.28% in Q3, 2010 from 3.55% as at Q3, 2009, but up from 2.31% and down from 4.30% as at the end of the financial year in December, 2009 and Q1 2010, respectively. This shows that the company's total costs as a percentage of TO stand at 96.72%, higher than 96.45% recorded in the corresponding period of 2009. PAT Margin currently stands at 2.23%, down from 2.41% in the corresponding period of 2009, but up from 1.41% as at FY 2009, and lower than 2.92% recorded in Q1 2010. The result also indicated that the percentage of TO, PBT, and PAT in Q3, 2010 to Full Year Audited TO, PBT and PAT for the period ended December, 2009 are: **79.02%, 112.30%** and **125.03%,** respectively.

A cursory look at the balance sheet position as at Q3 2010 compared with the position as at December, 2009 shows that the company's fixed assets increased by **2.26%** to **N3.26bn** from N3.18bn in FY 2009. This may be linked to the expansion plans of the company during the period. Stock decreased by **92.40%** to **N3.68bn** in Q3 2010 from N48.44bn in FY 2009.The impressive performance of the company during the period was reflected in the cash & cash balances which grew substantially by **83.99%** from **N1.27bn** in FY 2009 to N2.34mn in Q3 2010. MRS's working capital increased from **N556mn** in FY 2009 to N1.59bn in Q3 2010. Trade debtors increased by **26.09%** to **N2.18bn** from N1.73bn. The net assets increased by **33.66%** to **N3.96bn** from N2.97bn as at FY 2009.

A review of the Petroleum & Gas industry in Nigeria shows that the Federal Government of Nigeria (FGN) has implemented a number of reforms and initiatives in the last few years with the aim of bringing a lasting solution to the numerous problems that plague the industry. At the moment, the industry is important to the sustenance of the Nigerian economy as it accounts for about 80% of the country's revenue and 90% of the foreign exchange earnings. In addition, it accounts for about 15.70% of the country's Gross Domestic Product (GDP) as at June 2010. Some of the FGN initiatives are: Amnesty for the Militants; establishment of Petroleum Support Fund (FSP); Local Content Act (LCA); Petroleum Industry Bills (PIB); establishment of Sovereign Debt Note (SDN) and the proposed deregulation of the downstream sector. These initiative were put in place to achieve the following: protect the oil and gas facilities across the country; increase production of Crude oil; ensure regular supply of petroleum products to avoid queues at the filling station; encourage oil majors to import products and reduce financing costs for oil marketing firm; increase the participations of the Nigerian firms in the oil and gas industry. Although these measures have helped the petroleum marketing firms in the last one year, it is our view that the most important of the reforms is the full deregulation of the sector which has not been implemented. Currently, most quoted oil companies in Nigeria are primarily involved in petroleum marketing business without any incentive for them to engage in other viable investments such as constructing and running of refineries. We are of the opinion that the sector still has a lot of untapped opportunities which we think the current PIB and full deregulation of the downstream sector will address. Available data from the Petroleum Products Pricing Regulatory Agency (PPPRA) website as at November 26, 2010 shows that the price at which the Premium Motor Spirit (PMS) should be sold is N115.85per litre but the price is currently pegged at N65 per litter, meaning that government is paying N50.85 per litre as subsidy. Deregulation of the sector will attract further investments and bring in competition which has the capacity to lower retail price in the long run and allow government to spend its scarce resources on provision of social amenities and infrastructure which will make doing businesses in Nigeria competitive.

The capital employed as at December 31, 2009 was such that equity, deferred taxation and gratuity & other long term employee benefits accounted for 79.32%, 10.41% and 10.26% of the capital structure respectively. Its total Assets stood at N16.61bn, while total liabilities stood at N13.64bn. The short term liabilities stood at N12.87bn, accounting for 94.33% of the total liabilities while the long-term liabilities stood at N773.10mn accounting for 5.67% of the total liabilities. MRS had no long term interest bearing debt as at December 31, 2009. An analysis of the TO of MRS in 2009 shows that its revenue of N74.60bn was derived from **Retail Sale**, representing **88.90%** (N60.32bn), **Aviation**, representing **7.71%** (N5.75bn) and **Lubes**, representing 3.39%. MRS is organized into three business segments: marketing (sale & distribution of petroleum products in retail outlets and to industrial customers); Lube (manufacture & sale of lubricants and grease); and aviation (sale of aviation fuel to aircrafts). Its outstanding shares stood at about **253.988mn** out of which **152.39mn** is owned by MRS Africa Holdings Limited representing about **60%** of the shares, **ZSL A/C FOZ** holds about **19.59mn** shares, representing about **7.71%**, while the remaining **32.29%** is held by other Nigerians and institutions.

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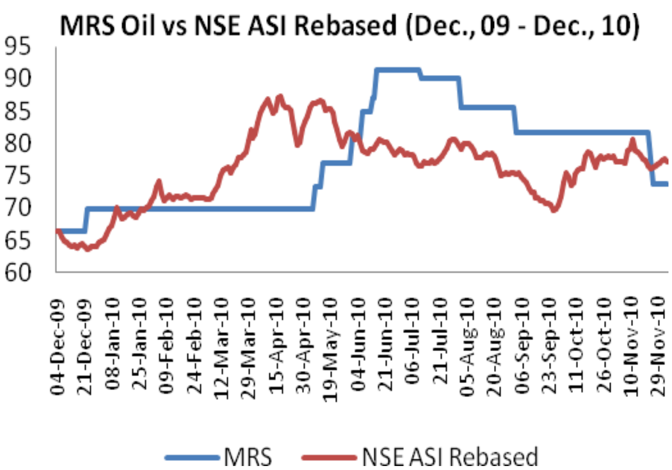
Comparative Analysis. As at December 2009							
Company	GEs	PBT	PAT	PAT Margin (%)	ROAE (%)	EPS*	PE*
MRS Oil	74,603	1,721	1,051	1.41	43.06	4.15	17.79
Mobil Oil	62,032	4,066	2,842	4.58	81.04	11.93	14.28
Oando	336,686	13,512	9,951	2.95	20.51	6.72	9.48
Total	178,570	6,163	3,968	2.22	55.68	15.44	15.20
Conoil	101,853	3,785	2,312	2.27	18.20	2.38	13.91
Source: Company Annual Reports, NSE FACTBOOK, *Current							
Financial Performance (N'mn)							
	Q3 2010	Q3 2009	% ∆	FY 2009	FY 2008	% ∆	FY 2010F
Gross Earnings	58,948	54,354	8.45	74,603	78,687	(5.20)	101.460
PBT	1,933	1,929	0.21	1,721	(305.73)	662.90	3,208
PAT	1,314	1,312	0.15	1,051	(225.43)	566.22	2,181
PBT Margin (%)	3.28	3.55	(0.27)	2.31	(0.63)	2.94	3.16
PAT Margin (%)	2.23	2.41	(0.18)	1.41	(0.46)	1.87	2.15



Directors As At December 31, 2009		
Name	Position	Shareholding (As at March31, 2010)
Alhaji S.I Dantata	Chairman	152,393,190
Mr. L.V. Tanoe	MD/CEO**	Nil
Mr. P. Alberti	Director	Nil
Alhaji D.M Barau	Director	Nil
Mallam Musa Yahaya	Ex. Director*	Nil
Mr. O.T. Adelekan	Director	16,331
Chief S.C. Ezendu	Director	47,368
Mr. O.M Cardoso	Director	Nil
Dr. S. Kewa	Director	1,989
Mrs. D.U. Ufot	Director	Nil
** Resigned * Appointed MD/CEO wef June 15, 2010		

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