Oando Plc: *Interim Results – Q3, September 2010*

Oando

December 09, 2010	BUY	Fair Value: NGN 71.97	Current Price: NGN64.00

Valuation/Analyst Recommendation

In arriving at a fair value for the ordinary shares of Oando, 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 **Turnover** of **N387.39bn**, **N464.87bn**, **N557.84bn**, **N647.09bn** and **N750.63bn** for 2010, 2011, 2012, 2013 and 2014, respectively. We estimate **EBIT** of **N34.87bn**, **N46.49bn**, **N55.78bn**, **N61.47bn** and **N67.56bn** for the same period, based on EBIT Margin of 9.00% for 2010, 10.00% for 2011 and 2012, 9.50% for 2013 and 9.00% for 2014. We estimate **EBITDA** of **N41.50bn**, **N53.72bn**, **N63.62bn**, **N69.92bn** and **N76.60bn** 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 **N7.30bn**, **N25.54bn**, **N33.45bn**, **N37.68bn** and **N43.33bn**. Our forecast PAT of **N13.56bn**, **N25.57bn**, **N36.26bn**, **N38.83bn** and **N39.41bn** is based on PAT margin of 3.50% for 2010, 5.50% for 2011, 6.50% for 2012, 6.00% for 2013 and 5.25% for 2014. Using a dividend payout of 50% for the period we arrived at **Dividend Payment** of **N6.78bn**, **N12.78bn**, **N18.13bn**, **N19.41bn** and **N19.70bn**. We applied a terminal growth rate of **7.69%**. We used a beta value of 0.77; risk free rate of **9.90%** and a **market risk premium** of **10.04%**. The company had long term interest bearing debt of **N21.25bn** as at the last audited account. Applying the foregoing parameters and taking cognizance of the long-term debt and applying a tax rate of 32%, the Weighted Average Cost of Capital (WACC) generates **17.20%**, which is our discount rate. Using **1,810.17mn** shares in issue, the **DCF** Model generates **N75.04** per share and the **DFE** Model generates **N68.22** per share. Applying a weight of 55% to the DCF and 45% to the DFE, we arrive at a value of **N71.97** per share, which is our fair value. Buying the stock at the current market price of **N64.00** and holding it to our fair value of **N71.97** and adding the present value of the 5-year forecast dividends, investors will earn a total return of **52.57%**. Relating this return to the WAAC at **17.21%**, investment in Oando shares at the current market price will record a positive alpha return of **35.37%**. The 2010 forward earnings yield based on our fair value generates **10.41%**, while the 2010 forward Dividend Yield based on **N3.75** Dividend Per Share at our fair value generates **5.20%**. The earnings yield at current market price is 10.50%. We therefore place a **BUY** on Oando shares at the current market price.

Business Description

Oando's activities are divided in to Exploration, Production, Energy Services; Gas and Power; Marketing; Supply & Trading, Refining and Terminals.

Ticker	**OANDO**
Sector	**Petroleum Marketing**
Date of Incorporation	**1956**
Date of Listing	**27th February, 1992 – NSE 1st November, 2005 – JSE**
Year End	**December**
No of Ordinary Shares	**1,810,169,255**
Capitalisation (₦)	**115,850,832,320**
% of Market Capitalisation	**1.47**
52-Week High(₦)	**128.50**
52-Week Low (₦)	**53.00**
YTD Return (%)	**21.28**
52-Week Avg. Trade	**2,227,103**
Beta Value	**0.77**
Current EPS (₦)	**6.72**
Current PE(x)	**9.52**

Positioned for Favourable Policy:

The unaudited Q3, 2010 result of **Oando Plc (Oando)** for the period ended September 30, 2010 showed that its Turnover (TO) increased by **9.77%** to **N277.52bn**, compared with N252.82bn in the corresponding period of 2009. The reduction in the cost relating to revenue which might have resulted from lower financing charges due to refinancing of high interest bearing loans and the Federal Government Sovereign Debt Note (SDN) for oil majors led to improved profitability. The Profit Before Tax (PBT) increased by **62.63%** to **N15.19bn** in 2010 from N9.34bn in the corresponding period of 2009. The tax provision increased by **145.63%** from N2.60bn in 2009 to N6.38bn in 2010, while Profit After Tax (PAT) increased to **N8.81bn** in Q3 2010 from N6.74bn in 2009, representing an increase of **30.68%.**

The company's profit margins increased in Q3 2010 over Q3 2009 and over the FY December, 2009. The PBT margin increased to 5.47% in Q3, 2010 from 3.69% as at Q3, 2009, and up from 4.01% as at the end of the financial year in December, 2009 but down from 6.27% as at Q2 2010. This shows that the company's total costs as a percentage of TO stands at 94.53%, lower than 96.31% recorded in the corresponding period of 2009. PAT Margin currently stands at 3.17%, up from 2.67% in the corresponding period of 2009, and up from 3.00% as at FY 2009, but lower than 3.80% recorded in Q2 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: **82.39%, 112.40%** and **87.24%,** respectively. This shows that the Oando should surpass its previous year's top and bottom line performance.

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 marginally. This may be linked to the expansion plans of the company during the period. Its fixed assets increased marginally by 4.30% to N137.38bn from N131.71bn in FY 2009. Stock increased by 115.88% to N20.93bn in Q3 2010 from N9.69bn in FY 2009. There was decrease in cash and bank balances, which dropped by 56.18% to N11.29bn in Q3 2010 from N25.76bn in FY 2009. Oando's working capital improved from a negative of N93.15bn in FY 2009 to a negative of N15.15bn in Q3 2010. Trade debtors increased by 34.59% to N66.99bn from N49.77bn, while the trade creditors decreased by 17.79% to N32.99bn from N40.13bn in FY 2009. The net assets also increased by 47.54% to N78.96bn from N53.52bn as at FY 2009.

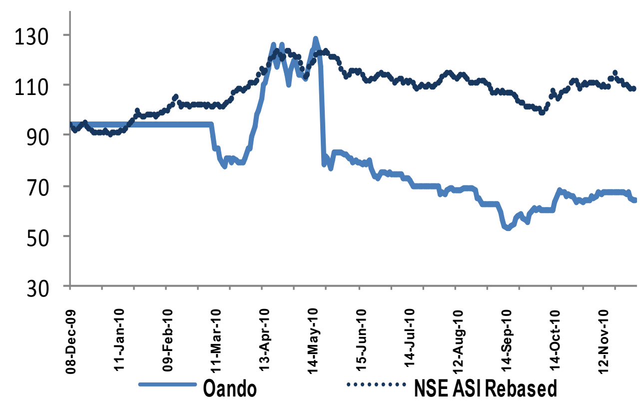
A review of the Petroleum & Gas industry in Nigeria shows that the Federal Government of Nigeria (FGN) has implemented a number of reforms and initiatives in the last few years with the aim of bringing a lasting solution to the numerous problems that plague the industry. At the moment, the industry is 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 accounted 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 stations; encourage oil majors to import products and reduce financing costs for oil marketing firms; and 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 N114.15per litre but the price is currently pegged at N65 per litter, meaning that government is paying N48.15 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.

Oando intends to maximize its operational efficiency of throughput of products through its existing storage facilities with the aim of extracting margin. It also intends to diversify its product lines as well as extend its customer base in Sub-Saharan Africa. The company also expects that the passage of the Petroleum industry Bill (PIB) and Nigerian Content Bill by the National Assembly are expected to increase the company's footprint in the industry as it would present the company with more opportunities for it to acquire more acreage from International Oil Companies (IOC). It plans to increase current daily production to 10,000bop/d and grow its reserves as well. The capital employed by Oando as at December 31, 2009 was made up of equity and long term liabilities in the proportion of 58.78% and 41.22% respectively. Its total Assets stood at N315.53bn, while total liabilities stood at N262.21bn. The short term liabilities stood at N226.27bn, accounting for 86.29% of the total liabilities while the long-term liabilities stood at N35.94bn accounting for 13.71% of the total liabilities. Oando has long term interest bearing debt as at December 31, 2009 which amounted to N21.25bn and is 23.80% of the capital employed. An analysis of the TO of Oando in 2009 shows that it has a well diversified revenue base. Its total revenue of N336.86bn are as follows: **72.57%** (N244.46bn) was derived within **Nigeria**, 2.59% (N8.71bn) from **Other West African Countries**, and **24.84%** (N83.68bn) from **Others**. The turnover by product lines are: **Crude oil**: 23.17%; **Fuel**: 64.91%; **Base oil**: 7.35%; **Gas**: 3.27%; **Barite, drill bits and oil well cement**: 0.11%; **non fuel revenue**: 0.03%; **others**: 1.14%. Oando's outstanding shares stood at about **905.08mn** as at December 31, 2009 out of which **223.27mn** were held by **Ocean & Oil Investment Limited** representing about **24.67%** of the shares, while the remaining **75.33%** (681.81mn) were held by other Nigerians and institutions. The company embarked on right issue of 1 right for 3 shares and approved a bonus of 1 for 2 during its Annual General Meeting (AGM) of May 07, 2010. The company has 38 subsidiaries and other related companies and associated companies.

Comparable Analysis. As at December 2009							
Company	GEs	PBT	PAT	PAT Margin (%)	ROAE (%)	EPS*	PE*
Oando	336,686	13,512	9,951	2.95	20.51	6.72	9.52
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
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	277,524	252,816	9.77	336,859	339,420	(0.75)	387,389
PBT	15,188	9,339	62.63	13,512	10,742	25.79	19,939
PAT	8,808	6,740	30.68	10,096	8,343	21.01	13,559
PBT Margin (%)	5.47	3.69	1.78	4.01	3.16	0.85	5.15
PAT Margin (%)	3.17	2.67	0.51	3.00	2.46	0.54	3.50

Oando Vs NSE ASI Rebased (Dec.2009-Dec. 2010)



Directors As At December 31, 2009		
Name	Position	Shareholding
Galadiman Zuru	Chairman	Nil
Adewale Tinubu	Group CEO	731,739
Omamofe Boyo	Deputy Group CEO	539,717
Mobolaji Osunsanya	Group Executive Director	287,344
Olufemi Adeyemo	Group Executive Director	312,242
Ademola Akinrele	Non- Executive Director	40,000
Sena Anthony	Non- Executive Director	565
Navaid Burney	Non- Executive Director	Nil
Michael A. Gbadebo	Non- Executive Director	15,000
Oboden Ibru	Non- Executive Director	5,294
Hamidu Mahmud	Non- Executive Director	8,347
O.P. Okoloko	Non- Executive Director	Nil
Amal Pepple	Non- Executive Director	Nil
Genevieve Sangudi	Non- Executive Director	Nil

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