

SHELL OMAN MARKETING COMPANY SAOG (SOMS.MSM)

Retail fuel sales expected to drop in 2009 as auto sales and demand for fuel weaken significantly year on year

RECOMMENDATION : HOLD
CMP : RO 1.800
TARGET PRICE : RO 1.520
VARIANCE : -16%

INVESTMENT OPINION

FINANCIAL INDICATORS	FY2008
CMP (23-Mar-09)	1.800
MCAP (RO Mn)	180
P/E (FY08)	14.4
P/BV (FY08)	6.72
DIV YIELD (FY08)	6.4%
ROAE	47.97%
ROAA	21.42%
LT DEBT/EQUITY	0
CURRENT RATIO	1.36
OPERATING PROFIT MARGIN	4.38%
NET PROFIT MARGIN	3.83%
NET DEBT (RO Mn)	-9.99
FCFE/SHARE	0.130
FCFE YIELD	7.3%

Source: FINCORP Investment Research

We believe that 2009 will be a challenging year for Shell Oman to improve its sales as the combined effects of a sharp economic contraction and tightness in availability of credit will have an adverse impact on fuel consumption, especially on the retail front. New car sales in Oman have been dismal in Q4 2008 and is likely to be weak in Q1 2009 too given the tightness in availability of credit and declining trend of private consumption. We expect a 15% drop in retail fuel sales on the back poor auto sales and lower demand forecast for fuel from retail customers as they tend to cut back on leisure travel in times of uncertainty .

Commercial fuel sales and lubricant sales are expected to grow albeit at a much slower rate as the economy decelerates. Aviation fuel sales may again grow at a brisk rate owing to the sharp growth in air traffic in Omani airports, especially in Muscat. We therefore maintain a HOLD on the stock with a target price of RO 1.520. This stock merits a premium valuation to its two competitors, Oman Oil and Al Maha Petroleum as a result of its market dominance and brand equity.

BUSINESS MODEL

Shell Oman Marketing Company is the leading fuel marketing company in the Sultanate of Oman having a network of 132 fuel delivery sites. The company's primary business segments include:

- Fuel sales to retail customers** (48% share in its FY08 sales) with a market share of 45.4% in Oman

COMPANY
UPDATE

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2. **Fuel sales to commercial customers** (20% share in its FY08 sales) which mainly involves supplying fuel to government infrastructure projects. Shell Oman has a lead market share in this segment too.
3. **Lubricant sales** (18% share in its FY08 sales): The lube market size in Oman is estimated at 37 million liters (excl. marine application lubes) and is fragmented. The company managed to increase its market share in this segment by 11% in 2008 which is commendable.
4. **Aviation fuel sales** (13% share in its FY08 sales): Sales in this segment jumped 116% YoY in FY08 and the company has a leading market share of 55% in this segment.

STRONG SEGMENTAL GROWTH IN 2008 BUT 2009 WILL BE CHALLENGING

Total revenue of the company grew 32% to RO 326 million from RO 247 million in 2007 driven by increased sales in all the four business segments as shown in Table 1 below.

- **Retail fuel sales:** Retail sales grew 13% by volume to 1.3 billion liters as a result of robust economic growth in 9M 2008 and launch of new fuel stations. The company recorded its highest ever monthly sale of 120 million liters in the retail segment in August 2008. Average throughput per site increased from 9.3 ML in 2007 to 10.2 ML in 2008 which is the highest in the industry. This has resulted in a better cost and operational efficiency for Shell retailers.

Retail market share, however, dropped from 47% in 2007 to 45.5% in 2008 owing to overall growth of industry volumes and new sites launched by its competitors. Shell Oman intends to grow organically by investing in viable new sites so as to increase its market share. Independent market surveys show that Shell Oman scores the highest in terms of customer service in Oman and continues to enjoy the preferred fuel brand status.

Retail fuel sale growth depends on personal consumption on auto in the form of new vehicle purchases and greater distances covered in leisure travel. The current global economic crisis has resulted in a sharp drop in new vehicle sales in Oman in Q4 2008 and possibly in Q1 2009 which is likely to have an adverse impact on retail fuel sales of the company in the current fiscal. Growing uncertainty on retaining their jobs in the private sector is forcing many families to cut their leisure travel which also would slow down retail fuel sales.

Hence, we expect retail fuel sales to drop 15% YoY by volume in FY 09.

- **Commercial fuel sales:** Commercial fuel sales grew 40% YoY aided by government spending on infrastructure development and tourism related projects. The company believes that the government would not significantly scale down its infrastructure related spending as outlined in the 2009 state budget. We expect this segment to grow at least 10% in 2009.

Table 1			
REVENUE	2008	2007	YoY %
BY SEGMENT			
Retail sales	157,185	139,051	13.04%
Commercial sales	65,593	46,824	40.08%
Lubricants sales	60,317	41,908	43.93%
Aviation sales	43,272	20,071	115.59%
BY LOCATION			
Within Oman	280,066	216,996	29.1%
Outside Oman	46,301	30,858	50.0%

Source: Company Financial Statements

- **Lube business:** Lubricant sales witnessed 44% supported by growth in exports as well as local volumes. Local volumes increased 14% to 20 million liters. Shell Oman Marketing Company is the main supplier for Shell Markets Middle East sourcing a volume of 80 million liters (ML).

The company sees its lubricant business as a key thrust area and intends to gain further market share providing high level of customer service.

<i>Table 2</i>							
	Q1 08	Q2 08	Q3 08	Q4 08	2008	2007	YoY %
Revenue	73,388	84,157	90,506	78,316	326,367	247,854	32%
Operating Profit	3,473	3,636	3,975	3,199	14,283	12,595	13%
Operating Profit Margin	4.73%	4.32%	4.39%	4.08%	4.38%	5.08%	-
Net Profit	3,062	3,164	3,498	2,780	12,504	11,062	13%
Net Profit Margin	4.17%	3.76%	3.86%	3.55%	3.83%	4.46%	-
EPS	0.031	0.032	0.035	0.028	0.125	0.111	13%
Number of sites	-	-	-	-	132	124	-
Average Throughput per site (million liters per annum)	-	-	-	-	10.2	9.3	-

Source: Company Financial Statements

The lube market in Oman is expected to grow only by 3-4% in 2009 as a result of low oil prices and economic slump. The prices of base oils which were very volatile in 2008 are expected to be much lower and stable in 2009 leading to cost savings. However, growth rate in sales is expected to moderate significantly in line with the GDP growth rate.

- **Aviation fuel sales:** The company has witnessed the highest growth in revenues of 115% in the Aviation sector buoyed by a 50% growth in total volumes of which volumes at Muscat International Airport increased 86%. Introduction of additional long distance destinations and entry of airlines such as Airblue and Jet Airways has contributed significantly to fuel demand at Muscat International Airport. Shell Oman Marketing Company has been able to gain a 55% market share in this segment and handles 75% of the 90 million liters per annum fuel requirement of Oman Air. It has also been able to retain its entire supply to carriers like Thai Airlines, KLM and secured additional fuel supply contracts from Royal Air Force Oman (RAFO).

By geographical segments, the company's sales within Oman grew 29% while sales outside Oman saw a 50% growth.

While cost of sales grew 34%, operating profit of the company grew 13% YoY at the end of FY 2008. Selling and distribution expenses were higher by 22% and administrative expenses increased by 10%.

The company's net profit rose to a record RO 12.5 million, 13% higher than RO 11 million achieved in FY2007.

Shell Oman Marketing Company operating profit margin fell from 5.08% to 4.38% in FY08 while net profit margin decreased to 3.83% from 4.46% in FY2007.

The company's earnings per share increased from RO 0.111 to RO 0.125 in FY2008. The company has declared a cash dividend of 115% i.e. RO 0.115 per share representing a payout ratio of 92% aggregating to a dividend yield of 6.4% at the current price of RO 1.800.

Table 3

	2008	2007
Cash dividend/share (RO)	0.115	0.110
Stock dividend/share (RO)	-	-
Total dividend/share (RO)	0.115	0.110
Dividend Payout Ratio	92%	99%
Dividend Yield	6.3%	-

Source: Company Financial Statements

BALANCE SHEET ANALYSIS

Total assets of the company reduced marginally by 1%. The company acquired plant and equipment worth RO 2.4 million during the year. The buildings of the company are constructed on land which has been leased to them by the Ministry of Oil and Gas for tenure of 10 years from November 1, 1997. This lease is in the process of being renewed.

Inventories and work in progress of the company has come down 12% while trade receivables declined 10%. Most of the trade receivables are 'Neither past due nor impaired' and are unsecured in nature. However, as a fallout of the global credit crisis, the company intends to manage its credit risks effectively by adopting a stringent credit policy going forward.

The company is completely debt free as at December 31, 2008 having repaid its short-term loans and bank overdrafts to the tune of RO 4 million and RO 0.4 million respectively. Cash and Cash Equivalents amounted to RO 9.9 million at the end of FY08 compared to RO 9.1 million at the end of FY07.

In terms of share holding pattern, almost 49% of the company is closely held by subsidiaries of Royal Dutch/Shell Company.

The company does not have any exposure to investments in the equity market.

Table 4

SHAREHOLDING PATTERN	2008	%	2007	%
Multi-vote shares				
<i>Shell Overseas Investments BV</i>	5,000,000	5%	5,000,000	5%
Ordinary Shares				
<i>BV Licht en Kracht Maatschappij</i>	20,000,000	20%	20,000,000	20%
<i>Shell Overseas Investments BV</i>	15,000,000	15%	15,000,000	15%
<i>BV Nederlandse Internationale Industrie-en Handel Maatschappij</i>	8,800,000	8.8%	8,800,000	8.8%
<i>Civil Services Pension Fund</i>	7,734,159	7.7%	7,658,354	7.7%
<i>MOD Pension Fund</i>	7,546,970	7.6%	7,299,970	7.3%

Source: Company Financial Statements

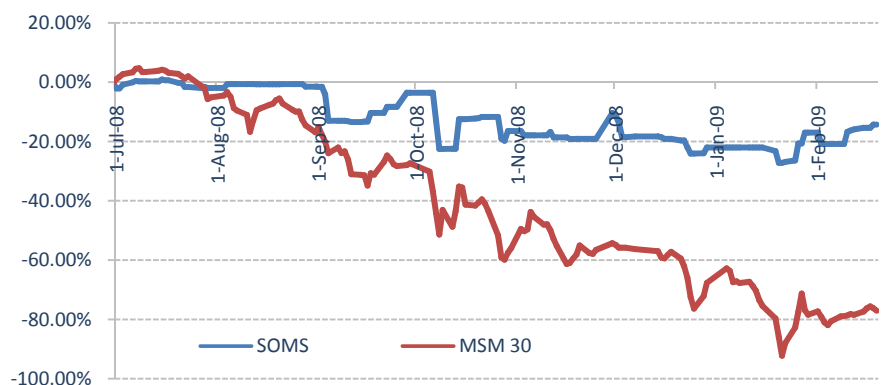
Book value per share amounted to RO 0.268 at the end of FY08 compared to RO 0.253 at the end of FY07. The stock trades at a P/BV multiple of 6.86x.

The company has very high return on average equity ratio of 47.97% while return on average assets is 21.42%. In addition, the company has a free cash flow per share of RO 0.130 attributable to equity holders which works to a FCFE yield of 7.3%.

STOCK PRICE PERFORMANCE

The stock currently trades at P/E multiple of 14.7x its trailing 12 months earnings. The stock lost 22% of its value during the second half of 2008 while the benchmark index lost 67%. The stock has a 3-year beta of 0.65.

Figure 1
Performance of SOMS vs MSM 30 Index -
July 2008-February 2009



Source: MSM

VALUATION

Shell Oman's business model matches that of a typical mature firm which pays back most of its earnings in the form of dividends to shareholders. Hence Dividend Discount Model would be an appropriate valuation technique for this stock. The necessary computations can be found in Table 5. The fair value of this stock works out to RO 1.599 which is 11% lower than its current market price.

As seen in Table 6, Shell Oman Marketing Company trades at a premium over its peers on P/E and P/BV multiples attributable to its market dominance and much higher ROE. The mean P/E multiple for the Oil marketing sector currently is 11.82x. SOMS therefore trades at a 22% premium over the mean P/E multiple. Assuming an EPS of RO 0.100 for FY09, the fair value works out to be RO 1.440.

Giving equal weightage to values arrived by DDM and Peer Comparison, the Fair Value for Shell Oman Marketing Company works out to RO 1.520.

Table 5

DIVIDEND DISCOUNT MODEL	
AVERAGE 3 YEAR ROE	42.89%
RETENTION RATIO	5.0%
g	2.0%
k	8.4%
R _f	4.50%
R _m	10.50%
3 YEAR BETA	0.65
DIVIDEND 2008	0.115
D ₁	0.100
P ₀	1.599

Source: FINCORP Investment Research

Table 6

PEER COMPARISON			
INDICATORS	SOMS	OOMS	MHAS
P/E (FY08)	14.40	12.09	8.97
P/BV (FY08)	6.71	3.63	2.39
ROE	46.6%	30.1%	26.6%
DIV YIELD (FY08)	6.4%	3.0%	5.2%
DIV PAYOUT (FY08)	92.0%	35.7%	46.9%

Source: FINCORP Investment Research

INVESTMENT RESEARCH

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