

Shell Oman Marketing Company

MSM Code: SOMS | Reuters Code: SHEL.OM | Bloomberg Code: SOMS OM|
Current Market Price: OMR 1.90 (As of April 27, 2010)
Initial Coverage: April 2010

April 2010

Stock Volatility	Expected Return (April 2010)		
	Low	Medium	High
	Low		
	Medium		
	High		

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- Shell Oman Marketing Company's (SOMC) share price fell 6.8% YTD, while the MSM 30 index increased 6.9% during the same period. In 2009, the index gained 17.0%, while SOMC's share price rose 14.1%.
- SOMC currently trades at a P/E of 13.9x; the company's PE rose 9% in 2009, but fell 11.3% on a YTD basis. We place fair value PE at 15x, indicating some upside potential due to its unique competitive positioning.
- SOMC's revenue fell 8.6% YoY to USD 769 mn in 2009 (31.7% increase in 2008), due to lackluster performance by the lubrication and aviation segments, which declined 29.7% and 19.7% YoY respectively. However, the company's revenue increased by 3.3% in 4Q 2009 to USD 210 mn. Operating profit for 2009 increased by 3.8% to USD 38 mn. The company's net profit in 2009 increased 4.1% YoY to USD 33.6 mn.
- The company's EBITDA margin increased to 6.1% in 2009 from 5.3% in 2008, and remained stable at 5.1% in Q4 2009. The company's EBIT margin dipped marginally to 4.0% in Q4 2009 (4.1% in Q4 2008) owing to a licensing fee of 0.4% of revenue imposed in Q1 2009, along with a price hike of products purchased from Sohar Refinery (effective August 2009).
- The sector witnessed a 7.3% YoY revenue decline in 2009 owing to reduced demand in the retail and commercial segments. The aviation segment witnessed margin pressure on account of a fall in international fuel prices, lower demand and rising consolidation in the industry.
- SOMC's margins and ROE are higher than industry peers. Its return metrics and competitive positioning justify the 25% P/E premium it commands over other peers (13.9x against industry average P/E of 11.1x). In addition, the company's dividend yield of 6.3% in 2009 is higher than the industry average of 4.7%.
- With Oman's real and nominal GDP expected to grow 4.7% and 16.6% respectively, population to increase by 3.3% and government expenditure to increase by 11.8% in 2010, Oman's oil marketing sector is likely to benefit. We expect a 7.6% increase in SOMC's revenue in 2010, while net profit is expected to increase by 1% to reach USD 34 mn.

USD Mn	2005	2006	2007	2008	2009	2010f
Revenue	473	584	639	842	769	828
Net profit	19	23	29	32	34	34
P/E (LTM)	11.5x	15.6x	14.5x	14.3x	15.7x	13.9x
P/B (LFI)	3.9x	6.0x	6.3x	6.7x	7.2x	9.6x
Market Cap	223	362	415	464	529	494
Stock Returns	8.3%	73.1%	21.6%	18.0%	21.8%	-6.8%

Note: 2010 figures - M.Cap., Stock Returns as on April 27, 2010

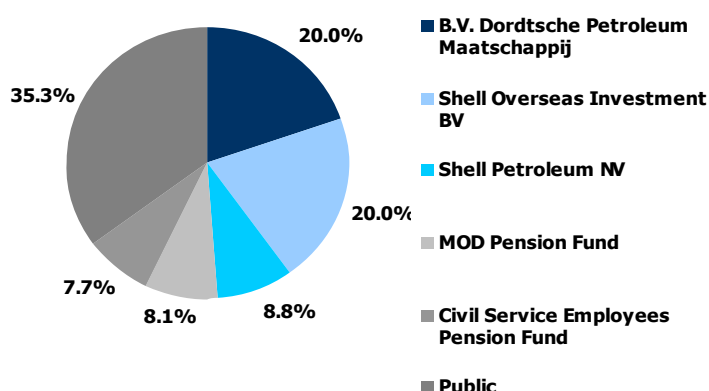
Source: Financial Reports, Bloomberg, Reuters

Company Overview

Largest company in terms of sales and market capitalization in the Oman oil marketing sector

Established in 1997, Shell Oman Marketing Company is an Oman-based company engaged in the marketing & distribution of petroleum products and blending of lubricants. The company, with a market capitalization of USD 494 mn (as of 27 April 2010) and sales of USD 769 mn in 2009, is the largest company in the oil marketing sector in Oman. Shell Group through its subsidiaries, B.V. Dordtsche Petroleum Maatschappij, Shell Overseas Investment, Shell Petroleum and Shell Gas BV hold 49% share of the company, while remaining 51% shares are held by other investors and public.

Figure 1: Shareholding pattern (as of December 2009)

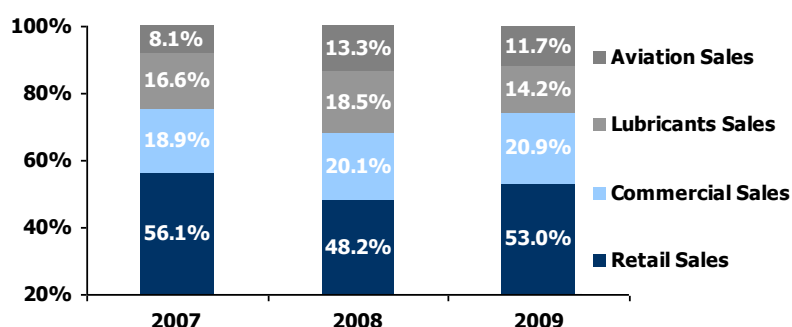


Source: Zawya

Retail sales contributed 53% to total revenue in 2009 and grew at a CAGR of 6.7% b/w 2007-2009

The company generates revenue from four segments - retail sales, commercial sales, lubricant sales and aviation sales. In addition, the company has recently added a fifth revenue stream through the sale of bitumen. The retail segment, with 53% of the total revenue, is the major revenue segment for the company, followed by commercial sales and lubricant sales, which contribute around 21% and 14%, respectively. Aviation sales contributed 11.7% to the total revenue, while the newly added bitumen sales generated mere 0.2% of the total revenue. The aviation segment increased at a CAGR of 31.6% over 2007-2009, the highest among its revenue segments, followed by commercial sales and retail, which grew at a CAGR of 15.4% and 6.7% respectively, over the same period.

Figure 2: Revenue segment wise over 2007-2009



Source: Company's financial

Investment Highlights

Increasing economic activity to drive the oil marketing sector

Rising Omani population, workforce and government expenditure to drive the oil marketing sector

Oman's rising population and increasing workforce has been a key driving factor for the country's oil marketing sector. Oman's population increased at a CAGR of 1.7% over 2005-2008 to reach 2.8 million in 2008, while its total workforce rose at a CAGR of 18.7% over the same period. These factors led to an increase in the number of driving licenses issued in Oman, and in turn drove the oil marketing sector. With Oman's population expected to have increased 3.3% YoY to 2.9 million in 2009, we expect the oil marketing sector's retail segment to benefit from it.

Further, the Omani government has increasingly focused towards higher non-oil sector participation in GDP leading to increasing investment towards infrastructure development. In addition, the lifting of restrictions on foreign investments and promotion of tourism is likely to boost revenue from the commercial and aviation segments. The country's nominal GDP increased at a CAGR of 24.7% from 2005-2008 to reach USD 59.9 bn in 2008. According to the IMF, Nominal GDP is expected to decline 11% in 2009 but rise by around 17% in 2010, while Real GDP is expected to increase 3.3% and 4.7% in 2009 and 2010, respectively. The government plans to increase total expenditure in 2010 by 11.8% to USD 18.5 bn. As mentioned earlier, the aviation segment is likely to benefit from government efforts to promote tourism through expansion of ownership rights to foreigners (including non-GCC) in certain areas of the country. Thus, Oman's macro-economic factors are likely to positively impact the oil marketing sector.

Focus towards higher revenue generating retail segment

SOMC's filling stations present all over Oman

SOMC has focused increasingly on its retail segment, which contributes around 50% to revenues and was the only segment to generate positive sales growth in 2009. The company targets retail growth through increasing the number of filling stations along with launching new products. The company's number of filling stations increased at a CAGR of 3.9% between 2006-2009 to 138 stations in 2009. In 2009, the company opened six new sites and rebuilt four sites. Throughput per site, which indicates operating efficiency, stands at 9.7 mn litres¹, higher than the industry average of 7.5 mn litres. The company had the highest number of stations among its peers in major cities like Muscat as of 2008.

SOMC's retail throughput higher than the industry average

Table 2: Trend in number of filling stations of SOMC

Cities	2006	2007	2008
Muscat	33	35	36
Al Batinah	24	25	27
Musandam	3	3	3
Adh Dhahirah	11	11	12
Ad Dakhliyah	14	15	15
Ash Sharqiyah	19	19	20
Al Wusta	4	4	4
Dhofar	15	15	16
Total	123	127	133

Source: Ministry of National Economy

¹ Source: Company's annual report

The company has launched new products and services, for e.g. Shell Super Petrol introduced by SOMC during Q3 2009 aims to provide higher mileage to customers. Shell fleet card products introduced with the aim to eliminate the need of cash purchase by the customers, witnessed a growth of 13% YoY and contributed 15% to the total revenue in 2009. The company has also introduced convenience stores under the name Select to provide wider facilities to its customers, which registered 4.6% YoY increase in sales in 2009. Going forward, we believe that these efforts are likely to help SOMC in generating higher revenue from its retail segment.

New deals to boost revenue

SOMC is expected to hold around 50% market share at MIA

SOMC has recently signed two new contracts for supplying aviation fuel to Fly Dubai and Aviation Service Management (ASM) at Muscat International Airport (MIA). In May 2009, the company won 100% of Indian airline fueling business at MIA. Subsequently, the company signed a contract with Air India, Indian Express and Indian Airlines to provide fuel for 3 years till April 2012. The company's market share in MIA is approximated to be around 50%. Thus, with the growth of tourism and increasing movement of aircrafts at MIA, SOMC is likely to benefit. In addition, the company has also signed a contract with Sohar Industrial Port Co. to establish bunker operation in port of Sohar. From June 2010 onwards, the company will supply marine fuels of different grades and lubricants to the ships at the port. We believe these new deals are likely to benefit the company going forward.

Generating better return than its peer

SOMC generating margins and returns above the industry average

SOMC has outperformed its peers in terms of operating margins and returns. The company's operating and net margin at 6.1% and 4.4% respectively, is above the industry average of 4.8% and 3.2% respectively. The company's return on equity at 46% is also well above the industry average of around 30%. The higher margin is on account of higher throughput in the retail segment, along with better cost management. The company trades at a P/E of 13.9x, which is higher than the industry average of 11.1x, however, it appears that its robust returns and margins justify this premium.

Table 3: SOMC's 2009 performance compared with regional peers

Companies (Fig in USD mn)	Revenue	EBITDA	EBITDA Margin	Net Margin	ROE	P/E
Shell Oman Marketing	769	47	6.1%	4.4%	45.9%	13.9x
Al Maha Petroleum	444	19	4.3%	3.3%	19.8%	10.7x
Oman Oil Marketing	438	23	5.2%	3.2%	23.7%	11.3x

Source: Bloomberg, Reuters

Discussion Notes

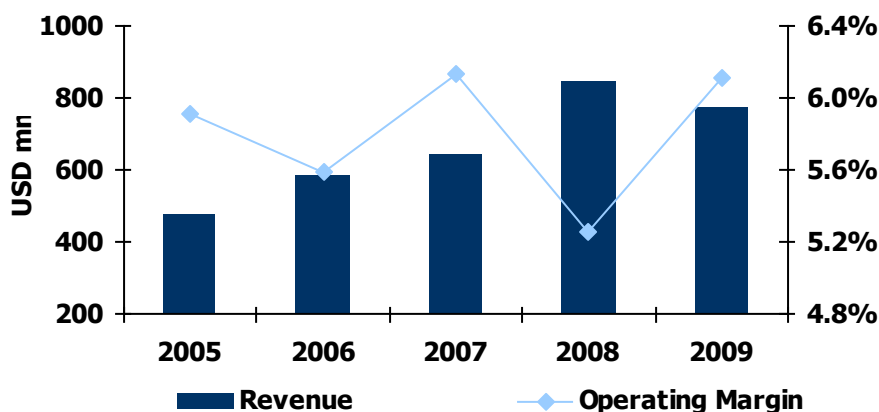
Looking back – 2009 results

Decline in revenue by 8.6% YoY in 2009 owing to fall in revenue from the lubricants and aviation segments

SOMC's 2009 revenue declined 8.6% YoY to USD 769 mn, led by 29.7% decline in lubricant sales and 19.7% decline in aviation sales. Operating profit rose 6.3% YoY to USD 47 mn in 2009 led by a 10.3% decline in cost of goods sold. The operating margin rose to 6.1% in 2009 from 5.3% in 2008. The company's administrative expenses increased 8.9% YoY in 2009

on account of a new government mandated licensing fee. Net profit increased 4.1% YoY to USD 33.6 mn in 2009 while net margin rose to 4.4% in 2009 from 3.8% in 2008.

Figure 3: Revenue and operating margin trend



Source: Reuters, Company Report

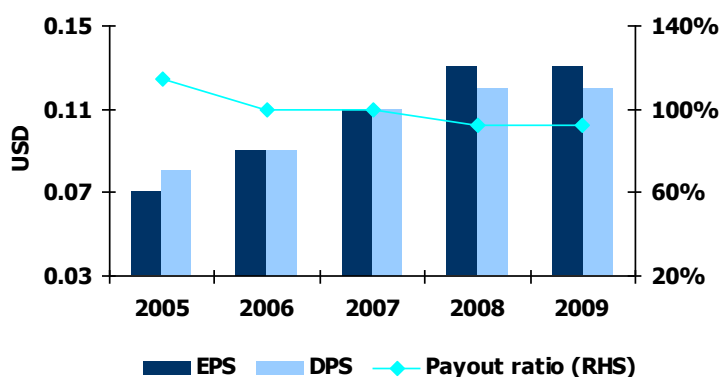
In Q4 2009, revenue rose 3.3% YoY to USD 210 mn. Cost of goods sold increased 2.3% YoY to USD 189 mn after the announcement of a price hike of refined products from the Sohar refinery. Net profit rose 1% to USD 7.4 mn in Q4 2009. However, on a sequential basis, the company's net profit declined 22% QoQ.

Strong dividend yield

Average payout ratio close to 100% over the period 2005-2009.

SOMC follows a high dividend paying strategy, with average payout close to 100% over the period 2005-2009. The company has a dividend yield of 6.3%, while its regional peers Al Maha Petroleum and Oman Oil Marketing have a dividend yield of 5.8% and 3.7% respectively. The company's dividend payment increased at a CAGR of 21.4% over the period 2005-2009 to reach USD 30 mn in 2009. However, SOMC's cash flow from operating activities declined 3% over the period to reach USD 36 mn in 2009. The company's free cash flow also declined at a CAGR of 8.2% over the period 2005-2009 to reach USD 23.8 mn in 2009. Thus, the company's high dividend payout may not be sustainable going forward.

Figure 4: Dividend payout

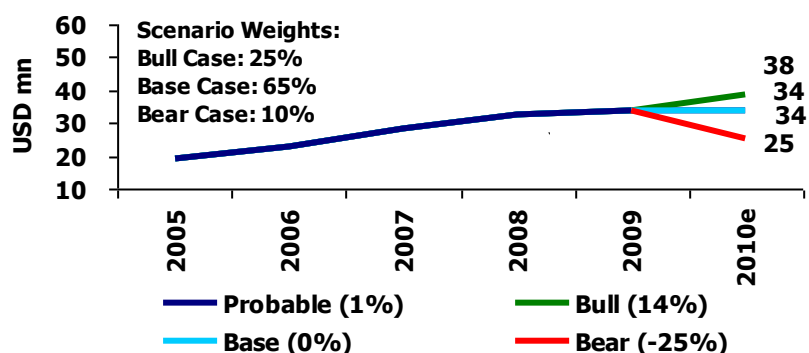


Source: Reuters

Looking forward – 2010

We expect 2010 revenue to grow 7.6% YoY to USD 828 mn, led by growth in the retail and commercial segments with net profit growing 1% to USD 34 mn. We expect the company's profitability and margins will be affected by the introduction of the licensing fee and increased purchase price of products from Sohar Refinery. Our call on 2010 net profit is a weighted product of three scenarios - the Bull Case (with a 14% growth in earnings, and a 25% probability of occurring), a Base Case (with a 0.3% rise in net earnings and a 65% probability of occurring), and finally, a Bear Case (with a decline of 25% and a 10% probability of occurring).

Figure 5: Net income



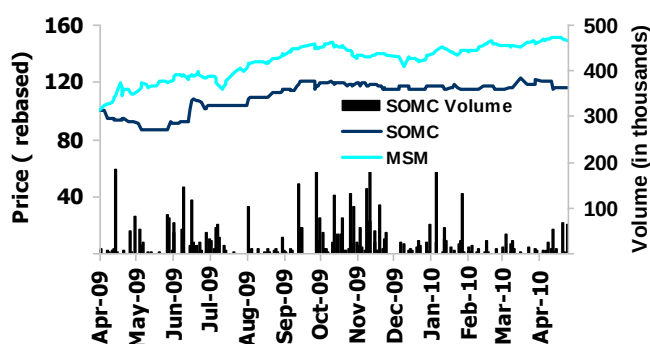
Source: Reuters Knowledge, Markaz Research

Valuation

In 2009, SOMC gained 14.1%, while the MSM 30 added 17.0%. On a YTD basis, SOMC lost 6.8%, while MSM rose 6.9%. The company's current PE is at 13.9x; its PE multiple declined 11.3% YTD. We believe that with Oman's real GDP likely to grow at 4.7% in 2010 and SOMC being the dominant player in the oil marketing sector is likely to benefit from this economic growth. The company's revenue is expected to grow 7.6% YoY in 2010, backed by the growth in its retail and commercial segments in addition to higher revenue from its aviation segment led by the signing of new deals recently. We thus place the fair value PE at 15x. We expect Shell Oman net income to increase by 1.0% YoY to USD 38 mn in 2010.

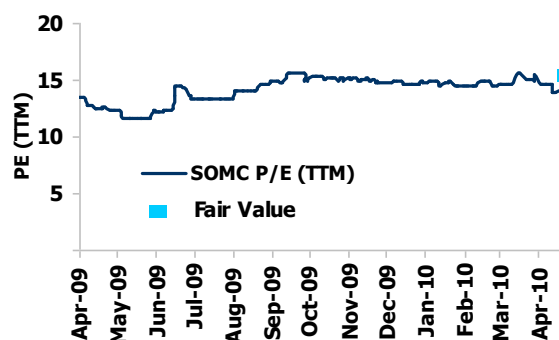
SOMC's Turnover Velocity has remained almost constant at 5.3% and 5.4% in 2009 and 2008 respectively indicating poor liquidity. SOMC has a slightly narrower volatility band than the index (Figure 8) but is currently trading at a higher MVX than the index leading us to believe the stock will provide Medium return with Medium risk in the near term.

Figure 6: Price & volume trend



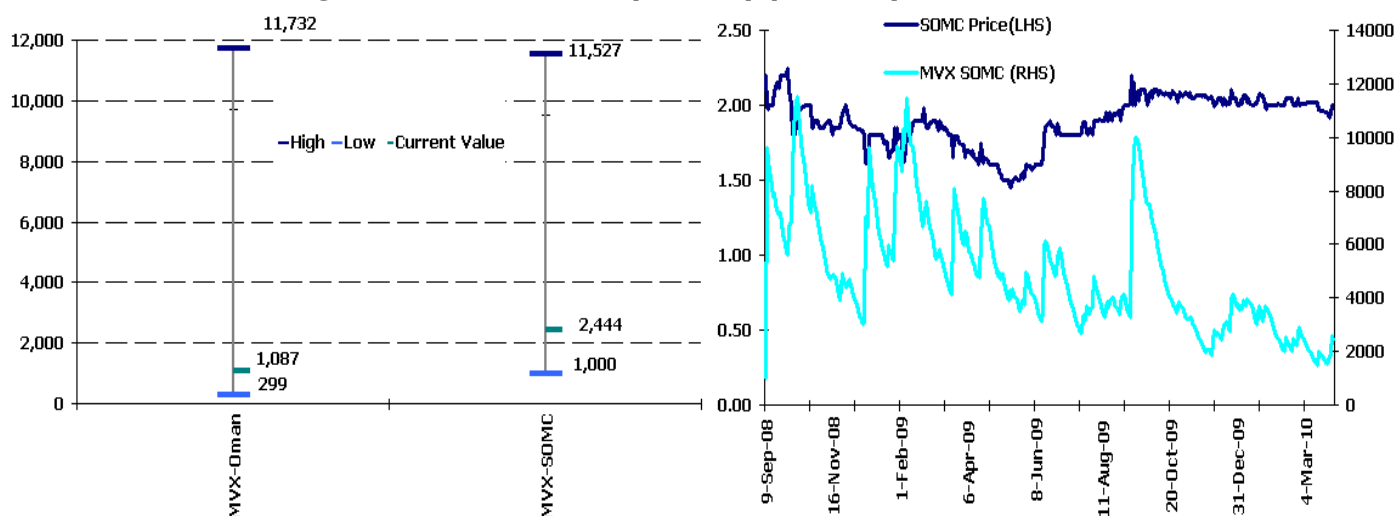
Source: Bloomberg

Figure 7: PE trend & fair value



Source: Bloomberg, Markaz Research

Figure 8: Markaz Volatility Index (April 2010)



Source: Bloomberg, Markaz Research

Appendix 1: Industry Overview

Boosted by infrastructure development, revenue from filling stations grew at a CAGR of 5.6% over 2006-2008

There are three companies present in Oman's oil marketing sector, viz. Shell Oman Marketing Co., Oman Oil Marketing Co. and Al Maha Petroleum Products Marketing Co. The sector is broadly classified into four segments: retail, commercial, aviation and lubricant. The retail segment is the biggest in terms of revenue, contributing around 50% to total revenue. The retail segment includes sale of fuel and other services at various filling stations across the country. The segment has experienced a continuous rise in the number of filling stations, led by increasing government initiatives towards infrastructure development. The asphalted carriageway² has risen to 23,223 km in 2008 from 6,257 km in 1995. In addition, the increase in the number of driving license issued has also been a key driving factor for growth in the retail segment. The number of driving license issued in 2008 increased to 113,000 from a mere 29,000 in 1995. These factors have led to the increase in the number of filling stations to 414 in 2009 from 352 stations in 2006. Al Maha Petroleum with 163 filling stations at end of 2009 has the highest number of stations in the country, followed by Shell Oman Marketing and Oman Marketing with 138 and 113 stations, respectively. The segment witnessed lower fuel demand in 2009, led by reduced consumer spending.

Table 1: Trend in the number of filling stations

Company	2006	2007	2008	2009
Shell Oman Marketing	123	127	133	138
Al Maha Petrochemical	136	146	154	163
Oman Oil Marketing	93	99	105	113
Total	352	372	392	414

Source: Ministry of National Economy, Company's financial

Commercial segment likely to benefit from the planned expenditure of USD 18.5 bn in 2010

The commercial segment includes sale of fuel to customers in various sectors, both government and private. The segment benefits from the overall economic development in the country. When spending on infrastructure development increases, oil marketing companies witness increase in revenue from the commercial segment. The segment witnessed a decline in 2009 revenues owing to decline in total expenditure to USD 16.6 bn in 2009 from USD 19.5 bn in 2008. However, the segment is likely to benefit from the planned expenditure of USD 18.5 bn on infrastructure development in 2010, an increase of 11.8%YoY.

Aviation fuel has witnessed price decline owing to low demand

The aviation segment includes sale of fuel and lubricants to passenger and cargo airlines. The segment is experiencing stiff competition among the marketing companies, with each company aiming to increase its market share in the country's major airports. Muscat International Airport (MIA) and Salalah are the two main airports in the country with the former being the larger of the two. The number of passengers and civil aircraft movement in MIA increased at a CAGR of 5.9% and 4.9% respectively, over the period 2000-2009. The segment witnessed a decline in revenue in 2009 due to reduction in international selling prices of aviation fuel on account of lower aviation fuel demand from airlines. Furthermore, consolidation in the airline industry has pressurized pricing and margins in this segment.

² Carriageway: A carriageway separates traffic travelling in opposite directions on a road by a barrier.

The Lubricants segment caters across all other segments and has also witnessed a downturn as customers are opting for low grade lubricants for servicing. The segment is also facing the pressure of volatile raw material prices leading to uncertain margins.

The sector witnessed a decline in revenue and margins in 2009

Oman's oil marketing sector revenue (based on revenues of the three listed companies) declined 7.3% YoY in 2009 to USD 1.7 bn. The sector's net profit declined 8.1% YoY in 2009 to reach USD 62 mn. The sector's operating and net margin declined to 5.2% and 3.2% respectively, in 2009 from 5.8% and 3.7% respectively, in 2008. Shell Oman with 47% contribution to the sector's revenue is the dominant player, while Al Maha and Oman Oil contribute equally - around 26%, to the sector's revenue.

Appendix 2: Key Statistics

Income statement (USD mn)	2005	2006	2007	2008	2009	2010f
Revenue	473	584	639	842	769	828
Gross Profit	50	59	68	78	84	90
Gross Margin	11%	10%	11%	9%	11%	11%
Operating Profit	21	26	32	37	38	38
Net profit	19	23	29	32	34	34
Balance Sheet (USD mn)	2005	2006	2007	2008	2009	2010f
Cash	30	15	24	26	20	
Total LT Assets	29	31	34	41	45	
Total Assets	112	138	152	151	155	
Total Current Liabilities	56	78	87	81	82	
Total Liabilities	56	78	87	81	82	
Total Shareholders' Equity	56	60	65	69	73	
Key Ratios	2005	2006	2007	2008	2009	2010F
Return on Assets (%)	17%	17%	19%	21%	22%	21%
Return on Equity (%)	34%	38%	44%	47%	46%	45%
Earnings Growth (%)	NA	19.6%	NA	NA	4.1%	1.3%
Revenues Growth (%)	NA	23.4%	9.4%	31.7%	-8.6%	7.6%
P/E	11.5x	15.6x	14.5x	14.3x	15.7x	
Price/Book	3.9x	6.0x	6.3x	6.7x	7.2x	
Current Ratio	1.5	1.4	1.4	1.3	1.3	
Market Price (SR)	0.6	1.1	1.3	1.6	1.9	
EPS (SR)	0.07	0.09	0.11	0.13	0.13	
Assets Growth	NA	23%	11%	-1%	3%	
Equity Growth	NA	7%	9%	6%	6%	
Annual Trading Volume (mn)	115	167	26	34	15	
Annual Trading Value (USD mn)	NA	31.0	32.8	27.2	25.27	
Turnover Velocity	NA	10.3%	8.6%	5.4%	5.3%	
M Cap (USD mn)	223	362	415	464	529	

Source: Zawya, Reuters, Company Financials

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Definitions - Return

Low	Where the potential return is less than 10%
Medium	Where the potential return is between 10% and 25%
High	Where the potential return is greater than 25%

Definitions – Volatility (Risk)

High	Where the Current MVX and band width of stock is more than the respective country benchmark
Medium	Where the current MVX is lower than benchmark and band width higher than or lower than benchmark
Low	Where the current MVX is lower than the benchmark and the band width lower than the benchmark

MVX refers to Markaz Volatility Index calculated by Markaz based on in-house proprietary model

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