

**Decent start to 2016 on benign finance charges (₦28.05 - SELL)**

- MRS Oil Nigeria Plc (MRS) released Q1 2016 unaudited financial statements wherein PBT and PAT came in at ₦626 million and ₦363 million, relative to losses in the corresponding period in 2015. Similarly, Q1 16 PBT and PAT beat our expectations of ₦163 million and ₦101 million, respectively, with deviation primarily due to higher than expected product sales, strong other operating income and benign finance charges.

**Strong PMS volumes growth buoys sales...**

- Q1 16 sales rose 17.5% YoY to ₦25 billion—9% ahead of our estimate—on the back of strong PMS sales of ₦21 billion (+25% YoY) which offset decline in AGO (-6% YoY) and ATK (-38% YoY). The upswing in PMS receipts reflects solid volume growth of 242 million litres (+26% YoY) and, perhaps, affirms our view that major marketers were less impacted by petroleum products shortage experienced in the latter part of period. In particular, despite forex shortage, MRS' import finance facilities remained elevated at ₦15 billion (FY 15: ₦16 billion) suggesting the company utilised most of its 30,000 metric tonnes Q1 16 PMS allocation.
- On the other hand, MRS posted net finance income of ₦2 million relative to net finance charges of ₦1.3 billion in Q1 2015 and our expectation for net finance charges of ₦217 million. The improvement largely stemmed

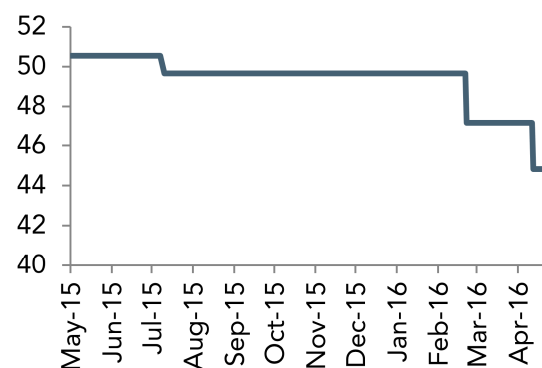
Income Statement Data (₦ million)*			
	2016 – 3M	2015 – 3M	%chg
<b>Revenue</b>	25,071	21,339	17.5%
<b>PBT</b>	626	(735)	NA
<b>Tax</b>	(263)	(185)	42%
<b>PAT</b>	363	(920)	NA

\* unless stated otherwise

Balance Sheet Data (₦ million)			
	2015-Mar	2015-Dec	%chg
<b>Fixed Assets</b>	18,748	19,054	-1.6%
<b>Receivables</b>	17,710	20,520	-13.7%
<b>Cash</b>	26,313	19,774	33.1%
<b>Payables</b>	21,596	21,226	1.7%
<b>Net Assets</b>	21,341	20,977	1.7%

**Stock Data**

<b>Price</b>	₦44.83
<b>52 week range</b>	₦44.83– ₦50.54
<b>Market Cap. (₦'m)</b>	11,386
<b>1-month Avg. Vol</b>	31,873
<b>Curr. PE</b>	13.2x
<b>Bloomberg Ticker</b>	MRSOIL.NL
<b>MRS Oil NigeriaPlc- Share Price Trend</b>	

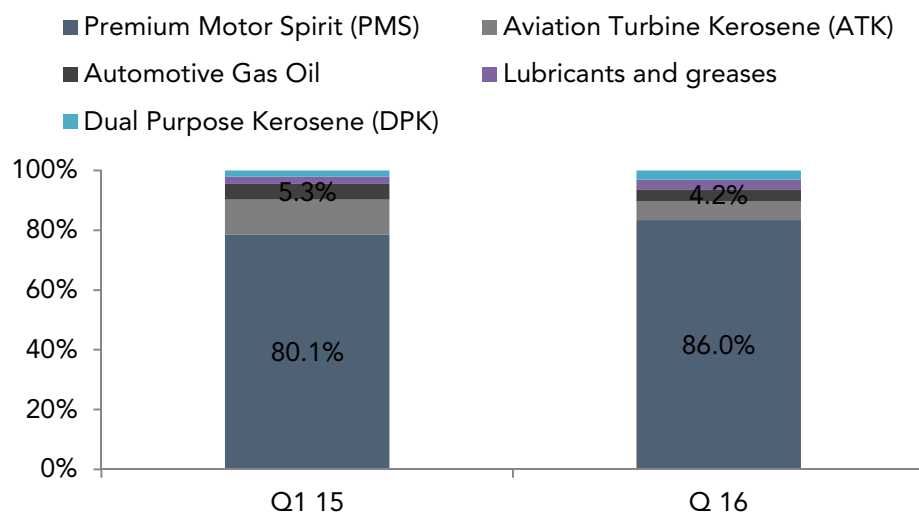

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from a drop in finance charges to ₦168 relative to the devaluation-induced finance charges of ₦1.4 billion recorded in Q1 15 even as finance income tripled to ₦170 million on elevated average cash balances of ₦23 billion.

**...but margins remain below peer average**

- However, cost pressures were quite evident as profitability margins contracted YoY. Input costs which rose 18% YoY to ₦23.3 billion resulted in gross profit rising only 8.5% higher YoY to ~₦1.8 billion with gross margin compressing 60bps YoY to 7% to match our forecast. In line with our thinking, gross margin pressures stemmed from the increase in thinner margin PMS in MRS' sales mix. Specifically, petrol with sub - 8% gross margin accounted for more than 86% of total Q1 16 sales (+5pps YoY) compared to only 4% of total sales for diesel with gross margin in excess of 30%.

**Figure 1: MRS' sales mix**

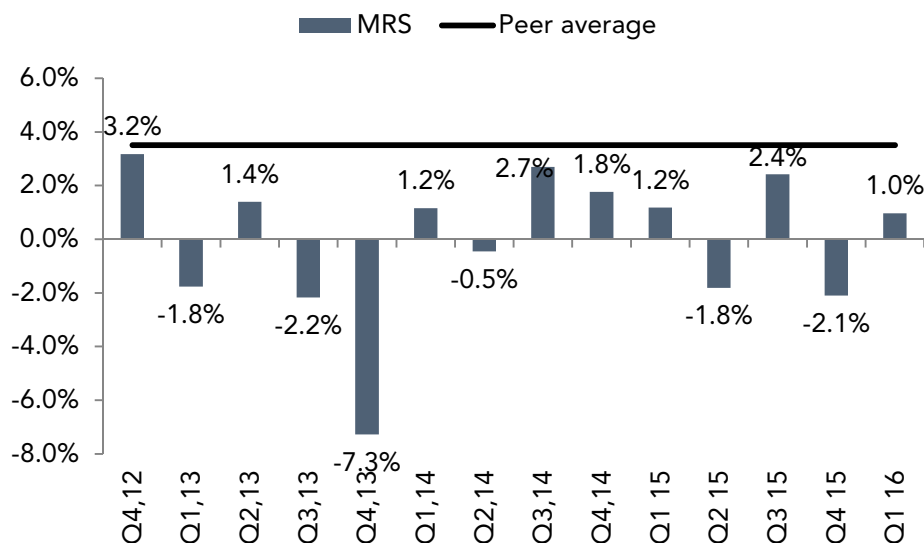


Source: Company financials, ARM Research

- Similarly, and in line with our expectations, MRS' operational efficiency remains below industry average. Core operating profit of ₦240 million (-4% YoY) which is in line with our estimates, implies related margin of 1%, ~250bps below industry average. In the same vein, though buoyed by other operating income of ₦382 million—relative to our expectation of ₦144 million—operating profit rose to ₦625 million (+5% YoY), related margin of 2.5% (-30bps YoY) sits ~200bps

below industry. Q1 16 PBT and PAT margins of 2.2% and 1.4%—nearly double the company’s average of the last 16 quarters—are also ~150bps below peer average.

**Figure 2: Core operating margin of MRS vs. peer average**



Source: Company financials, ARM Research

### Weak operational efficiency underpins subdued outlook

- Despite the stronger than expected Q1 16, we remain cautious on MRS’ outlook. Our cautious stance is hinged on somewhat blurred industry outlook, but more pertinently, MRS’ volatile and below peer operational efficiency. On the industry, the abolition of fixed retail pricing for PMS for price modulation—which allows quarterly adjustment of PMS prices in line with changes in input costs—has not gone as planned as petrol prices remain fixed despite the rebound in oil prices. As a result every litre of PMS consumed since April was subsidised, after subsidy free Q1 16. Subsidy which averaged ₦5/litre over April 2016 and is set to climb following the extended rally in oil prices. Without implementation of the mechanism for setting PMS prices, we expect the usually subsidy related issues, particularly delayed reimbursement to weigh on sector volumes as marketers look to minimize potential subsidy arrears.

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- For MRS, even if there is minimal supply disruption, like in Q1 16, MRS' weak operational efficiency is likely to limit impact on core operating profit. Against this backdrop, we have retained our 2016E revenue and input cost estimates, but revised operating costs higher to ₦6.1 billion (vs. ₦5.1 billion previously) in line with recent run-rate. Consequently, our estimate for 2016E core operating profit (₦731 million) is now 50% lower than previous with related margin still depressed at 1%. However, following fairly robust other income, driven by higher storage cost, our other operating income forecasts is now double prior at ₦1.3 billion (-12% YoY). Furthermore, given sizeable cash balances which has averaged ₦20 billion over the last three quarters, we have revised our 2016 estimate for finance income higher to ~₦600 million (vs. ₦200 previously). Net adjustments drive our 2016E PBT and PAT 27% higher to ₦1.4 billion (-3%) and ₦964 million (+3.1%), implying respective margins of 1.7% and 1.1%.
  - Over our forecast horizon (2016 to 2020) we expect revenue CAGR of 2.3% (vs. 3.1% in the last 5 years) while improvement in other operating income drive recovery in PAT CAGR to 0.2% vs. 12% yearly contraction in the past five years.
  - Net impact of adjustments drive our FVE 10% higher from prior to ₦28.05 with current market price at a 50% premium. Excluding the ₦1.3 billion subsidy reimbursements in Q4 2015, MRS currently trades 13.2x and 11.8x current and 2016E P/E, unjustified premiums—given sub-industry average operating margin—to domestic peers averages of 11.5x and 9x. We retain our **SELL** rating on the stock.

## MRS Oil Nigeria Plc - Summary of Results and Forecasts - Naira (₦)

QUARTERLY					
Income Statement (₦'mln)*	Q4 2015A	Q1 2016A	Q2 2016F	Q3 2016F	
Sales	25,071	19,419	19,588	20,353	
Cogs	(23,315)	(17,838)	(17,915)	(18,487)	
Gross profit	1,756	1,582	1,673	1,866	
Operating cost	(1,513)	(1,538)	(1,537)	(1,558)	
Operating profit	625	350	429	603	
Profit before taxation	626	185	282	325	
Tax	(263)	(70)	(107)	(13)	
Profit after taxation	363	115	175	311	
Earnings per share	1.43	0.45	0.69	1.23	
ANNUAL					
Income Statement (₦'mln)	FY 2014A	FY 2015A	FY 2016F	FY 2017F	FY 2018F
Sales	92,325	87,099	84,431	92,325	94,737
COGS	(85,367)	(80,677)	(77,555)	(85,345)	(87,660)
Gross profit	6,959	6,422	6,877	6,981	7,077
Operating cost	(5,782)	(6,257)	(6,146)	(6,607)	(6,774)
Operating profit	2,432	1,611	2,006	1,837	1,769
Net finance cost	(1,150)	(150)	(588)	(475)	(489)
PBT	1,282	1,461	1,418	1,361	1,281
Tax	(536)	(525)	(454)	(436)	(410)
PAT	746	936	964	926	871
Earnings per share	2.94	3.68	3.80	3.64	3.43
Dividend per share	0.88	1.10	1.14	1.09	1.03
Balance Sheet (₦'mln)					
	FY 2014A	FY 2015A	FY 2016F	FY 2017F	FY 2018F
<b>Assets</b>					
Fixed assets	20,212	19,054	18,056	17,079	16,082
Inventories	3,823	6,260	6,018	6,623	6,802
Trade debtors	20,672	20,520	19,891	21,751	22,319
Cash and other bank balances	11,480	19,774	19,317	19,229	20,822
<b>Total Assets</b>	<b>57,847</b>	<b>66,894</b>	<b>64,525</b>	<b>65,952</b>	<b>67,304</b>
<b>Liabilities</b>					
Trade Creditors	17,328	21,226	21,525	22,173	22,783
Borrowings	11,614	16,400	13,120	13,252	13,384
<b>Total liabilities</b>	<b>52,308</b>	<b>61,569</b>	<b>59,200</b>	<b>60,627</b>	<b>61,979</b>
<b>Shareholders' fund</b>	<b>20,218</b>	<b>20,977</b>	<b>21,652</b>	<b>22,300</b>	<b>22,910</b>
Key Ratios					
	FY 2014A	FY 2015A	FY 2016F	FY 2017F	FY 2018F
<b>Profitability margins</b>					
Gross margin	7.5%	7.4%	8.1%	7.6%	7.5%
EBITDA margin	2.6%	3.6%	4.3%	3.7%	3.6%
Operating margin	4.4%	1.8%	2.4%	2.0%	1.9%
PBT	1.4%	1.7%	1.7%	1.5%	1.4%
Net margin	0.8%	1.1%	1.1%	1.0%	0.9%
<b>Valuation multiples</b>					
EV/EBITDA	9.7	2.7	0.0	0.0	0.0
P/CF	11.0	4.9	3.0	16.1	4.8
P/B	4.6	0.6	0.5	0.5	0.5
P/E	17.4	12.8	11.8	12.3	13.1

Source: ARM Research \*unless otherwise stated

## ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6 month period (minimum) to the review date. We adopt a 5 point rating system for this category of stocks and a 3 point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
<b>STRONG BUY</b>	>20%	<b>BUY</b>	>20%
<b>OVERWEIGHT</b>	10% — 20 %	<b>NEUTRAL</b>	5% — 20 %
<b>NEUTRAL</b>	0% — 10 %	<b>SELL</b>	<5%
<b>UNDERWEIGHT</b>	-5% — 0%		
<b>SELL</b>	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
<b>BUY</b>	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
<b>OVERWEIGHT</b>	Accumulate security to an extent moderated by cognizance of its benchmark weight
<b>NEUTRAL</b>	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject reasonable portfolio constraints
<b>UNDERWEIGHT</b>	Minimise exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio

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