



**Report Date: August 10, 2007**

**Valuation Price: N178.50**

**Recommendation: HOLD/LONG TERM BUY**    **Premium to Valuation Price: 5.32%**

### **EXECUTIVE SUMMARY AND INVESTMENT RATIONALE**

- Mobil Oil Nigeria Plc is one of the leading companies in the Nigerian Oil and Gas sector with primary activities revolving round marketing of petroleum products as well as manufacturing of automotive/industrial lubricants and petroleum jelly. The company is a subsidiary of Mobil Oil Corporation, Fairfax, U.S.A, (now Exxon Mobil), which owns 60 per cent of its total equity. Mobil became a quoted company on the Nigerian Stock Exchange on April 24, 1979 under Petroleum Marketing sector.
- Mobil benefits from the technical know-how of its parent company, Exxon Mobil Corporation in form of provision of assistance in lubricants manufacturing and specialties, research and development, marketing support and training.
- The company is well known for giving high returns to shareholders. The company's return on equity averaged 123% over the past five years. The company, amidst industry production crisis, has recorded a 5-year average turnover growth rate of 13.1% and stable net profit margin of 4%. In view of the resolve of the present government to stop the production crisis in the industry, Mobil has much more earnings potentials. Moreover, the increasing trend in the international crude oil price places Mobil at a vantage position to make greater returns.
- Mobil shares are illiquid in the market and thus, does not attract the attention of large-volume investors. However, its volatility index of 0.5899 makes it relatively less sensitive to swings in the overall market.
- Risks to our valuation are the vicious circle of violence and disruptive activities of the Niger-

Delta militants which remain a major threat to Mobil's supply. If not abated on time by the present government, it might further impact negatively on the company's turnover as experienced in the prior year. Worse still, government regulation via pricing and invariably margins is another critical success factor on which the fortunes of Mobil, like other players in the industry, depend. Operators in the downstream sector of the energy sector lacks absolute discretion to determine pricing of products, thus, constrained in setting prices that will maximize returns to equity holders.

- We expect a return of the company's activities to normalcy during 2007 and beyond after a major change in operational procedures and processes. We project turnover and PAT growth of 13 per cent and 43 per cent, translating to N58.31bn and N2.449bn respectively. We arrive at a forecast EPS of N10.11 for the year ending December 31, 2007. Assuming a payout ratio of 95 per cent, our estimated DPS for 2007 is N9.68.
- We therefore recommend the stock for Long term BUY especially for value investors with long term investment bias.

#### **PRICING OF PETROLEUM PRODUCTS IN NIGERIA:**

Petroleum Product Pricing represents a major problem in the oil industry which is still highly regulated. Pump price of fuels such as PMS (Premium Motor Spirit), Kerosene, Diesel Oil (AGO) are fixed by government. Though several palliative measures such as Petroleum Equalisation Fund and Petroleum Subsidy Fund are put in place in order to soothe the burden of high regulation on petroleum marketers, marketers still groan under the impact of the price ceiling placed on fuel oils.

While the Petroleum Equalisation Fund is applied for the reimbursement of oil marketing companies for any losses suffered by them from the sale of petroleum products at uniform prices throughout the country, the Petroleum Subsidy Fund is meant to reimburse oil marketers for the high cost of importation of refined petroleum products. Attractive as some of these measures are, their administration, with regard to timeliness of processing reimbursements, and appropriateness, especially in the era of deregulated markets, remain knotty issues between the oil marketers and the government.

#### **RECENT DEVELOPMENT:**

In 2006, Mobil invested about US\$3.5million in a leading software technology (SAP) to further

integrate and automate its processes. With this new technology in place, the company's dealers in Lagos area can now place orders on the internet thereby improving efficiency and reducing transaction costs. The company plans to fully integrate activities in other parts of the country by 2008. This strategic and proactive investment decision puts Mobil at more competitive edge ahead the anticipated full deregulation of the downstream sector.

## **ANALYSIS OF FINANCIALS:**

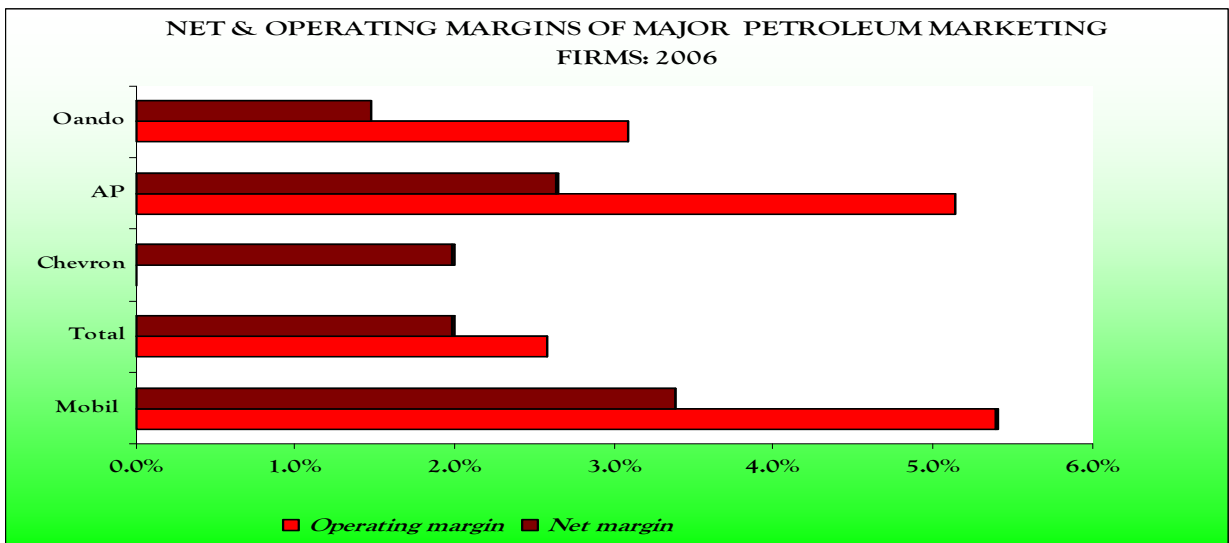
### **Turnover Growth:**

Mobil grew its turnover from N31.51bn in 2002 to N50.81bn in 2006, translating to an average annual growth rate of 13.8 per cent in revenue over the last five years. However, this performance is pale in comparison with its peers in the petroleum marketing industry, such as **Chevron (Texaco), Oando, Total and Conoil** over same period. Oando recorded an average annual turnover growth rate of 54.1 per cent between 2002 and 2006, while **Conoil, Chevron and Total** recorded average annual turnover growth rate of 46.1 per cent, 25.3 per cent and 20.8 per cent respectively over same period. However, Mobil's year-on-year turnover growth rate increased continually from 16.4 per cent in 2002 to 25.4 per cent in 2004, though with a sharp decline to 9.4 per cent in 2005. In 2006, the company experienced abysmal performance, recording a negative year-on-year turnover growth rate of 0.2 per cent as turnover declined from N50.91bn in 2005 to N50.81bn in 2006. Texaco also posted a negative year-on-year turnover growth rate of 0.1 per cent as its total revenue fell to N126.6 bn in 2006 from N126.7 bn recorded in 2005. **The decline in Mobil's total revenue in 2006 has however been linked to shortfall in fuel supply caused by reduction in imports by NNPC, which then resulted in 13 per cent decline in the company's sales volume in 2006 relative to 2005.**

### **Profitability:**

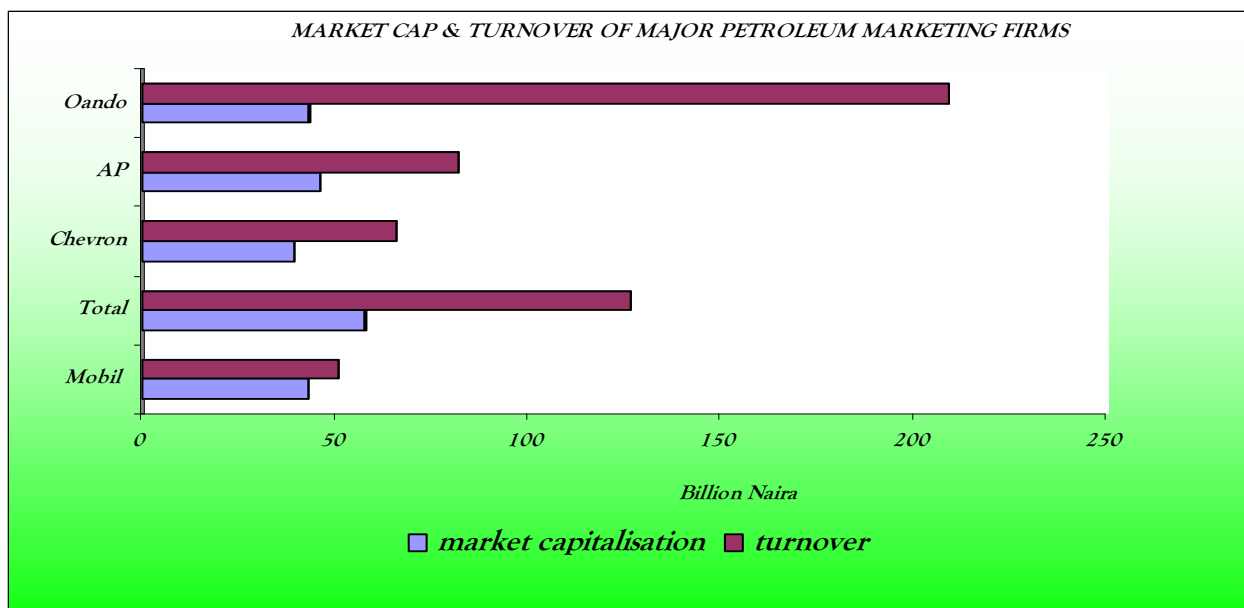
Mobil's gross profit margin dropped from 16.6 per cent in 2005 to 12.8 per cent in 2006. This averaged 15.8 per cent in 4 years. The observed downward movement in gross margin is attributable mainly to decline in sales volume in the face of ceiling imposed by Federal Government on petroleum products pricing which prevents Mobil and other petroleum marketers from raising their products prices in response to hike in inputs costs. Furthermore, the decline in gross margin coupled with high administrative expenses, which rose by 66.7 per cent from N687.0m to N1.15bn, impacted

on the company's operating margin which also fell from 7.9 per cent to 5.4 per cent between 2005 and 2006. Mobil's After Tax Profit, which has increased continually between 2002 and 2005 with an average annual growth rate of 50.1 per cent, fell from N2.42bn in 2005 to N1.72bn in 2006, translating to a decline of 29.2 per cent. Besides the negative factors, such as price ceilings, production disruptions, etc, peculiar to the oil industry in 2006, the astronomical increase in Mobil's administrative expenses arising from training costs associated with implementation of its **new SAP software system** and other administrative costs associated with relocation of its head office to Apapa has been adduced to the observed decline in its after tax profit.



The presence of industry-wide crisis is quite prevalent and replicated in performance of virtually all its peers. **Total** similarly reported a decline of 30.4 per cent in after tax profit from N3.62 bn in 2005 to N2.52 bn in 2006. However, **Oando** reported a significant growth of 73.4 per cent in after tax profit from N1.77 bn in 2005 to N3.08 bn in 2006, while Chevron posted a growth of 25.6 per cent in after tax profit from N1.05 bn to N1.31 bn over same period.

Mobil's return on average equity (ROAE), which averaged 205.2 per cent over the last four financial years, declined continually from 424.9 per cent in 2003 to 55.9 per cent in 2006. Conversely, the company's return on average asset (ROAA) displayed fluctuations in the last four years. The ROAA, which stood at 32.5 per cent in 2003, declined to 18.7 per cent in 2004, rose to 26.1 per cent in 2005 and then declined to 16.8 per cent in 2006. Nevertheless, the company's ROAE and ROAA for 2006 financial year remain above industry averages of 46.6 per cent and 9.6 per cent respectively.



**Liquidity, Efficiency and Solvency:**

Mobil's current ratio averaged 0.77 times over the last four years, implying its total current assets only cover 77 per cent of its total current liabilities. The current ratio for 2006 financial year stood at 0.79 times, down from 0.90 times recorded in 2005, suggesting worsening liquidity position. Conversely, trend in the company's acid-test ratio, which averaged 0.49 times over the past four years, portends improving liquidity position. The acid-test ratio which stood at 0.34 times in 2003 rose continually to 0.63 times in 2006, meaning that Mobil's readily realizable short-term assets now cover 63 per cent of its total short-term liabilities. **Although most petroleum marketing companies maintain negative working capital which seems a deliberate strategy of employing cheap funds to boost returns, Mobil's liquidity position, in terms of current and acid-test ratios, is below the industry performance with average current ratio and acid-test ratio for its industry standing at 1.01 and 0.69.**

In addition, a review of Mobil's cash flows also reveals declining liquidity. The company's operating cash flow-to-net income ratio, which measures the extent to which net income generates cash for a business, averaged 1.28 times in the past four financial years and declined continually from 2.64 times in 2003 to 1.03 times in 2006. Similarly, the company's operating cash flow-to-current liabilities ratio declined from 0.54 times in 2005 to 0.15 times in 2006, while its cash operating cycle, which indicates the average number of days it takes a company to turn its acquired inputs into actual cash inflows through sale of its output, increased from 13 days in 2005 to 30 days in 2006, thus

implying that Mobil is tying up more capital in its processes. **The worsening trend in Mobil's liquidity is corroborated by trends in its average receivables' days and average payables' days.** Average receivables' days increased from 32 days in 2005 to 38 days in 2006, meaning that it provides more finance to its customers. Conversely, Mobil enjoyed less finance from its creditors as the average payable days declined from 32 days in 2003 to 29 days in 2006.

Furthermore, there are indications of deterioration in Mobil's efficiency in the use of assets. The company's total asset turnover declined continually from 3.86 times in 2004 to 2.92 times in 2006, meaning that the extent of revenue generated from the use of its assets has decreased over the three-year period. This deterioration contributed to the decline in both ROAE and ROAA between 2004 and 2006.

In terms of long-term solvency, Mobil remains a very stable company. The company has no fixed-interest long-term debt in its capital structure. The company's total debt-to-total assets, which averaged 87.3 per cent between 2003 and 2006, declined from 96 per cent in 2003 to 84 per cent in 2006, indicating reduced exposure to debt. Similarly, total debt-to-equity declined from 2233 per cent in 2003 to 515 per cent in 2006. The company's debts are mainly made up of interest-free liabilities, thus it has low interest payments obligations. The company's **Earnings Before Interest and Tax (EBIT)** sufficiently covers its interest obligations. Its interest cover, with a four-year average of 15 times, rose from 6 times in 2003 to 15.4 times in 2006.

#### **Value to Investors:**

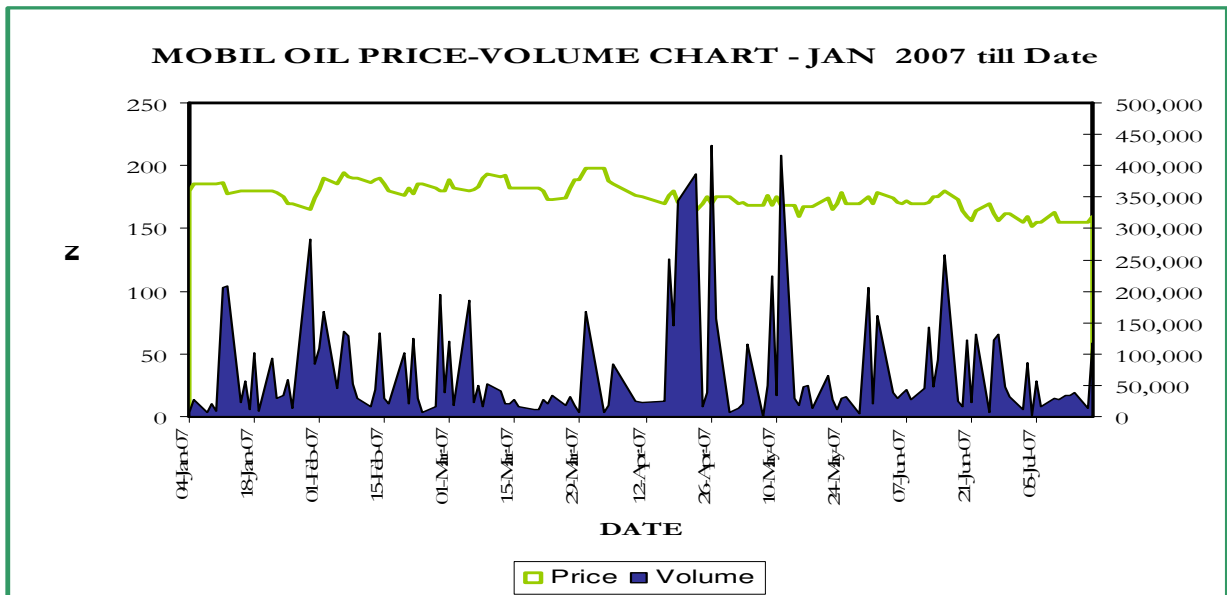
Mobil's EPS increased from N2.46 in 2002 to N7.14 in 2006, translating to a growth rate of 30.5 per cent (CAGR) in five years. Over the same period, Oando reported an EPS growth of 195 per cent, while Conoil, Chevron (Texaco) and Total recorded 26.6 per cent, 11.2 per cent and 9.7 per cent respectively over same period. Mobil, like other Petroleum marketing firms, maintains a generous dividend policy. The company's dividend pay-out ratio averaged 96 per cent between 2002 and 2006, with the highest of 100 per cent recorded in 2002, 2003 and 2006. Mobil's dividend yield currently stands at 4.6 per cent which is above the industry average of 4.0 per cent while its earnings yield stands at 3.83 per cent compares to the industry average of 4.55 per cent. Mobil only declared bonus once (1 for 4: FY 2003) in the last five financial years.

### Technical Analysis for Mobil Oil:

Mobil Oil ranks as one of the blue chip stocks on the floor of the Nigerian Stock Exchange by paying superior and consistent cash dividends to shareholders. However, it has not made appreciable returns to shareholders in terms of capital appreciation in the past 2 years.

In 2006, Mobil traded at an average daily price of N171.72 for the year, recording the highest price of N196 and the lowest price of N150.50 for the year, giving a high-low differential of 30.23%. It closed the year at N178.87, recording a capital appreciation of 6.5 per cent for the year. The average daily traded volume for the year is 77,063 units.

Mobil's High-Low Price range for 2007 is N198-N151.05 (On March 30 and July 4, 2007 respectively). Its price was adjusted for a cash dividend of N7.14 on April 20, 2007. The average daily volume traded from January till date is 70,000 units. With a security beta of 0.58, the stock fluctuates less often than the market in terms of returns.



### VALUATION:

In valuing MOBIL, a number of valuation metrics, such as Price-to-Book Value method, Price-to-Sales method, Price-to-Earnings method, and Discounted Cash Flow method. Our beta value is 0.5889 with a risk premium of 7 per cent and discount rate of 14.88 per cent. We also assume a terminal growth of 8 per cent. After applying appropriate weights with a bias for Discounted Cash Flow and Price-Earnings valuation methods, we arrived at a fair value of N178.50.

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