

### Leo Venezuela

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09 June 2011

### Philippines Power

Reuters PNX.PS  
Bloomberg PNX PM

#### Priced on 8 June 2011

Phils Phisix @ 4,255.4

12M hi/lo P15.24/2.67

12M price target P12.28  
±% potential 0%  
Target set on 12 Jan 11

Shares in issue 489.9m  
Free float (est.) 28.7%

Market cap US\$139m

3M average daily volume  
P4.4m (US\$.1m)

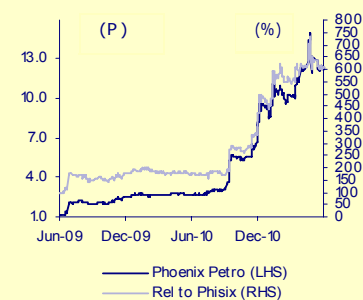
Foreign s'holding 0.9%

#### Major shareholders

Phoenix Petroleum Holdings Inc  
53.1%  
Udena Corp 13.4%

#### Stock performance (%)

	1M	3M	12M
Absolute	1.8	18.4	344.8
Relative	1.0	8.5	242.2
Abs (US\$)	1.5	19.0	379.7



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## Looking forward to next year

We are downgrading our recommendation on Phoenix Petroleum to an Outperform, not because of poor fundamentals, but because it has already hit our target price. Since we initiated coverage on this counter, it has significantly outperformed the market despite a spike in regulatory risk and charges that the company had engaged in the smuggling in of petroleum products. The continued roll-out of its filling stations in 2H2011 will be a strong driver of its earnings growth surge next year and will cause the continued outperformance as the market prices in the company's strong 2012 earnings growth.

### Already hit target price

Since we initiated coverage on Phoenix Petroleum at the beginning of this year, this counter has massively outperformed with it up by 41.8% versus the market's 5.5% rise. As a result, it has already hit our P12.28 target price (originally P15.97 but adjusted for a 30% stock dividend issued in May). We believe that this increase is due to the strong earnings growth of the company as it rolls out its aggressive expansion plan over the next 5 years despite two issues that may cause some overhang over the company.

### Two issues: deregulation and alleged smuggling

When oil prices spiked earlier this year, there were calls by some sectors for the repeal of the Oil Deregulation Law and for some government regulation in the pricing of petroleum products. Some more militant groups have actually called for the renationalization of the sector. Despite these calls, we reiterate our view that deregulation is here to stay and President Aquino's government has also maintained its policy calling for a deregulated environment for the local oil industry. Last May, the Bureau of Customs had charged the company with smuggling with the company's alleged non-payment of P5bn in customs duties, value-added taxes and other fees. The BoC had also alleged that the company had failed to submit numerous import documents. Based on our last check, the company has still to receive the formal charge sheet from BoC.

### Some catalysts down the road

While the counter has already hit our target price, we believe that it will continue to outperform as the market factors in the strong 54.7% EPS growth of the company next year. The roll-out of the service stations continues on schedule and assuming a roll-over of earnings into 2012 (EPS P2.17) and based on the same 40% discount to the 2012 market PE of 12.3x we have used, there is a potential for us to increase our target price to P16.

### Financials

Year to 31 Dec	09A	10A	11CL	12CL	13CL
Revenue (Pm)	5,873	14,792	19,455	24,874	33,608
Net profit (Pm)	751	427	686	1,062	1,576
EPS (P)	2.79	1.13	1.40	2.17	3.22
CL/consensus (1) (EPS%)	-	-	100	100	-
EPS growth (% YoY)	249.2	(59.4)	23.6	54.7	48.4
PE (x)	4.4	10.8	8.7	5.6	3.8
Dividend yield (%)	0.0	0.4	0.8	1.2	1.2
FCF yield (%)	(38.3)	(31.5)	(4.9)	(9.2)	18.4
PB (x)	2.2	1.9	1.9	2.0	1.4
ROE (%)	67.7	21.4	24.2	34.4	43.0
Net debt/equity (%)	127.7	114.6	59.5	81.0	27.9

Source: CLSA Asia-Pacific Markets

**PNX has risen 41.8% since initiation at the beginning of the year**

## Already hit its target price

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Figure 1

### 2007-2011 PNX share price performance (P)

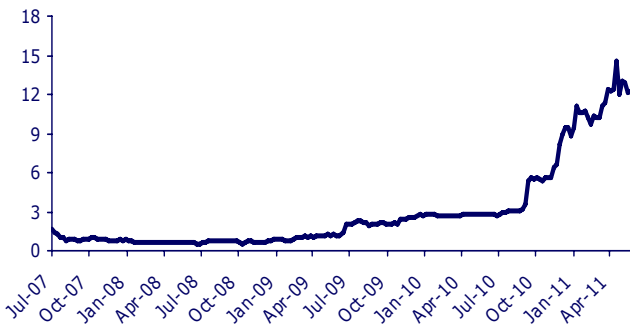
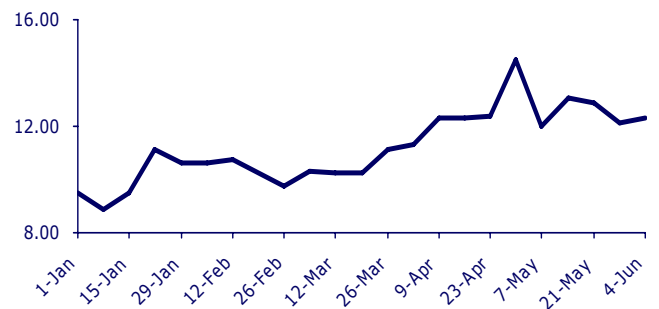


Figure 2

### YTD PNX share price performance (P)



Source: CLSA Asia-Pacific Markets

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**Service station roll-out is on schedule**

The company has already a total of 178 services stations as of end-1Q2011, which is already 81% of the 219 stations we are forecasting by the end of the year. As of end-1Q2011, another 31 service stations are construction with the bulk of them in Luzon. Luzon currently accounts for 21% of the company's service stations from just 3% in 2008

Figure 3

### Number of service stations

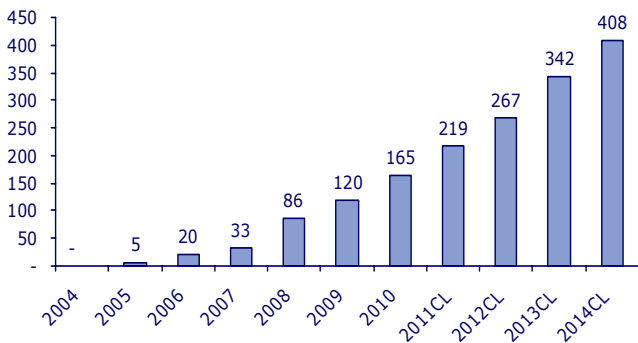
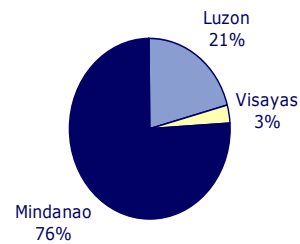


Figure 4

### Geographical breakdown of service stations (%)



Source: CLSA Asia-Pacific Markets

Source: CLSA Asia-Pacific Markets

## Two issues: deregulation and alleged smuggling

**Deregulation is here to stay**

When oil prices spiked earlier this year, there were calls by some sectors for the repeal of the Oil Deregulation Law and for some government regulation in the pricing of petroleum products. Some more militant groups have actually called for the renationalization of the sector. Despite these calls, we reiterate our view that deregulation is here to stay and President Aquino's government has also maintained its policy calling for a deregulated environment for the local oil industry. For more details on the deregulation of the Philippine oil industry please refer to our previous note on Phoenix Petroleum "The Little Giant" 13 January 2011.

**Alleged non-payment of customs duties from June 2010 to April 2011**

Last May, the Bureau of Customs had charged the company with smuggling with the company's alleged non-payment of P5bn in customs duties, value-added taxes and other fees when the company imported finished petroleum products during the period from June 2010 to April 2011. The BoC had also alleged that the company had failed to submit numerous import documents. Based on our last check, the company has still to receive the formal charge sheet from BoC.

**The smuggling case had caused some price correction**

Because of this charge, there was a weakness in PNx's share price performance at came down from its all-time P14.50 to correct to around P11.50 before trending up again.

**We believe that the smuggling case will not prosper**

We believe that the smuggling charges will not prosper and that the market will eventually discount this going forward.

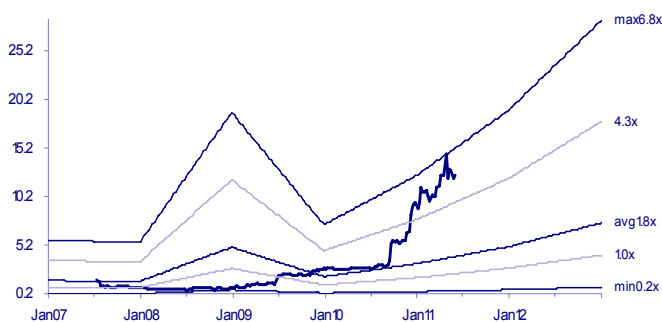
**Potential to increase target price to P16 on 2012 roll-over**

## Some catalysts down the road

While the counter has already hit our target price, we believe that it will continue to outperform as the market factors in the strong 54.7% EPS growth of the company next year. The roll-out of the service stations continues on schedule and assuming a roll-over of earnings into 2012 (EPS P2.17) and based on the same 40% discount to the 2012 market PE of 12.3x we have used, there is a potential for us to increase our target price to P16.

Figure 5

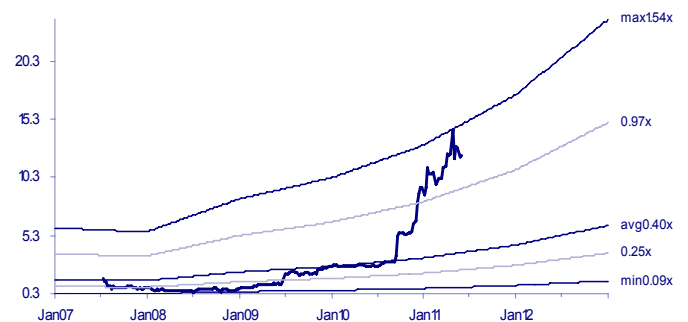
**12-month forward PE bands (x)**



Source: CLSA Asia-Pacific Markets

Figure 6

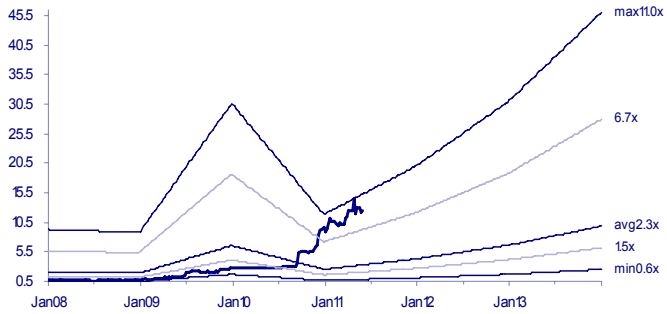
**12-month forward PB bands (x)**



Source: CLSA Asia-Pacific Markets

Figure 7

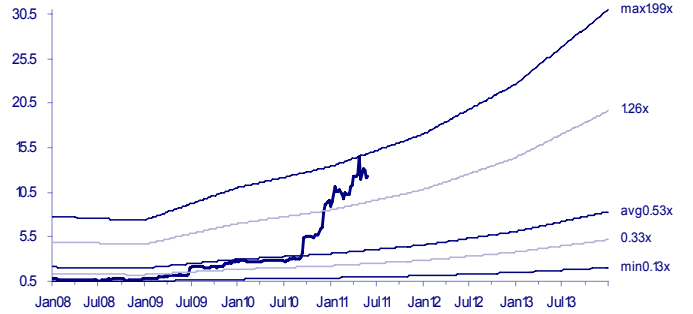
**Trailing PE bands**



Source: CLSA Asia-Pacific Markets

Figure 8

**Trailing PB bands (x)**



Source: CLSA Asia-Pacific Markets



## Summary financials

Year to 31 December	2009A	2010A	2011CL	2012CL	2013CL
<b>Summary P&amp;L forecast (Pm)</b>					
<b>Revenue</b>	<b>5,873</b>	<b>14,792</b>	<b>19,455</b>	<b>24,874</b>	<b>33,608</b>
Op Ebitda	361	750	1,162	1,558	2,131
Op Ebit	284	641	953	1,265	1,770
Interest income	5	102	6	8	11
Interest expense	(115)	(316)	(258)	(176)	(143)
Other items	573	4	20	20	20
<b>Profit before tax</b>	<b>747</b>	<b>431</b>	<b>722</b>	<b>1,117</b>	<b>1,658</b>
Taxation	5	(3)	(35)	(55)	(82)
Minorities/Pref divs	0	0	0	0	0
<b>Net profit</b>	<b>751</b>	<b>427</b>	<b>686</b>	<b>1,062</b>	<b>1,576</b>
<b>Summary cashflow forecast (Pm)</b>					
<b>Operating profit</b>	<b>284</b>	<b>641</b>	<b>953</b>	<b>1,265</b>	<b>1,770</b>
Operating adjustments	0	0	0	0	0
Depreciation/amortisation	77	109	209	293	362
Working capital changes	(837)	(1,209)	(1,065)	20	11
Net interest/taxes/other	(65)	(223)	832	(1,554)	(369)
<b>Net operating cashflow</b>	<b>(541)</b>	<b>(681)</b>	<b>930</b>	<b>24</b>	<b>1,773</b>
Capital expenditure	(719)	(767)	(1,224)	(573)	(672)
<b>Free cashflow</b>	<b>(1,260)</b>	<b>(1,448)</b>	<b>(294)</b>	<b>(549)</b>	<b>1,100</b>
Acq/inv/disposals	(261)	128	115	135	152
Int, invt & associate div	(34)	(3)	6	8	11
<b>Net investing cashflow</b>	<b>(1,014)</b>	<b>(642)</b>	<b>(1,102)</b>	<b>(430)</b>	<b>(510)</b>
Increase in loans	1,415	1,109	1,200	(874)	(294)
Dividends	0	(14)	(38)	(73)	(92)
Net equity raised/other	149	468	0	0	0
<b>Net financing cashflow</b>	<b>1,564</b>	<b>1,563</b>	<b>1,162</b>	<b>(948)</b>	<b>(386)</b>
<b>Incr/(decr) in net cash</b>	<b>9</b>	<b>239</b>	<b>990</b>	<b>(1,354)</b>	<b>878</b>
Exch rate movements	0	0	0	0	0
<b>Opening cash</b>	<b>357</b>	<b>366</b>	<b>605</b>	<b>1,595</b>	<b>241</b>
<b>Closing cash</b>	<b>366</b>	<b>605</b>	<b>1,595</b>	<b>241</b>	<b>1,119</b>
<b>Summary balance sheet forecast (Pm)</b>					
Cash & equivalents	366	605	1,595	241	1,119
Debtors	1,369	2,593	1,999	2,376	2,979
Inventories	458	1,052	1,445	1,851	2,510
Other current assets	726	621	694	694	684
Fixed assets	1,700	2,358	3,373	3,652	3,963
Intangible assets	0	0	0	0	0
Other term assets	69	97	76	76	76
<b>Total assets</b>	<b>5,003</b>	<b>7,641</b>	<b>9,417</b>	<b>9,045</b>	<b>11,416</b>
Short-term debt	1,549	2,704	874	294	285
Creditors	1,059	1,637	2,575	3,337	4,579
Other current liabs	53	53	53	53	53
Long-term debt/CBs	770	723	2,633	2,339	2,055
Provisions/other LT liabs	44	63	68	68	68
Minorities/other equity	45	5	5	5	5
Shareholder funds	1,484	2,456	3,209	2,948	4,371
<b>Total liabs &amp; equity</b>	<b>5,003</b>	<b>7,641</b>	<b>9,417</b>	<b>9,045</b>	<b>11,416</b>
<b>Ratio analysis</b>					
Revenue growth (% YoY)	27.3	151.9	31.5	27.9	35.1
Ebitda growth (% YoY)	61.2	107.8	55.0	34.0	36.8
Ebitda margin (%)	6.1	5.1	6.0	6.3	6.3
Net profit margin (%)	12.8	2.9	3.5	4.3	4.7
Dividend payout (%)	0.0	4.4	7.1	6.9	4.7
Effective tax rate (%)	(0.6)	0.8	4.9	4.9	4.9
Ebitda/net int exp (x)	3.3	3.5	4.6	9.3	16.2
Net debt/equity (%)	127.7	114.6	59.5	81.0	27.9
ROE (%)	67.7	21.4	24.2	34.4	43.0
ROIC (%)	12.8	15.4	18.2	23.5	31.0
EVA@/IC (%)	(1.5)	1.2	4.0	9.3	16.9

Source: CLSA Asia-Pacific Markets

**Recommendation history - Phoenix Petroleum Philippines Inc PNX PM**

Date	Rec level	Closing price	Target
12 January 2011	BUY	8.62	12.28

Source: CLSA Asia-Pacific Markets

**Key to CLSA investment rankings:** **BUY** = Expected to outperform the local market by >10%; **O-PF** = Expected to outperform the local market by 0-10%; **U-PF** = Expected to underperform the local market by 0-10%; **SELL** = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

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**Note: In the interests of timeliness, this document has not been edited.**

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