

Corporate profitability in 4Q2009

Key Takeaways

Corporate sector profitability has sharply rebounded (up 89%YoY) during the last quarter of 2009 (4Q2009), relative to the first 3 quarters of the year. The sharp recovery in corporate earnings has been particularly driven by improved performance of banks and oil marketing companies. Banks have benefited from a lower quantum of provisioning in 4Q2009 even after excluding impairment losses from both the periods while oil marketing companies' profitability were buoyed by robust furnace oil sales and inventory gains. However, uncertainty on the rate and modalities of the Capital Gains Tax (CGT) overshadowed the positive result announcements, as the KSE-100 Index managed to post a meager return of 1.3% since the beginning of the year, compared to the 5 year historical average of 15.1%. Looking ahead, we expect corporate earnings to rise by 22% in FY10, with Banking, Oil Marketing and Auto sectors leading the way.

Our sample includes 38 companies, which represents 76% of the total market capitalization of the KSE-100. We have removed one time gains recorded by Oil and Gas Development Company (OGDC) and National Bank of Pakistan (NBP) in the shape of a revision of the Qadirpur Wellhead gas prices and transfer of NIT LOC fund units, respectively. Total profits were reported at Rs51.2bn (US\$612mn) in 4Q2009 as against Rs27.2bn (US\$340mn) in the corresponding period last year.



JS Global Capital Limited

KSE-100 Index:
9,511.53

Market Cap:
Rs2,721bn
US\$32.0bn

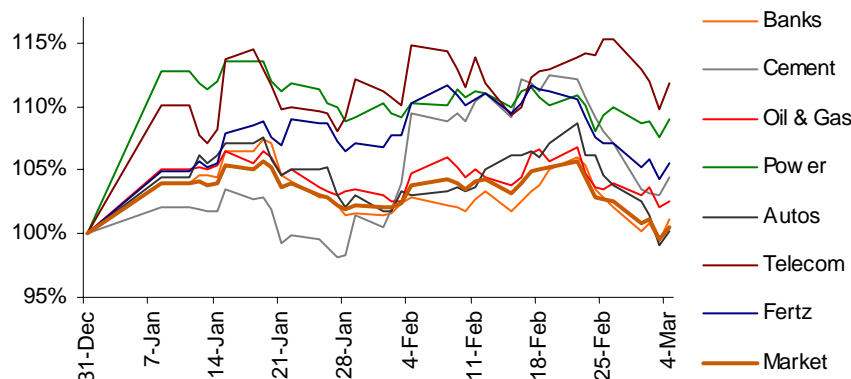
Market PE:
8.2x (2010E)

Market Dividend Yield:
6.6% (2010E)

1-yr High/Low:
9,954.41/5,557.92

Market estimated free float:
25%

Relative YTD performance: KSE-100 index versus sectors



Source: JS Research

Pakistan Market - Key Statistics

	2008A	2009A/E	2010F	2011F	2012F
Earnings Growth	5%	-6%	23%	21%	7%
PER (x)	11.6	10.0	8.2	6.9	6.3
Dividend Yield	5%	6%	7%	8%	9%
PBV (x)	2.6	1.7	1.5	1.3	1.2

Source: JS Research

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Winners

Banks

The banking sector's profitability during 4Q2009 recovered significantly, mainly due to lower provisioning for Non Performing Loans (NPLs). Our sample which includes 9 banks booked cumulative profits of Rs19.4bn (US\$232mn) in 4Q2009 as against earnings of Rs3.8bn (US\$47.6mn) in the corresponding period last year, up 411%. This excludes impairment losses from both the reported periods, however if impairment losses are not removed, corporate earnings have depicted a growth of 173%. The extra-ordinary results have failed to move stock prices in general as the sector's market capitalization merely increased by 1.1% YTD though NBP was the only exception which rose by 24%. Going forward, we expect the sector's earnings to grow by 17% in 2010 as the amount of provisioning declines and credit off-take improves on the back of gradual economic recovery. NBP remains our top pick in the sector.

Power

Following an up-tick in HUBCO's tariff, steep rupee depreciation and higher production bonuses, power sector earnings rose by 44%YoY in 4Q2009. The sector's market capitalization resultantly increased by 9% YTD, with HUBCO rising by 8% owing to an above than expected result announcement. Our sample includes HUBCO and KAPCO, which together reported profits of Rs3.1bn (US\$37.4mn) in 4Q2009 as against profits of Rs2.2bn (US\$27.1mn) in 4Q2008. We maintain our 'Over-Weight' stance on the sector with an expected growth of 8% in FY10. HUBCO remains our preferred play in the sector.

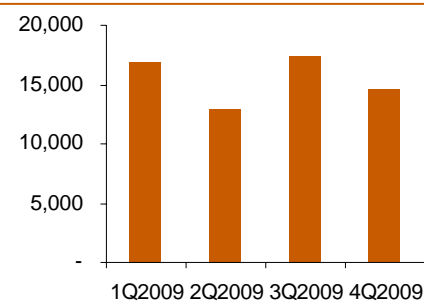
Oil and Gas Marketing

Absence of inventory and exchange loss, along with robust furnace oil sales have been key factors behind the turnaround in earnings of the oil and gas marketing companies. Our sample of 5 companies reported profits of Rs4.7bn (US\$56.2mn) in 4Q2009 as compared to losses of Rs4.6bn (US\$57mn) in the corresponding period last year. However, the sector failed to perform admirably (3% YTD) as the issue of circular debt remained a concern for investors. On the back of robust furnace oil growth and rising international oil prices, we expect the sector's profitability to turn green in FY10 and to post 22% growth in FY11. PSO and APL remain our top picks in the sector.

Autos

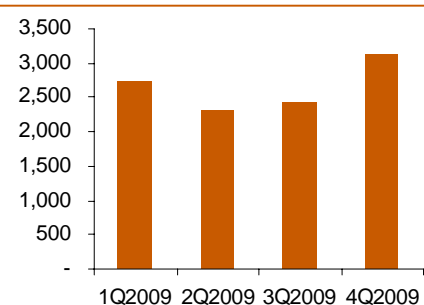
Higher car prices and volumetric sales have helped the auto sector's profitability to make a sharp comeback in 4Q2009. Our sample of 2 companies booked profits of Rs650mn (US\$7.8mn) in 4Q2009, which compared to Rs102mn (US\$1.3mn) in 4Q2008, was up 534%. Based on the said reasons, we expect a 60% earnings growth in FY10 with a 'Market-Weight' stance on the sector.

Bank's profitability (Rs mn)



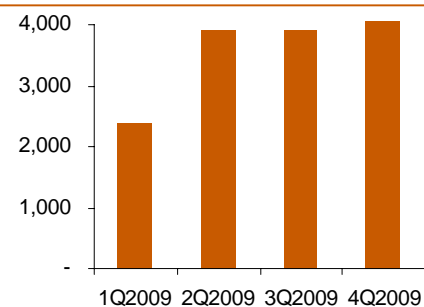
Source: Company accounts

Power sector's profitability (Rsmn)



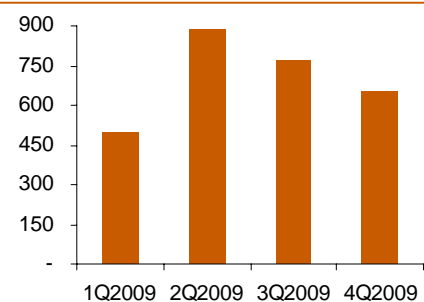
Source: Company accounts

OMC sector's profitability (Rs mn)



Source: Company accounts

Auto sector's profitability (Rs mn)



Source: Company accounts

At Par

Fertilizer

Higher urea and DAP off-take along with superior prices helped the fertilizer sector's profitability to rise by 24%YoY. Going forward, given the enhanced production capacity, we expect earnings to grow by 4% in 2010, with ENGRO being our top pick in the sector.

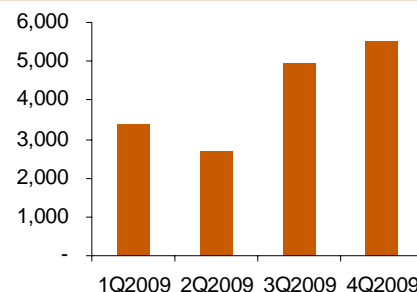
Telecom

Improved margins owing to cost cutbacks by PTCL helped the Telecom sector's profitability to grow by 24%. Our sample includes PTCL and WorldCall, which together booked earnings of Rs2.6bn (US\$31.6mn) in 4Q2009 as against Rs2.1bn (US\$26.6mn) in 4Q2009. PTCL remains our top pick in the sector.

Refinery

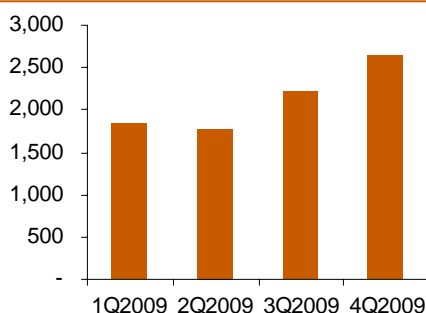
Though refiners recorded cumulative losses of Rs365mn (US\$4.4mn) in 4Q2009, the magnitude declined due to absence of inventory losses from Rs3.1bn (US\$39mn) in 4Q2008. We maintain our 'Market-Weight' stance on the sector.

Fertilizer profitability (Rs mn)



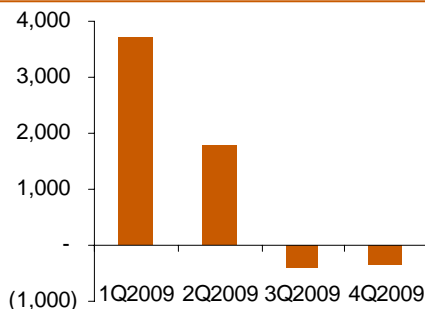
Source: Company accounts

Telecom profitability (Rs mn)



Source: Company accounts

Refinery's profitability (Rs mn)



Source: Company accounts

Losers

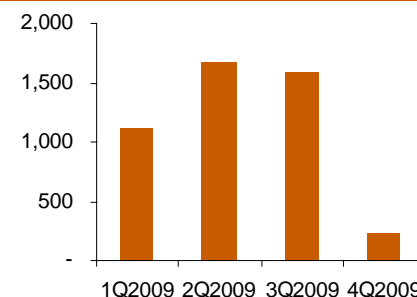
Cement

Despite higher volumetric sales, low retention prices dragged down profitability of the cement manufacturers. Our sample includes 5 companies which recorded profits of Rs230mn (US\$2.7mn) in 4Q2009 as against Rs1.1bn (US\$13.4mn) in the corresponding period last year. On the back of higher volumetric sales and expected gradual recovery in prices, we reiterate our 'Buy' call on both DG Khan and Lucky Cement.

E&P

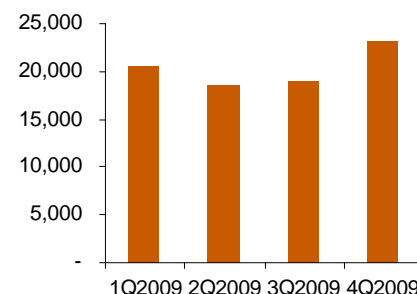
The E&P sector's profitability was down 5% during 4Q2009, mainly due to lower wellhead gas prices, despite new production flows. The sample companies (3) registered lower profits of Rs19.5bn (US\$233mn) in 4Q2009 as against Rs20.4bn (US\$255mn) in 4Q2008. This excludes one time gain recorded by OGDC in the shape of upward revision of Qadirpur Wellhead gas prices for period effective June 2008. If the gain is included in our analysis, the sector has registered an impressive growth of 13%. We maintain our 'Over-Weight' stance on the sector, with PPL and POL being our top picks.

Cement's profitability (Rs mn)



Source: Company accounts

E&P sector's profitability (Rs mn)

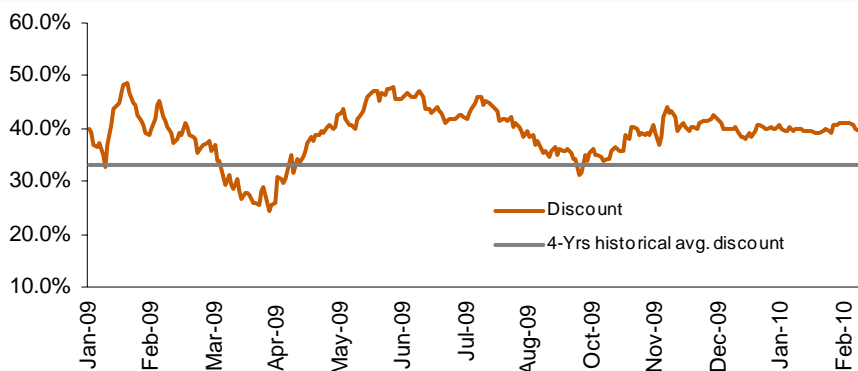


Source: Company accounts

Outlook: Recovery to continue in 2010

We expect the local equity market to continue its positive momentum in 2010 (market up 60% in 2009 – best in 4 years), riding on gradual economic recovery, as evident from 4Q2009 corporate profitability. Pakistan currently trades at an attractive one year forward PE of 6.9x and at a discount of 40% to the average PE of 11.6x of regional Asian emerging and frontier markets defined by the MSCI. The prevailing discount is higher than the 5 year historical average of 34%. This is likely to revert back to historical levels amid improved risk profile, which should propel the market to cross the 10,500 mark. We remain bullish on the Oil, Fertilizer, Power, Cement and Telecom sectors with PPL, PSO, ENGRO, POL, HUBCO, PTC, LUCK, DGKC and NML being our preferred plays for 2010.

Pakistan's PE discount relative to Asian EM



Source: JS Research, Reuters

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ANALYST CERTIFICATION

I, Syed Atif Zafar, the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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