

July 02, 2009

Pakistan Market**MORNING BRIEFING****Refineries: Deemed duty and 4Q earnings estimates** KSE100 Index: Closing 7270.72 ↑ (+108.54)

In recent oil price adjustment, deemed duty on diesel has increased in absolute terms by 20% (Rs0.5 per liter). This is primarily due to rising international oil prices. However, the impact would be visible in the next quarter earnings. According to our estimates, PRL would be the major beneficiary (per share annualized earnings impact of Rs5 per share) which will be followed by NRL (Rs4 per share) and ATRL (Rs2.3 per share), provided product prices remain the same during next 11 months.

Though the earnings would likely remain depressed in FY09, we now suggest investors to focus on next year's earnings multiples. The sector is trading at 26% discount to market on forward PE multiple. We maintain 'Buy' stance on NRL and ATRL which are trading at FY10 PE of 4.8x and 5.9x, respectively.

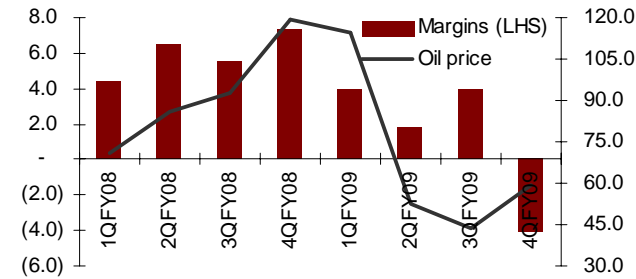
How this deemed duty works for refinery?

Currently, refineries are getting 7.5% deemed duty on the C&F price of diesel. This is over and above the spread (difference between the C&F price of diesel and crude price) that they are getting. This duty varies with the international oil price fluctuations. Since international diesel oil prices have increased by an average US\$12 per barrel (Rs6.26 per liter) in last 1-month, this duty has increased in absolute terms by Rs0.5per liter to Rs3.0 per liter. If this deemed duty remains at the same level for next 11-month, annualized earnings impact would be higher for PRL (Rs5 per share) followed by NRL (Rs4 per share) and ATRL (Rs2.3 per share). During 11MFY09, average monthly diesel sales of PRL, NRL and ATRL stood at 44k tons, 71k tons and 44K tons, respectively.

Another quarter of depressed earnings likely

Despite huge inventory gains expected in 4QFY09, most of the refineries are expected to post losses amid negative margins on fuel business. Average margins which stood at positive US\$4per barrel in last quarter have turned negative to US\$4 per barrel, as per our estimates. Only NRL in our JS universe sample companies is set to post impressive last

quarter earnings of Rs12 per share (full year EPS Rs23)- led by better margins on lubricants. On the other hand, both PRL and ATRL are expected to post quarterly losses of Rs11 (full year loss per share of Rs116) and Rs2 per share (full year EPS Rs10.7). Our earnings estimates include pre tax inventory gains of Rs1bn, 0.6bn and Rs0.4bn for PRL, NRL and ATRL respectively, assuming 20, 8 and 9 days of inventory levels.

Graph: Margins and Arab light crude price trend (US\$/bbl)

Source: Reuters, JS Research

Outlook: 'Market-weight' maintained

After the dismal performance in FY09, we expect a better earning outlook in next year earnings. As per our estimates, margins which off late have turned positive to US\$1 per barrel are likely to keep earnings in positive terrain, assuming oil prices stay constant. We are maintaining 'Market-weight' stance in the refinery sector and suggest investors to take long-term exposure in NRL and ATRL, both trading at FY10 PE of 4.8x and 5.9x, respectively.

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Also in focus**SBP receives US\$500mn ADB loan**

SBP has confirmed the receipt of US\$500mn from ADB to promote economic stability through social welfare programme. This is expected to boost foreign reserves above US\$12bn, highest since May 2008. According to the break up available, US\$150mn will go to the Benazir Income Support Fund while the rest will be directed towards removing subsidies and implementing market based prices for wheat and electricity.

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