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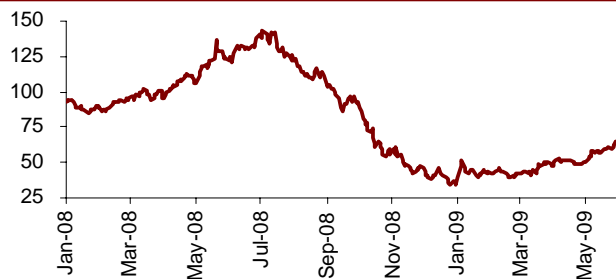
Pakistan Market**Oil prices, earnings impact and Pakistan economy****MORNING BRIEFING**

KSE100 Index: Closing 7210.34 ↓ (-66.27)

Oil prices (Arab Light) have surged by 90% since it hit the trough of US\$33/bbl in December 2008. This has multiple implications ranging from country's external account to budget revenues, corporate earnings and inflation. In today's briefing we flag the magnitude of oil on Pakistan economy and investments.

Arab light price trend and outlook

Earlier than expected global economic recovery and steep production cut by OPEC has led the price discovery in oil futures. Oil prices have risen by over 90% since it hit the bottom of US\$33/bbl- seven months ago. Interestingly, in the recent rally the prices for Saudi crude (Arab light) has rebounded sharply relative to WTI crude led by resilient demand for crude from Asia and Middle-Eastern economies and production cut by OPEC. Since September 2008 OPEC has cut over 3.25mn bpd, with major contribution coming from Saudi Arabia, which constitutes 30-31% of OPEC production. As per latest figures, 61% of Asia crude demand is met by Middle Eastern crudes mainly Arab light.

Graph: Arab Light crude price trend (US\$/bbl)

Source: Reuters

Looking forward, we expect oil prices to reverse, as the US inventory levels are hovering at 20-year higher level. Recent quarterly data of US, Japan and EU are all suggesting an ease on downturn, however, they are still depicting a contraction. We expect the demand for crude will remain

subdued in the major industrial economies; however, US dollar weakness against major currencies is the major risk. On the back of this, we expect oil prices would remain between US\$50-60/bbl during next 6 months, in line with the Reuters Analyst oil price projections. On the other hand, spread between Arab light and WTI is expected to remain thin on the back of demand & supply rebalancing.

Impact on economy

Recall, oil prices pushed Pakistan towards recession. By the same token, the fall in oil prices has eased pressure on twin deficits and inflation. We flag the concern of higher oil prices on external account and budget revenues. As per our calculation, US\$10/bbl increase in crude prices will add US\$900mn pressure to import bill and current account deficit. Additionally, it also has the potential to dent the government's ability to raise Petroleum Development Levy (PDL). Government has earned roughly Rs75bn through PDL in 9MFY09. Additionally, every 10% increase in energy prices has 1.5% direct impact on CPI. Currently government is collecting Rs8.5-10.5/liter on various oil products (Rs9bn a month).

As per our analysis, the PDL breaks even at US\$75-76/bbl range. The impact of higher twin deficit and inflation is expected to weigh on our currency outlook. Moreover, IMF's conditionality of transferring diesel payments from SBP to interbank market from August 1st, may add further pressure to exchange rate. At current prices, Pakistan imports roughly US\$200-250mn worth diesel per month.

Impact on oil stocks

E & P: At current exchange rates, a US\$10/bbl increase in oil prices has a positive 5-6% impact on E&P sector. Within E&P, POL tends to benefit the most and has an 8% impact on earnings due to higher share in revenue mix, followed by OGDC at 7% PPL at 4%.

OMCs and Refineries: Changes in oil product prices are more relevant than the actual crude oil price change, as the

former results in inventory gains/losses for OMCs. According to our analysis, a 10-dollar increase in oil prices would result in inventory gains of Rs2.8-3.3bn (before tax), provided that other things remain the same. This is assuming average 14-16 days of inventory levels. The impact would be higher on PSO (EPS impact of Rs7-9/share) while Rs4-5/share for Shell Pakistan. Like wise, refineries would incur 1.8-2.1bn (before tax) inventory gains on crude.

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Also in focus**Cabinet to review proposed Textile policy**

The Prime Minister on Monday constituted a cabinet committee to evaluate the proposed textile policy with an aim to achieve US\$25bn export target over the next five years. Pakistan's textile exports have witnessed a declining trend in FY09 with exports down 9.3% in 10M (Jul-Apr) FY09, thus prompting need for quick action to reverse this trend. The proposed policy also plans to focus on research and development in quality of fibers in order to improve efficiency of domestic products in the international market.

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