

March 03, 2010

**Pakistan Market****LOTPTA: Positives Overplayed – Sell****MORNING BRIEFING**

KSE100 Index: Closing 9546.39 ↑ (+47.82)

We initiate coverage on Lotte Pakistan PTA (LOTPTA) with a 'Sell' stance and a target price of Rs8 per share. The company is a sole producer of Purified Terephthalic Acid (PTA) in the country and has a market share of 80-85% in the local PTA market. PTA is a chief raw material used in the production of Polyester Staple Fibre (PSF), Polyester Filament Yarn (PFY) and Polyethylene Terephthalate (PET) resin. Since its takeover by the Lotte Group, the company's profitability has shown a remarkable turnaround with EPS jumping from a negative Rs1.16 in 2008 to Rs2.24 in 2009. Despite improvement in the company's fundamentals, we believe, the stock is over valued at the current level of Rs9.51 (a premium of 16%) as it has already priced in most of the positives. The scrip is currently trading at a PBV of 1.6x compared to the market's 1.5x, a premium of 9%.

**2009: Best year since inception**

In 2009, the profitability turnaround came with exceptional primary margins which benefited mainly on account of lower Paraxylene (Px) prices and higher PTA prices amid robust demand from the downstream sector. The former is linked with international crude oil prices, while the latter is driven by the global cotton crop outlook. Escalating cotton prices amid global cotton shortage alongside falling crude oil prices created favorable demand supply dynamics for the company. The dual effect caused gross profit margin to stand at an astounding 15.6 % compared to an average of 5.1% in the last three years and a meager 2.6% in 2008.

**Are margins sustainable, going forward?**

Our answer is no, on account of a rebound in international crude oil prices and better cotton crop outlook in 2010. However, we believe the company is likely to remain in control to accommodate financial costs and mitigate exchange losses on the \$63mn loan, while its potential to generate income through its cash balance is likely to remain intact in 2010. Overall, we expect company's EPS to decline from Rs2.24 in 2009 to Rs1.81 and Rs1.74 in 2010 and 2011,

respectively.

**Key points to watch out for**

We believe, apart from primary margins, the company's fundamentals are further dependent upon continuation of duty protection and its initiatives in new projects (power plant in our case).

- **Duty protection critical for survival:** At present, the company is subject to 7.5% duty protection (previously 15%) and may see a further downward revision. Since the revenue stream is contingent upon the level of tariff protection, a further cut would not bode well for the company.
- **New power plant to improve earnings:** On a positive note, the company is flexing its muscles to involve itself in new projects and is already in the process of setting up a 40MW cogeneration power plant. We have not incorporated the details of the project in our valuation as the project is in its initial stages and the details are awaited.

**Table: Key Valuation Ratios**

	2010E	2011F	2012F
EPS (Rs)	1.81	1.74	1.68
PE (x)	5.25	5.47	5.64
PBV (x)	1.63	1.34	1.15
EV/ton (US\$)	373	160	228

Source: JS Research

**For more details please refer to our detailed report titled "LOTPTA: Positives overplayed – Sell".**

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**Also in focus****US\$400mn CSF dues from 2008, rejected**

The US has decided against the reimbursement of over US\$400mn out of the total US\$1.4bn claimed by Pakistan for the expenses incurred under the Coalition Support Fund (CSF) in the year 2008. New guidelines requiring 'enhanced oversight and accountability' have been cited as reasons for this move. In addition to the initial payment of US\$548mn, a final payment for US\$349mn was paid recently for the said year, after a delay of 18 months. This move has raised concerns over claims worth over US\$2bn for the year 2009, which are currently being evaluated for reconciliation. Further cuts or delays in payments under the CSF, are likely to keep Pakistan's foreign reserve position in check.

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