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Pakistan Market**PSO: FY10 EPS expected at Rs69.1 – BUY****MORNING BRIEFING**

KSE100 Index: Closing 10388.64 ↑ (+15.11)

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Pakistan State Oil (PSO) is scheduled to announce its FY10 result on Aug 06, 2010. We expect the company to post earnings of Rs25.1 per share (up 76%QoQ) in 4QFY10, taking the full year (FY10) profits to Rs11.8bn (EPS of Rs69.1) compared to a loss of Rs6.7bn (loss per share of Rs39.05) last year. In addition to 16%QoQ and 5%QoQ growth in volumes and margins, respectively, we also expect PSO to book a net interest income of ~Rs500mn in 4QFY10. However, we expect a lower than average historical cash payout (below our initial expectation) due to the prolonged circular debt issue and the proposed acquisition of an additional 30% stake in Pakistan Refinery Limited (PRL). Hence, a final cash payout of Rs5-7/share is expected along with a possible bonus issue.

FO and HSD sales propels volumes by 16%QoQ

Furnace Oil (FO) and High Speed Diesel (HSD) sales witnessed an increase of 26%QoQ and 8%QoQ, respectively, resulting in total sales volumes for the company rising by 16%QoQ to 3.84mn tons. On yearly basis too, volumes rose by 5% mainly owing to 25% growth in FO sales amid rising demand from the power generation sector.

PSO's quarter sales

('000 tons)	4QFY10A	3QFY10A	Δ%
Mogas	225	232	-3%
HOBC	2	2	-4%
SKO	25	26	-3%
JP	161	186	-13%
HSD	1,059	981	8%
LDO	1	3	-47%
FO	2,367	1,876	26%
Total	3,840	3,305	16%

Source: JS Research

Margins on regulated products up 5%QoQ

Margins on regulated products averaged 5% higher compared to the previous quarter, as the international oil prices

witnessed a similar increase (adjusted for one month lag in local oil prices) during the period. However, due to volatility in the oil prices, we expect the company to book pre tax inventory loss of Rs135mn compared to Rs370mn in the preceding quarter.

Interest income/expense could surprise yet again

While PSO had booked a net interest expense of Rs1bn during the 3QFY10, we expect the company to book a net interest income (interest income recovered from power companies less interest expensed to refineries) of ~Rs500mn on the back of substantial recoveries from HUBCO and KAPCO. This further substantiates our earnings to Rs25.1 per share in 4QFY10.

Recommendation: 'Buy' maintained

PSO is trading at a FY11F PE of 4.6x and offers a potential upside of 38% to our target price of Rs390. Hence, we maintain our 'Buy' stance on the scrip. We have incorporated 0.5% turnover tax in our valuation on the assumption that the FBR will withdraw the increase of turnover tax to 1%. After incorporating 1% turnover tax, PSO still offers a likely upside of 10%, to its consequent target price of Rs310.

PSO FY10 earnings estimates

(Rs mn)	FY10E	FY09A	Δ%
Net Sales	788,982	612,696	29%
Cost of products sold	760,143	609,685	25%
Gross profit / (loss)	28,839	3,010	858%
Other operating income	1,568	1,452	8%
Operating costs	9,578	10,815	-11%
Other income	7,200	777	827%
Profit / (loss) from operations	28,029	(5,577)	NM
Finance costs	10,643	6,232	71%
Profit / (loss) before tax	17,937	(11,357)	NM
Taxation	6,094	(4,658)	NM
Profit / (loss) after tax	11,843	(6,699)	NM
EPS / (LPS)	69.05	(39.05)	NM

Source: JS Research and Company accounts

Also in focus**Cotton arrivals start flowing in**

According to the Pakistan Cotton Ginners Association (PCGA), fresh cotton arrival season has commenced as total arrivals as of August 1, 2010 came at 267k bales. Going forward, the recent flooding in the country could affect the crop and we could see the arrival numbers for the season to arrive below expectations. Nevertheless, we expect the cumulative arrivals for FY11 to come around 13.2mn bales.

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