

September 04, 2009

Pakistan Market

**PSO: Power Play****MORNING BRIEFING**

KSE100 Index: Closing 8817.60 ↓ (-61.04)

We reiterate our 'Buy' stance on PSO with a revised fair value of Rs380. We expect higher furnace oil (FO) demand and resolution of circular debt would be the two major short-term earning triggers for the company. According to our estimates, FO demand is expected to increase by 5-6mn tons during next 4-years which will be 60-75% higher than existing FO demand.

The jump in demand would come from 1) recently approved 2250MW FO based rental power plants 2) upcoming IPPs of 3500MW capacity and 3) existing dual-fuel (gas+oil) thermal power plants. Since the entire additional demand will be met through imports (due to refinery constraints), PSO will remain the major beneficiary as it 1) handles more than 90% of the country's oil product import 2) has a vast storage network and 3) has the largest distribution network.

Trading at FY10E and FY11F PE of 5.9x and 3.4x, respectively. The stock is available at a huge discount of 27% and 51% versus market's PE of 8.1x and 6.9x, respectively. We maintain our 'Buy' stance on PSO which is offering a potential upside of 36% at current levels.

**27% & 51% discount to market on FY10 & FY11 PE**

The scrip is available at significant discount of 27% and 51% to market on FY10E and FY11F earnings multiples versus historical (FY04-FY08) average discount of 13%. Moreover, FY10 and FY11 dividend yield also looks attractive at 10% and 15%, respectively.

**EPS of Rs63 in FY09 excluding one timers**

During FY09, PSO posted loss per share of Rs39.1 primarily due to huge inventory losses, exchange losses and high financial charges. Interestingly, if we adjust these one timers, PSO's earnings should come around Rs63 per share during FY09.

**FO demand to increase by 5-6mn tons in 4 years**

Currently, the country generates 32% of electricity through furnace oil and 34% from gas. During the last 4-years, FO

demand grew by an average of 15% annually due to higher consumption from thermal power plants. We expect 13% annualized FO sales growth during next 5 years following the commissioning of power plants.

**Sales revenue to reach Rs1 trillion**

We expect PSO's gross sales to reach ~Rs1trillion mark by FY12, compared to Rs719bn in FY09 (FO contribution in revenue would be 53% against current share of 38%). Thus, we expect FO sales revenue to reach at Rs530bn in FY12 almost double than FY09 estimate of 270-300bn.

**Circular debt resolution to boost EPS by Rs16-18**

PSO's financial charges during FY09 increased by 6 fold to Rs6.2bn mainly due to heavy bank borrowing to address liquidity crunch resulting from circular debt. The government has already assured that the circular debt would be resolved in few days. GoP and the major stake holders are already on board to finalize the TFCs worth Rs90-100n.

**Risks**

- Oil price
- Circular debt
- Timely payments
- Port constraints

**For further details please see our short report titled "PSO: Power Play" released earlier.**

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**Also in focus****Pakistani forex reserves rise to \$14.31 bn**

Foreign exchange reserves of the country rose to US\$14.31bn in the week ended Aug 29 compared to US\$12.85bn previously. SBP's reserves rose by US\$1.43bn to US\$10.79bn, while those held by commercial banks rose to US\$3.52bn from US\$3.49bn a week earlier. This was on the back of increased SDR allocation by the IMF of US\$1.2bn. Forex reserves have now reached their highest level since Jan 08, when they stood at Rs15bn.

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