

July 07, 2009

**Pakistan Market****OMCs: FY09 oil sales trend and outlook****MORNING BRIEFING**

KSE100 Index: Closing 7538.49 ↑ (+67.21)

After posting annual growth of 7% during last 5-years, oils sales in FY09 remained flat at 18.5mn tons (excluding non-energy products). Though black oil demand remained robust mainly due to higher demand for furnace oil (FO) by thermal power plants, white oil sales remained depressed amid slowdown in economic activity & higher infiltration of smuggled products into the local market. However, despite penetration of these products, highest monthly petrol sales (160k tons) were recorded in June 2009.

**Oil sales flat at 18.5mn tons in FY09**

Total volumetric sales of various oil products during FY09 stood flat at 18.5mn tons (according to OCAC). These numbers exclude non-energy products like lubricants, naphtha, asphalt and base oils. FO/black oil, which retains the major chunk of oil sales (44% share) is currently witnessing a higher demand from power plants due to gas and hydel-electricity shortages. As a result, sales rose 7% to 8mn tons during FY09.

According to latest statistics, Pakistan reliance on FO has increased substantially over the last few years as 32% of the electricity is now generated through FO, compared to 16% three years ago. And that is the reason why its demand grew annually by an average 17% during last 3-years. We expect FO demand growth will remain robust at least for next 3-4 years amid higher FO demand from multi-fuel thermal power plants (due to rising gas shortage) and new rental power plants- which run mostly on FO. This paints a favorable landscape for OMC's in general and PSO in specific since it holds 87% share in FO marketing.

**White oil sales showing declining trend**

In contrast to Black oil (mainly FO), white oils dropped by 5%-mainly due to negative growth of 8% in diesel sales. Broad reasons of declining HSD consumption are 1) slowdown in transportation related activities due to economic slowdown, and 2) Availability of cheap smuggled Iranian diesel & petrol

in the market. Sales of petrol (Mogas), on the other hand, grew by 4% which could have been much higher, had these smuggled products not penetrated into the local market.

We expect diesel sales to reverse upon economic recovery in FY10 while petrol sales likely to grow by 3% annually during next 2-4 years. With the inclusion of fixed carbon surcharge tax, we might see volatile prices of diesel and other regulated products at retail level. However, this will not hamper white oil sales unless we witness any abnormal increase in oil prices.

**Table: Oil Product sales (in 000 tons)**

	FY09				YoY-Growth			
	Industry	PSO	Shell	APL	Industry	PSO	Shell	APL
HSD	7,613	4,666	1,482	294	-8%	-11%	-11%	31%
FO	8,093	6,987	79	468	7%	11%	-59%	-6%
Mogas	1,527	734	369	77	4%	2%	0%	91%
SKO	179	101	19	19	-21%	-34%	-30%	-10%
LDO	89	29	0.40	51	-29%	-40%	-77%	-16%
JP	1,031	582	355	70	11%	19%	24%	-15%
<b>Total</b>	<b>18,532</b>	<b>13,098</b>	<b>2,304</b>	<b>979</b>	<b>0%</b>	<b>1%</b>	<b>-10%</b>	<b>6%</b>

Source: OCAC, \* excluding Non-Energy products & local JP8(Defence)

**PSO: top pick in OMCs**

PSO is set to be a primary beneficiary of the expected increase in FO demand mainly on the back of its substantial market share (86% share). Thus we expect PSO to post average annual volume growth of 5% during next 4-years. If we exclude one timer like huge inventory losses, exchange losses and higher financial charges (due to circular debt), this years earnings would have been positive Rs40-45 per share, we believe. With the absence of these factors next year, we might see PSO posting EPS of Rs48 in FY10. We maintain 'Buy' stance on PSO which is trading at FY10 and FY11 PE of 4.8x and 4.0x with dividend yield of 11.4% and 14.9%, respectively.

farhan.mahmood@js.com  
92 (21) 111-574-111 (3103)

**Also in focus****SC stops Nepra from increasing power tariff**

In a decision by Supreme Court (SC), Nepra has been directed not to raise the proposed 17% power tariff. Moreover, Nepra has been ordered to submit details pertaining to the cost of power generation and revenue breakdown in order to ascertain the number of additional charges being collected by the power companies. Currently, the cost of generation has increased due to lower hydel-power generation. We believe once the 500-600MW new rental power plants come online during 2-3 months, the government would be able to justify hike in electricity rates.

**JS Global Capital Limited**

6th Floor, Faysal House, Main Shahrah-e-Faisal, Karachi

**Research:**

Tel: +92 (21) 32799005

Fax: +92 (21) 32800163

js.research@js.com

**Fixed Income Sales:**

Tel: +92 (21) 32799541-44

Fax: +92 (21) 32800163

tariq.usman@js.com

**Equity Sales:**

Tel: +92 (21) 32799513

Fax: +92 (21) 32800166

junaid.iqbal@js.com

**Corporate Finance:**

Tel: +92 (21) 32799005

Fax: +92 (21) 22800163

azhar.iqbal@js.com

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