

August 09, 2010

## Pakistan Market

MORNING BRIEFING


**PSO: Solid core performance; tax uncertainty remains** KSE100 Index: Closing 10315.20 ↓ (-36.52)

PSO announced a strong result of Rs9.1bn (EPS of Rs52.76) compared to a loss of Rs6.7bn (loss per share of Rs39.05) last year. Though still impressive, the result was far below our expectations of Rs69.05 per share owing to a one off deferred tax asset reversal of Rs2.8bn (impact of Rs16.3 per share), a result of the increase in turnover tax rate to 1% in the Budget FY11. The management remains confident that the turnover tax rate will revert to its original 0.5% and hence the deferred tax asset could be restated in the coming quarter.

### Vol. growth to remain primary earning driver

Amongst the differences between FY10 and FY09 were the robust Furnace Oil (FO) sales, which went up 18%YoY. The increased sales were led by a higher demand from the power generation units. Going forward, this trend is likely to continue as additional 2,500MW capacity is expected to be added to the National Grid by 2013. We expect sustained growth in PSO's FO sales over the next 3-4 years and a CAGR of 7% during FY10-13.

Moreover, diesel sales (HSD) which dropped 10% for PSO and 3% industry-wide are expected to pick up once the recent gas substitution for diesel is over. After posting a growth of 2%YoY in 9MFY10, HSD sales witnessed a decline of 14%YoY in the 4QFY10 after the ECC decided to re-direct gas supplies from fertilizer plants and CNG distributors to power generation units.

### PRL acquisition; +ve in the long term

PSO recently announced its intention to increase its shareholding in Pakistan Refinery Limited (PRL) to 48% from the existing 18% by acquiring Shell's 30% stake (subject to the due diligence). We favorably view this potential acquisition for PSO in the long term; as it will provide vertical integration and reduce PSO's reliance on imports. Moreover, if this deal materializes, PSO will go for the expansion/up-gradation of PRL that should enhance the share of high margin lubricants business, from the current 5-6% share in the company's gross profit.

### Valuation: offering a potential upside of 44%

Post announcement of the FY10 result; we have raised our earnings estimate by 8-9% for FY11-13 on the back of higher than expected volumetric sales. However, we have reduced our dividend forecast for FY11 to Rs16 per share from Rs24 earlier due to the uncertainty of the resolution of the inter-corporate debt. Based on a simple average of DDM and FCFE methodologies, our target price for the scrip arrives at Rs390, which offers a 44% upside to the current market price. We have a 'Buy' recommendation on the scrip.

### Key risks to our base case:

**The increase in turnover tax:** In the FY11 Budget, the government decided to raise the turnover tax rate to 1%. As a result, PSO will be paying an effective tax rate of 59% (earnings erosion of 33-40% during FY11-14). However, the management remains confident based on the news flow received from the government that the turnover tax rate would be reverted to 0.5% for the downstream sector. As per our calculations, at the 1% turnover over tax rate, PSO's target price reduces by Rs125 to Rs265.

**Inter-corporate debt:** Delayed resolution of the inter-corporate debt is another key risk. We have reduced our dividend payout to 25% in FY11 compared to the historical average of 65-70%.

#### PSO: Key valuations

	FY08A	FY09A	FY10A/E	FY11F	FY12F
EPS (Rs)	81.9	(39.1)	52.8	65.6	68.2
PE (x)	5.0	NM	5.1	4.1	4.0
PBV (x)	2.3	1.7	1.6	1.3	1.1
Div. yield (%)	5.7%	2.2%	3.0%	6.0%	13.0%
ROE (%)	45.4%	-28.6%	37.0%	34.0%	29.0%

Source: JS Research

For more details, please refer to our short report titled "PSO: Solid core performance; tax uncertainty remains".

atif.zafar@js.com

92 (21) 111-574-111 (ext. 3118)

### Also in focus

#### Well-17 near Qadirpur shut down due to flood

According to news reports, OGDC has temporarily suspended hydrocarbon production from its Well-17 near the Qadirpur field due to fear of floods. Since the field has more than 30 wells currently engaged in oil and gas production, this temporary production suspension from one well is likely to have a minimal impact on the earning projections of the two listed stake holders OGDC (75% stake) and PPL (7% stake). Industry sources have indicated that the field is still safe from the flood. At current levels, we maintain our 'Buy' call on PPL with 'Hold' on OGDC.

### 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) 32800165

tariq.usman@js.com

#### Equity Sales:

Tel: +92 (21) 32799513

Fax: +92 (21) 32800166

junaid.iqbal@js.com

#### Corporate Finance:

Tel: +92 (21) 32799571

Fax: +92 (21) 32800164

sajid.farooqi@js.com

JS RESEARCH IS AVAILABLE ON BLOOMBERG, CAPITALIQ & THOMSON REUTERS