JS Research

October 09, 2009

Pakistan Market

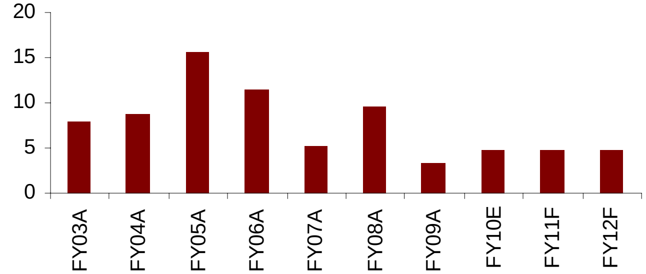
MORNING BRIEFING

NRL: Market ignoring lube earnings/'Buy'

KSE100 Index: Closing 9740.87 ↓ (-95.63)

Among refinery sector, we believe, NRL offer most stable and consistent earnings, even at a time when petroleum prices remained volatile. We believe market is ignoring its lube business which alone is trading at FY10E PE of 4.8x. The stock is available at 38% discount compared to its historical 7-years (FY03-FY09) average PE of 7.7x. We have excluded year FY05 in our analysis due to NRL's acquisition by Attock Group. Offering a descent upside of 24% to our fair value of Rs284, we maintain our 'Buy' stance on NRL.

Graph: Lube business PE (x)



Source: JS Research

National Refinery	
Market Price: Rs230.44	**Kats Code:** NRL
Market Cap: Rs18.4bn (US$221mn)	**Bloomberg Code:** NRL PA
1-yrs Avg. Daily Volume: 0.09mn shares, Rs16.5mn (US$0.2mn)	**Reuters Code:** NATR.KA
1-year High/Low: Rs236.11/90.41	

Fuel versus lube margins

Historically fuel margins have been very volatile and difficult to forecast. NRL also incurs inventory gains and losses on fuel business when ever oil prices increase or decrease. Hence, it is difficult to access historical fuel margins since there is no break up of inventory gains and losses available.

On the other hand, lube business of the company has been very stable during the last few years due to NRL's pricing power in this segment. The lube business provides hedge to any sharp decline in oil price. Since FO is a base material for lube manufacturing, decline in oil price reduces cost of production. Thus, NRL due to its pricing power in lube segment maintains healthy margins which offset the impact of inventory losses on fuel business.

Trading at lowest multiple on lube earnings

Excluding FY09 due to abnormally low stock prices amid market crash, the scrip is trading at its lowest multiple of 4.8x on one year forward lube earnings compared to an average of 7.7x during last 7-years (FY03-FY09). We have excluded FY05 in our analysis since the stock price was abnormally high due to company's acquisition by Attock Group. This highlights that the market is ignoring the stable lube earnings. (see graph).

Fuel business: Earnings dampener in FY09

Fuel business remained the earnings dampener for NRL throughout FY09.NRL reported loss of Rs33.8 per share in fuel business compared to Rs53 per share profit realized in lube business. As a result, NRL reported a meager profit of Rs19.2 per share in FY09 versus Rs75.1 per share in FY08. Loss in fuel business was due to one offs like 1) huge exchange losses of Rs2.4bn against crude oil purchases amid currency devaluation and 2) inventory losses due to sharp decline in oil price (estimated at Rs1.5-1.7bn–after tax).

Base case FY10 EPS expected at Rs50

Our base case earnings estimate for FY10 is Rs50 per share, which includes both lube and fuel earnings. We have assumed fuel margins of US$3 per barrel in our financial models. Further, due to our average oil price assumption of US$60 per barrel in FY10, we expect NRL to incur inventory losses as well. The stock is trading at FY10 dividend yield of 12.2%. We maintain our 'Buy' stance on NRL at current levels.

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

Also in focus

YTD foreign flows near equilibrium

Cumulative foreign portfolio data could turn positive for the first time in the current calendar year, as foreign interest in the local bourse continues to remain strong. Net foreign outflows in the current calendar year have now come down to US$4.1mn from a high of US$292.3mn in mid June this year. Improving macro economic fundamentals, political stability and relatively cheap valuations remain the key reasons behind this turnaround. For the calendar year 2008, foreigners were net sellers of equities worth US$443mn.

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

Equity Sales:
Tel: +92 (21) 32799513
Fax: +92 (21) 32800166
junaid.iqbal@js.com

Fixed Income Sales:
Tel: +92 (21) 32799541-44
Fax: +92 (21) 32800165
tariq.usman@js.com

Corporate Finance:
Tel: +92 (21) 32799005
Fax: +92 (21) 32800163
azhar.iqbal@js.com

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