

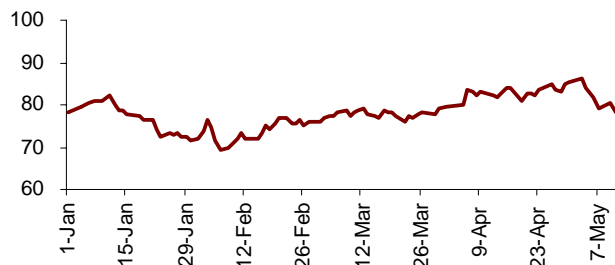
May 14, 2010

**Pakistan Market****Falling oil prices and its implications****MORNING BRIEFING**

KSE100 Index: Closing 10279.52 ↑ (+57.48)

With rising concerns about Europe's financial health, another round of commodity price meltdown has begun. Looking particularly at oil prices, WTI has fallen by 7.1% since May 5th and is currently hovering in the vicinity of US\$74 per barrel. Interestingly, Arab Light (benchmark crude grade for Pak energy sector) remained relatively stable and is hovering around US\$80 (down 6.4% during the same period).

Though deemed positive for the macro fundamentals, the persistent decline in international crude and oil product prices has alerted investors who are now raising questions regarding future profitability of the listed energy companies, especially the E&Ps and Oil Marketing Companies. We believe, at current price levels there is limited downside risk to earnings however, if Arab Light price converges towards WTI, earnings estimates could see a downward revision.

**Arab Light price in 2010**

Source: Reuters

**E&P: FY10 & FY11 estimates still intact**

Compared to 10MFY10 Arab Light price of US\$74 per barrel, our FY10 oil price assumption is still intact at US\$73. Similarly, our FY11 crude price assumption of US\$77 per barrel also seems conservative in comparison to the last closing price of US\$80 per barrel, indicating a lower risk of downward revision in our earnings forecasts for the two years. However, if the Arab Light price converges towards WTI price levels, we might see a downward revision in our earnings

estimates for the E&Ps. As per our estimates, US\$1 per barrel change in our oil price assumption impacts JS Universe E&P sector profits by 0.5%.

**E & P sector earning estimates**

	FY10E	FY11F
OGDC	13.1	15.2
POL	32.3	40.9
PPL	24.8	33.8

Source: JS Research

**Inventory losses could erode OMC profits**

For OMCs, continuous fall in oil prices would not only lead to lower OMC margins going forward (excluding HSD) but would also impact profits through inventory losses.

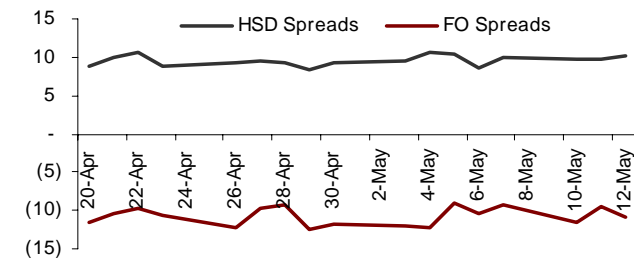
**OMC sector earning estimates**

	FY10E	FY11F
APL	54.3	61.3
PSO	52.2	60.8
SHEL	24.3	27.6

Source: JS Research

**Refineries: Inv. losses could curb better spread**

As in the case of OMCs, if oil prices continue to slide, refineries could also record inventory losses in the coming quarters. However, product spreads on FO and HSD have shown slight improvement as the Arab Gulf prices for the two products have fallen by 5.7% and 6.2%, respectively compared to the 6.4% fall in crude price since May 5.

**FO & HSD spreads**

Source: Reuters

The relative stability in product prices would be reflected in coming month's prices for local refineries, providing further strength to the local GRMs. This trend should enable the refineries to somewhat mitigate the impact of potential inventory losses on their profitability.

**Power tariffs could see downward fuel adjustment**

Given the current declining trend of FO prices globally, a fall in prices throughout the next month could call for a downward fuel adjustment in power tariffs in the coming month. Based on the current decline of 5.7% in FO prices, we estimate the potential tariff adjustment to stand in the vicinity of Rs0.1 per unit in June. If passed on, this adjustment would offer slight relief to the power consumers.

**Outlook: 'Buy' intact on PPL, POL, PSO and Hubco**

Currently, we remain overweight on the E&P and Power sectors, with PPL, POL, PSO and Hubco as our preferred plays in the energy chain.

**Energy & Power Valuation snapshot**

(FY11F)	PE (x)	Div. yield	Target Price
PPL	5.8	11.2%	236
POL	5.8	10.4%	285
PSO	5.0	7.9%	390
HUBC	6.2	15.3%	45

Source: JS Research

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