

July 17, 2009

Pakistan Market**POL: Trading at book value****MORNING BRIEFING**

KSE100 Index: Closing 7715.42 ↑ (+29.27)

We believe expected gas flows from Tal block in the next 3-months is likely to mitigate dwindling oil price risk off-late. We expect production additions from Tal block to contribute Rs5-5.6 per share to the earnings (18-20%) next year while the full impact would be realized in FY11. Additionally, POL is the only stock in the JS E&P universe which is trading close to book value with near term earning growth potential. Moreover, with 7% and 8% decline in oil and gas production MoM (as reported by PPIS), we have revised downward our earning estimates for POL to Rs24.8 per share for FY09 from Rs26.1 per share.

The stock is available at significant 22% discount to the market on one year forward earnings multiples. Regionally, major E&P companies are trading at an average 16.4x, on that count POL seems cheapest. The stock is currently trading at an implied oil price of US\$40 per barrel compared to our oil price assumption of US\$54 per barrel for FY10 and US\$77 for FY12. Our target price for the stock is Rs245 offering handsome 59% upside- we recommend 'Buy' at current levels. Risk to our thesis are 1) sharp decline in oil prices 2) delay in additional production from existing and new fields (Manzalai and Mamikhel) and 3) continuation of circular debt.

Cheap on regional valuations

Despite the fact that POL posted one of the highest returns in 2009YTD versus regional peers, it is still available at a huge discount on earnings multiple on year forward earning thanks to near-term capacity additions and expected recovery in its hydrocarbon base. Moreover, it is also cheapest on P/BV and EV/EBITDA implying upside potential from current levels while dividend yield and ROE is also attractive. It is the only E&P stock in our JS universe with near term earnings growth. Our near term (FY10) earnings estimates are based on oil assumption of US\$54 per barrel—enough to absorb US\$5-10 per barrel downward volatility from current level of US\$60 per barrel.

Tal Block addition: Earnings catalyst

In a recent discussion with industry experts we came to know that the much awaited 200mmcf (million cubic feet per day) additional gas from Manzalai (Tal block) is expected to come online by September 2009 (we are assuming one month delay). Earlier, production was expected to commence in 4QFY09. At present, gas production from Tal block stands approximately at 52mmcf. Moreover, 45mmcf additional gas from Mamikhel is also expected in December 2009, but we have taken 25mmcf in our model.

Production: Already bottomed out

During FY09, we saw overall volumes of the company post negative growth (oil: -26%, gas: -14%). According to the provisional numbers, average oil and gas production during FY09 stood at 3.8kbpd (FY08: 5.1kbpd) and 38mmcf (FY08:44mmcf). The major contributors behind this decline are Pindori and Pariwali.

Average daily oil and gas production from Pindori is down 73% to 809bpd (FY08: 3.0ktons) and 72% to 2.5mmcf (FY08: 8.9mmcf), respectively while production from Pariwali also remained subdued at 1.5kbpd (down 23%YoY) and gas declined to 15.8mcf (down 18%YoY). We believe, the downside risk in volumes is minimal given the fact that production has already bottomed out. We expect overall volumes to grow by an average 31% during next 3 years.

Pindori: Forgotten but not lost

Pindori, which was the largest oil producing field for the POL, saw its production decline by an average 37% during last 5 years. Currently the field is producing approx.330bpd while average production in FY09 stood at 809bpd, down 73%YoY. Though the reserve size of the field is 32.8mn barrels, - enough for more than 50 years, the consistent decline in oil production is a result of significant drop in well head flow pressure and higher water levels. However, work over job at Pindori-3 for water shut-off is still in progress which is expected to recover additional 500bpd of oil.

Going forward, we have assumed 1000bpd from Pindori.

Risks to our valuation

- Downward rally in oil prices
- Delays in Manzalai
- Ongoing circular debt issue

For more details please refer to our short report titled "POL: Trading at Book Value" released earlier today.

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Also in focus**C/A deficit narrows by 36% to US\$8.8bn**

The country's current account deficit for FY09 came in at US\$8.8bn, down 36% from US\$13.86bn a year earlier. Moreover C/A deficit as percentage of GDP reduced to 5.4% in FY09 as against 8.7% in FY08. Major reasons for the decrease were the surge in home remittances and decline in commodity prices.

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