

August 18, 2009

**Pakistan Market****NRL: FY09 earnings preview/ 'Buy' maintained****MORNING BRIEFING**

KSE100 Index: Closing 7932.55 ↓ (-78.76)

NRL board is expected to meet on August 19, 2009 to announce FY09 results. We expect a full year EPS of Rs22.7, down 70% YoY – however, 4QFY09 earnings would arrive at Rs12.1 per share. Moreover, we expect a final cash dividend of Rs17/share with the results. The scrip, since the beginning of 2009, has outperformed KSE 100 Index by 90%, posting a healthy return of 126%.

Currently, crude oil is trading at US\$67 per barrel while furnace oil and diesel are trading at US\$7 per barrel discount and US\$9 barrel premium to crude oil price, respectively. In worst case (assuming average oil prices of US\$59/bbl in FY10 and zero margin on fuel business), full year earnings would be Rs38-40 per share while in best case (assuming fuel margin averages US\$4 per barrel in FY10) earnings would be Rs68-70/share.

We maintain our 'Buy' stance on NRL which is currently available at FY10F and FY11F dividend yields of 9.3% and 10.7%, respectively versus historic 5-year average dividend yield of 6.0%. Moreover, the scrip is available at FY10F and FY11F PE of 4.5x and 4.1x compared to last 5-year's (FY04-FY08) average PE of 5.3x (excluding year 2005). Besides attractive dividend yield, the stock is offering a healthy upside of 30% to our fair value of Rs280/share.

**Fuel business to be an earnings dampener in FY09**

Fuel business remained the earnings dampener for NRL throughout FY09. Out of the Rs22.7/share profit expected in FY09 (FY08 EPS Rs75.1), fuel business is likely to contribute a loss of Rs30/share (Rs38.3/share profit in FY08). However, lube business is expected to show robust earnings of Rs52.7/share (Rs36.8/share in earnings during FY08), thanks to better lube margins this year, which is likely to tone down dismal fuel segment performance.

Loss in fuel business is due to one offs like 1) huge exchange losses against crude oil purchases amid currency devaluation (per share impact estimated at Rs15.0 in FY09) and 2) huge inventory losses due to more than US\$70/bbl decline in oil (estimated impact of Rs20-22/share in FY09).

**Rs48/share earnings likely in FY10**

Given its low risk to fluctuating oil prices compared to its peers and stable lube earnings, we expect NRL to post an EPS of Rs48 in FY10. Our base case earning is subject to US\$59 per barrel average oil price and prevailing product spreads (difference between crude oil and product price).

**Oil price risk is minimal**

Relative to its peer (PRL), oil price risk is minimal for NRL. According to FY08 oil statistics, NRL has a designed crude oil storage capacity of 156k tons (16-17days). Moreover, the lube business of the company provides a 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. This partially offsets the impact of inventory losses which was evident this year.

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**National Refinery**

<b>Market Price:</b> Rs214.63	<b>Kats Code:</b> NRL
<b>Market Cap:</b> Rs17.2bn (US\$208mn)	<b>Bloomberg Code:</b> NRL PA
<b>1-yrs Avg. Daily Volume:</b> 0.08mn shares, Rs13.6mn (US\$0.2mn)	<b>Reuters Code:</b> NATR.KA
<b>1-year High/Low:</b> Rs241.50/90.41	

**Also in focus****Furnace oil price up by 6%**

PSO has increased furnace oil (FO) price by Rs2,500 for the next 15 days to Rs43,384 per ton, up 6% from Rs40,926 per ton previously. The rise in FO price is due to higher oil prices in the international market. According to our calculation, PSO's annualized earning will improve by Rs2.0-2.5/share, if international furnace oil price remains the same during next 12 months. We maintain a 'Buy' stance on PSO at current levels.

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