

November 19, 2009  
Pakistan Market

MORNING BRIEFING



## APL: Earnings to improve in 2QFY10 / 'Buy'

KSE100 Index: Closing 9144.76 ↓ (-60.22)

Declining furnace oil volumes and lower absolute margins on oil products drove a 7%YoY decline in 1QFY10 profits of Attock Petroleum Limited (APL). Earnings for the quarter arrived at Rs734mn (EPS of Rs12.7) as against profits of Rs785mn (EPS of Rs13.6) in the corresponding period last year. Nonetheless, with the stock trading at an attractive FY10E and FY11F PE of 5.8x and 5.5x, respectively, we reiterate our 'Buy' recommendation on the scrip.

### Fall in furnace oil sales – earnings dampener

Contrary to industry's growth of 26% in the furnace oil (FO) segment, APL witnessed a substantial fall of 28% as WAPDA directed its supplies to PSO from APL. We believe this is down to PSO's higher tolerance with regards to WAPDA receivables coupled with absorbing financial charges on its books. Resultantly, APL's market share in FO business fell to 3.5% from 5.8% earlier. Moreover, along with the 26% decline in FO prices, furnace oil sales in rupee terms are estimated to have dropped by 49%YoY. HSD volumes increased by 36%, while Mogas and Jet fuel sales registered negative growths of 6% and 33%, respectively. Consequently, the company's overall market share fell by 147bps to 4.4%. With a decline of 40% in international crude oil prices, cost of products sold slipped by 16% to Rs15.8bn. Thus, gross profit reduced to Rs759mn, down 14%YoY with gross margins remaining flat at 4.6%.

Other operating income primarily from commission and handling declined by 38%YoY to Rs186mn. However, income from bank deposits and short term investments increased to Rs253mn by 54%YoY mainly because of higher average cash and bank balances during the period. Going forward, we believe resolution of the circular debt is likely to improve the other income component for the company. As of Sept 30, Rs2.8bn receivables are due from govt. owned entities. Other operating expenses also witnessed a fall of 20% to Rs131mn. Hence, net margins improved by 46bps to 4.4%.

### FO sales rebound in Oct – strong demand ahead

With rising demand from dual gas thermal power plants, furnace oil sales of APL during Oct 2009 rose to 46k tons, up 66%MoM and 32%YoY mainly a consequence of poor sales in Sept 2009. Going forward with IPPs and rental power projects coming online within the next 2 years, we expect APL to post average annual volumetric growth of 5% during the next 3 years in FO business. Moreover, after a depressed last month due to extended EID holidays, diesel sales also picked up during Oct 2009, up 77%MoM and 134%YoY. Hence, total sales for the company were up 56%MoM and 54%YoY.

### Strong earnings expected next quarter

With improving furnace oil and diesel volumes along with rising international oil prices, strong earnings are expected in 2QFY10. Moreover, with international oil prices hovering around US\$78-80 per barrel (US\$66/barrel on Sept 30, 2009), there remains an opportunity to book inventory gains.

### Key Risks:

- The government's inability to resolve the circular debt issue will squeeze liquidity for the company and more importantly hinder growth for the FO business segment.
- OMCs are currently getting 4% margin on regulated products (Petrol, Kerosene and LDO) subject to oil prices trading in the band of US\$40-80/ barrel. Currently, with international oil prices hovering close to US\$80/barrel, there remains a risk of margin reduction on regulated products.

### Recommendation: 'Buy' maintained

Trading at FY10E and FY11F PE of 5.8x and 5.5x, respectively and offering a dividend yield of 8.7% and 9.9%, we reiterate our 'Buy' stance on the scrip.

atif.zafar@js.com  
92 (21) 111-574-111 (ext. 3118)

#### Attock Petroleum

<b>Market Price:</b> Rs322.05	<b>Kats Code:</b> APL
<b>Market Cap:</b> Rs18.6bn (US\$222mn)	<b>Bloomberg Code:</b> APL PA
<b>1-yrs Avg. Daily Volume:</b> 0.2mn shares, Rs60mn (US\$0.7mn)	<b>Reuters Code:</b> APL.KA
<b>1-year High/Low:</b> Rs401.07/137.14	

### Also in focus

#### Auction prices in improving macro position

T-bill yields for the 12 month paper dropped 31bps to 12.21% in the auction held yesterday. The decline was inline with market expectation of a reduction in policy rate in its review expected on Nov 24, 2009. We expect SBP to cut the policy rate by 1ppt in this months review on the back of macro imbalance reversal and improved external account flows.

### 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) 32799005  
Fax: +92 (21) 22800163  
azhar.iqbal@js.com

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