

July 20, 2009

Pakistan Market**PSO: Higher FO demand to jack up earnings/'Buy'**

KSE100 Index: Closing 7764.01 ↑ (+48.59)

MORNING BRIEFING

We expect a significant turnaround in PSO's earnings next year as we believe FY09 earnings dampeners like huge inventory and exchange losses would be missing next year. Moreover, financial expenses which soared by 7.4 times to Rs4.7bn (during 9MFY09) will reduce going forward amid improvement in cash flows following partial resolution of circular debt during next couple of months.

Recently, government has announced disbursement of Rs15bn to PSO on war footings. On the other hand, company expects Rs8-15bn during next few days. Trading at FY10 PE of 4.9x and dividend yield of 11.1%, PSO remains one of our top picks. The scrip has so far in 2009 outperformed KSE-100 index by 33% and posted handsome 65% return YTD.

FY10 EPS expected at Rs48

Though market is expecting lower earnings next year, we believe PSO to post Rs48 per share earnings in FY10. According to our estimates, if we adjust FY09 earnings with inventory losses, exchange losses and financial charges, PSO might have posted earnings of Rs43-45 per share during 9MFY09 instead of loss per share of Rs54 during 9MFY09. Our next year earnings are based on oil price assumption of US\$54 per barrel. Thus, we have already incorporated inventory losses of Rs1.6bn (before tax) in our earnings projection for PSO.

Furnace oil: Black gold for PSO

To rescue the electricity shortage, government has devised a road map according to which the 3300MW rental power plants would be online during next 6-months. These plants (mostly run on furnace oil) would require additional 2.8-3.3mn tons of furnace oil i.e one-third of the existing country's total FO demand. PSO would remain the major beneficiary since it enjoys 86% market share in this product line. Based on this, we expect FO sales of the company to post 7% CAGR during next 3 years. Moreover, any delay in the IPI gas pipeline would spur demand for FO- augers well for PSO.

Tariff hike will ensure timely payments to PSO

Once the rental power plants come online, we might see sequential power tariff rate hikes going forward. This will ensure timely payment by power plants to PSO. Currently, PSO has receivables of Rs80bn from Wapda and IPPs. At the same time, it has payables of Rs52bn to refineries. According to some media reports, PSO is likely to receive Rs15bn during next few days.

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Pakistan State Oil

Market Price: Rs233.79	Kats Code: PSO
Market Cap: Rs40.1bn (US\$489mn)	Bloomberg Code: PSO PA
1-yrs Avg. Daily Volume: 1.3mn shares, Rs277mn (US\$3.4mn)	Reuters Code: PSO.KA
1-year High/Low: Rs425.56/96.00	

Also in focus**US\$4bn IMF Loan likely to be approved**

According to a newspaper report IMF has accepted Pakistan's request for an additional US\$4bn. Although official announcement is yet to be made, the newspaper reported that US\$2bn would be provided in the current fiscal year while the remaining US\$2bn would be disbursed in the next fiscal year. This loan would be a major boost for the finances of the country at a time where commitments from FoDP are in doubt.

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