

May 20, 2009

**Pakistan Market****Refineries: Negative margins so far in 4QFY09****MORNING BRIEFING**

KSE100 Index: Closing 7067.85 ↓ (-105.00)

Though, it is largely perceived that inventory gains on crude would result in better earnings for the refineries in 4QFY09, however, the reality is other way round. So far, Gross Refinery Margins (GRMs) have depicted a negative trend during April-May period. Our analysis is based on April production numbers and we have assumed same oil prices till May end. On the back of rising oil product prices we have incorporated improve margins for June 2009.

**Negative margins so far on fuel business**

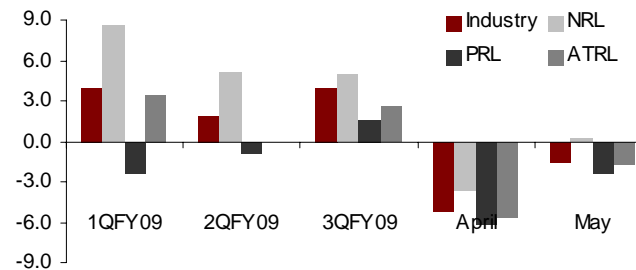
During the first 2 months of ongoing quarter (4QFY09), GRMS on fuel products (weighted average spread of various products less processing cost) recorded at US\$-3.4/bbl compared to US\$5/bbl in preceding quarter. Historically, GRMs remained robust during Apr-June period on ground of higher global oil demand. As per our analysis, negative margins are due to lower spreads earned on diesel (profit making product) and higher negative spread on furnace oil (a loss making product), relative to 3QFY09. Currently, GRMs on diesel stands at US\$2/bbl, down from US\$6/bbl 3QFY09 and furnace oil at negative US\$5/bbl vs negative US\$3/bbl last quarter. Both these products make up 72% share in overall production.

**Slight recovery in GRMS expected in June**

Moreover, we expect, GRMs to inch-up in the range of US\$1-2/bbl in June 2009, providing international crude oil prices remain flat for next 40 days. If that happens we might see refinery losses narrowing down to US\$-1.5 per barrel for 4QFY09. The rational behind improved margin is price mechanism, which sets on one month lag basis. In other words, oil product prices in Pakistan are determined on the basis of last 30 days international prices. The rising international product prices during the month of May will be reflected in June margins.

Based on last month production data, it appears that margins across refining industry have dwindled substantially in the last

couple of months. GRMs for PRL is expected to hit massively at negative US\$4.33/bbl, followed by ATRL (negative US\$3.7/bbl), and NRL (negative US\$1.7/bbl).

**Graph: GRM trend (US\$/bbl)**

Source: OGRA &amp; JS Research

**Inventory gains to partially offset -ve GRMs**

Only ray of hope for the refineries is the inventory gains, though hard to predict. However, according to our analysis, increase in crude oil prices bodes well for PRL since it has 15-18 days of average crude oil storage capacity, one of the highest in the industry. So far in 4QFY09, crude oil prices have rallied by 14%.

We maintain our 'Market-weight' stance on refinery sector at current levels.

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**Also in focus****SC grants PTCL 5 weeks to improve service quality**

After taking notice of high prevailing Petroleum products prices, Supreme Court of Pakistan (SC) has moved its focus to the telecom sector through notice of the recent degradation of services of PTCL. According to news reports, the court had summoned PTCL officials to seek explanation on the issue and upon request from the company's official has now given PTCL 5 weeks grace time to improve service quality.

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