

October 20, 2009

Pakistan Market**PSO: Inventory gains to jack up earning in 1QFY10**

KSE100 Index: Closing 9411.29 ↓ (-426.83)

MORNING BRIEFING

We expect PSO to post robust earnings of Rs15.9 per share in 1QFY10 versus loss of Rs48.9 per share in corresponding period last year. The turn around in earnings is primarily expected on the back of upbeat furnace oil sales and inventory gains. Last year, the company suffered losses due to huge inventory and exchange losses. We also expect an interim dividend of Rs5-6 with the result. Trading at FY10E and FY11F PE of 6.7x and 3.8x, respectively we recommend 'Buy' on PSO at current levels. The scrip offers an attractive upside of 17% to our target price of Rs380.

Furnace oil & inventory gains: Earnings propeller

During 1QFY10, the company sold 2.2mn tons of furnace oil (FO) compared to 1.7mn tons last year, up 31%YoY. The surge is attributed to rising demand from existing dual and oil fired power plants. The company has met met 89% of the country's FO demand, thanks to PSO's huge distribution network.

Besides, impressive FO sales, the company is likely to incur pre-tax inventory gains of Rs2.2bn (assuming 10 days of inventory levels). This is due to 20-22% increase in major oil product prices during the period.

1QFY10 EPS expected at Rs15.9

We expect PSO to post profit of Rs2.7bn (EPS Rs15.9) during 1QFY10 as compared to a loss of Rs8.4bn (loss per share of Rs48.9) in the same quarter last year. The turn around in earnings is expected mainly due to robust furnace oil sales and huge inventory gains. Gross profit is likely to reach at Rs7.7bn versus gross loss of Rs7.4bn last year. However, higher financial charges are expected to partially dilute the impact of huge inventory gains. We expect the company to announce an interim dividend of Rs5-6 per share with the results.

Last year, the bottom-line suffered due to huge inventory losses and exchange losses. The company reported inventory

losses of Rs14.5bn while exchange losses arrived at approximately Rs3bn.

Table: Financial Highlights

(Rs mn)	1QFY10E	1QFY09A	Δ%
Net sales	149,711	188,980	-21%
Gross profit	7,707	(7,404)	NM
Admin & other expenses	1,530	1,272	20%
Depreciation	280	279	0%
Financial charges	1,950	1,072	82%
Other income (net)	250	(2,576)	NM
PBT	4,197	(12,603)	NM
PAT	2,728	(8,383)	NM
EPS	15.9	(48.9)	NM

Source: JS Research & Company accounts

Recommendation: 'Buy'

The recent increase in power tariff is likely to ensure timely payments by Wapda. However, energy companies still owe more than Rs75bn to the company which is a concern despite the fact that the government has recently issued TFCs worth Rs82bn. Hence, if the payments on current supplies are delayed, there could be a risk of further piling of the circular debt which could hamper FO supplies. The scrip is trading at FY10E and FY11F PE of 6.7x and 3.8x, respectively. Moreover, dividend yield is also attractive at 9.0% and 13.2%. We therefore maintain our 'Buy' stance on PSO.

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Pakistan State Oil

Market Price: Rs323.61	Kats Code: PSO
Market Cap: Rs55.5bn (US\$666mn)	Bloomberg Code: PSO PA
1-yrs Avg. Daily Volume: 1.6mn shares, Rs360.3mn (US\$4.3mn)	Reuters Code: PSO.KA
1-year High/Low: Rs342.95/96.00	

Also in focus**Oil prices hit year high at US\$79.9/barrel**

Amid improved industrial production in the US coupled with tensions in oil rich Nigeria and flagging US currency, oil prices on Monday, rose to a year high of US\$79.9 per barrel. We believe the surge in oil prices can be an alarming signal for Pakistan's external accounts.

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