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Pakistan Market**Refineries: Last quarter was not good****MORNING BRIEFING**

KSE100 Index Closing 5136.48 ↓ (-121.80)

Bad news for the local refiners on all fronts during the outgoing quarter. Margins, oil prices and production all showed negative trend for the refineries in 2QFY09. Besides these factors, liquidity crises continue to haunt local refined oil production. We maintain our market weight stance on refineries.

Further, we believe 1HFY09 earnings to remain in negative zone amid huge inventory losses on crude oil. Only National Refinery in our JS sample companies would likely to post profits in 1HFY09, thanks to better margins on lube segment. Trading at FY09PE of 2.8x dividend yield of 14% we think NRL is the only stock in this sector which is worth taking some exposure.

39% decline in margins QoQ

After incorporating December production numbers, local refinery margins have dropped by 39%QoQ to US\$3.2/bbl in 2QFY09 versus average margin of US\$5.3/bbl. These are the weighted average margin or GRMs minus processing cost (not incorporating inventory losses). There are two broader reasons for declining margins. One reason is the steeper decline in diesel prices relative to crude oil and second is the reduction in deemed duty (part of local refineries margin) in absolute terms. Diesel, being the heavy weight product (38% share), average spread (difference between diesel price less crude price) is estimated to reduce to US\$22/bbl in 2QFY09 versus US\$36/bbl in 1QFY09. Thus, reducing weighted average diesel margin to US\$8/bbl as against US\$14/bbl in the preceding quarter. Similarly, weighted average margin on petrol and JP also fell QoQ while margins on furnace oil showed improvement from -US\$8/bbl to -US\$4/bbl.

On the other hand, declining oil prices have resulted in 53% decline in deemed duty in dollar terms (50% in rupee terms) which is a major concern for the refineries.

PRL: Inventory losses to off set rise in GRMs

PRL is the only company to depict improvement in refinery margins in 2QFY09, reason being better FO margins.

Furnace oil makes up around 47% of the company's product mix. Thus, we expect fuel margins to get doubled (US\$3.4/bbl) for PRL in 2QFY09. However, inventory losses will likely to offset the improvement in margins despite the fact that company is likely to reduce its 20 days of average crude oil storage amid liquidity concerns. This is the reason we believe the company to remain in losses in 2QFY09 as well. During 1HFY10, PRL produced 800k tons of oil products, down 19%YoY while 20% QoQ.

NRL: Better lube margins

As per our estimates, during Oct-Dec 2008, average fuel refinery margins for NRL are likely to hover around US\$9.1/bbl, down 28%QoQ. We believe lube margins are likely to improve due to lower feed stock prices amid declining crude oil prices. Thus despite incurring inventory losses, we expect NRL to post profits in 1HFY09. NRL refined 779k tons of oil products during Jul-Dec 2008, down 13%YoY, while 17%QoQ.

ATRL: margins down 48% QoQ

We expect average margins to stand at US\$3.9/bbl, down 48%QoQ. Similar to other refineries, ATRL is likely to post huge inventory losses on crude in 2QFY/09 as well. During Jul-Dec 2008, production is down by 9% while up 2%QoQ.

Not enough cash to operate at full capacity

Slowdown in economy is not a major reason which led to fall in refineries production, we believe. It is the liquidity which is restricting refineries to operate at full capacity. During 1HY09, total crude oil imports stood at 3.8mn tons, down 12% while average crude oil supplied to refineries would be approx. 1.6mn tons. Assuming all the crude imported and purchased from E&P companies is processed, average refinery utilization stood at 65-68% during 1HFY09.

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Also in focus**WTI crude at US\$44/bbl on NYMEX**

Oil prices in the international markets have rebounded in last few days. WTI crude at NYMEX is trading at US\$43.9/bbl on cash counter, similar levels were seen at the beginning of this year. However, oil markets are still bearish on oil demand and foresee oil prices to average US\$50/bbl in 2009 as per Reuters Oil Poll. In 2008, average WTI oil price stood at US\$99/bbl.

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