

July 30, 2009

**Pakistan Market****FO: Capacity constraints & rental power plants****MORNING BRIEFING**

KSE100 Index: Closing 7536.98 ↓ (-137.79)

To curb electricity shortage, the government has already devised a plan to bring in additional 3300MW power plants on war footings by December 2009. These power plants will mostly run on furnace oil (FO) and hence require additional 3-3.4mn tons of FO (if they operate at full capacity). However, due to storage and port constraints, there are concerns that these plants could not run at full capacity and require additional storage to cater future FO demand.

For this, decision is under way to build additional storage which requires investment of Rs8-9bn and will need another 1-2 years. Thus in short term we might see new power plants operating at lower capacity due to supply constraints. However, considering the largest storage network, PSO remains the prime beneficiary to handle such huge demand going forward. We maintain our 'Buy' stance on PSO which is currently trading at FY10 and FY11 PE of 4.9x and 4.0x, respectively.

**Demand & supply balance**

Due to restrictive hydel power generation and consistent decline in gas supplies to thermal power plants, reliance on FO for power generation has increased. Currently, daily FO consumption is approx. 38,000 tons whereas refineries are producing only 10,000 tons. The 28,000 tons per day of shortfall is met through imports. That said, the monthly imports would be somewhere around 840k tons. During last fiscal year (FY09), despite huge upsurge in FO demand, average daily consumption stood at approx. 22,000 tons against inherent demand of 30-35k tons. Hence, we saw rise in electricity shortage. The major reason behind restrictive consumption was the unavailability of finances due to circular debt situation. Last year, monthly imports stood at 14000 tons last year (or approx. 420k tons per month).

**Capacity constraints**

FO is imported only at FOTCO jetty. The capacity of FOTCO is 9mn tons per annum or 750k per month. Thus, due to capacity constraints at ports, it is likely that the FO demand

will not be met on time. Moreover, the prevailing circular debt has also hampered storage levels at power plants. Against 1.1mn tons of storage capacity, power plants are currently running at stock level of 0.3mn tons, according to PSO. Thus it is important that the new power plants should have adequate storages. Other wise there is a possibility that these new power plants might not run at full capacity.

**JS view on FO demand**

We believe FO demand is expected to grow by 10% annually during next 3 years. During FY09, total FO consumption stood at 8mn tons, up 7%YoY. We believe, PSO will remain the major beneficiary since it enjoys 86% market share in this product line. We maintain our 'Buy' stance on PSO.

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**Also in focus****12 month T bill yields rise by 34bps**

In Yesterday's T-bill auction cut off yields on the 12month bill rose by 34 bps to 11.88%, while bids for the 3month paper and 6month paper were rejected by SBP. A total of Rs44bn was raised from the auction. This rise in yield was largely expected and came in after mixed signals on the upcoming monetary policy statement.

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