

Target Price: Rs245

Trading at book value

We believe expected gas flows from Tal block in the next 3-months is likely to mitigate dwindling oil price risk off-late. We expect, production additions from Tal block to contribute Rs5-5.6 per share to the earnings (18-20%) next year while the full impact would be realized in FY11. Additionally, POL is the only stock in the JS E&P universe which is trading close to book value with near term earning growth potential. Moreover, with 7% and 8% decline in oil and gas production MoM (as reported by PPIS), we have revised downward our earning estimates for POL to Rs24.8 per share for FY09 from Rs26.1 per share.

The stock is available at significant 22% discount to the market on one year forward earnings multiples. Regionally, major E&P companies are trading at an average 16.4x, on that count POL seems cheapest (see graph 2). The stock is currently trading at an implied oil price of US\$40 per barrel compared to our oil price assumption of US\$54 per barrel for FY10 and US\$77 for FY12. Our target price for the stock is Rs245 offering handsome 59% upside- we recommend 'Buy' at current levels. Risk to our thesis are 1) sharp decline in oil prices 2) delay in additional production from existing and new fields (Manzalai and Mamikhel) and 3) continuation of circular debt.

Cheap on regional valuations

Despite the fact that POL posted one of the highest returns in 2009YTD versus regional peers, it is still available at a huge discount on earnings multiple on year forward earnings (see graph 1)- thanks to near-term capacity additions and expected recovery in its hydrocarbon base. Moreover, it is also cheapest on P/BV and EV/EBITDA implying upside potential from current levels while dividend yield and ROE is also attractive. It is the only E&P stock in our JS universe with near term earnings growth. Our near term (FY10) earnings estimates are based on oil assumption of US\$54 per barrel-enough to absorb US\$5-10 per barrel downward volatility from current level of US\$60 per barrel.

However, any delay in capacity addition would be a negative trigger in the short run. We expect POL to post earnings CAGR of 17% over FY09-FY13 versus last 4-year annual earnings growth of 30%.

KATS Code: POL

Bloomberg Code: POL PA

Reuters Code: PKOL.KA

Market Price:
Rs154.52

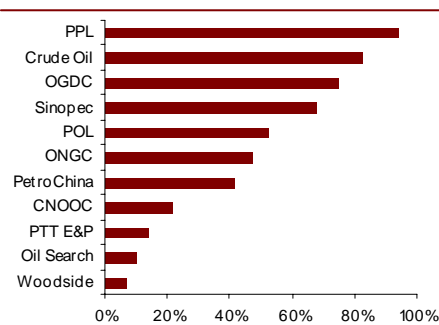
Market Cap:
Rs36.6bn
US\$442.8mn

1-yr Avg. Daily Volume:
2.7mn shares
Rs450.7mn
US\$5.5mn

1-yr High/Low:
Rs315.00/81.53

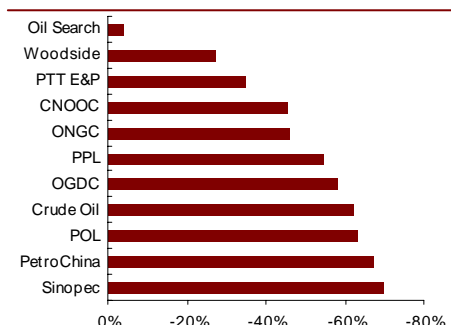
Estimated free float:
107.9mn shares (45.6%)

Graph 1(a): 2009 YTD Return



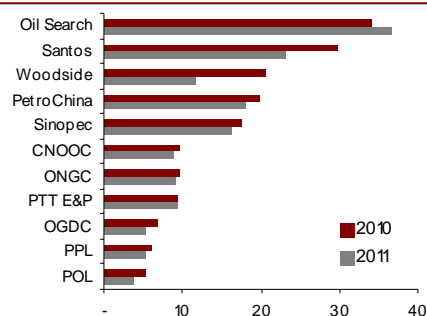
Source: Reuters, JS Research

Graph 1(b): 2008 Return

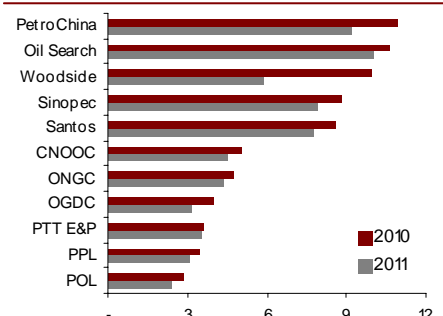


Source: Reuters, JS Research

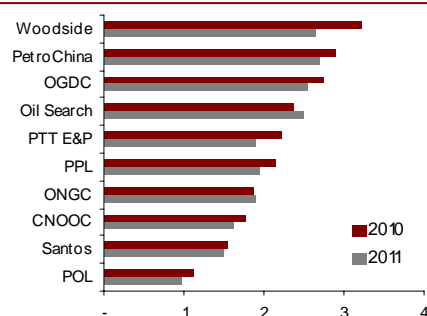
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Graph 2: PE

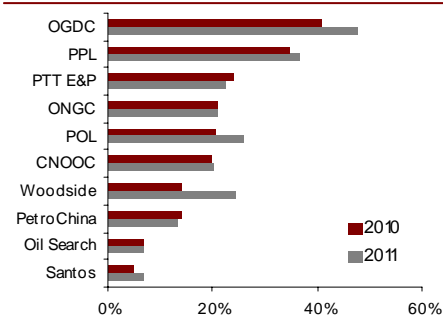
Source: Reuters, JS Research

Graph 3: EV/EBITDA

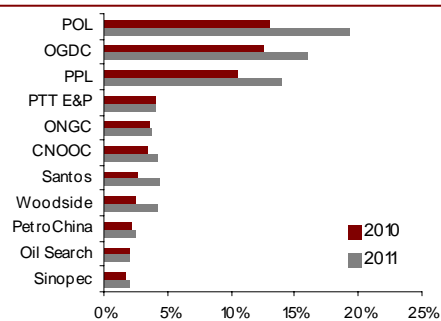
Source: Reuters, JS Research

Graph 4: P/BV

Source: Reuters, JS Research

Graph 5: ROE

Source: Reuters, JS Research

Graph 6: Dividend yield

Source: Reuters, JS Research

Tal Block addition: Earnings catalyst

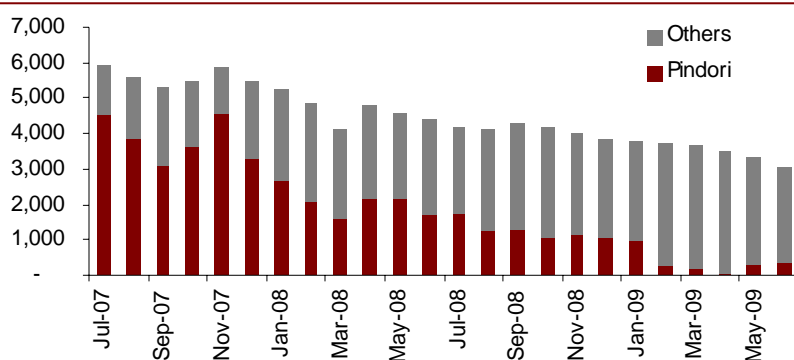
In a recent discussion with industry experts we came to know that the much awaited 200mmcf (million cubic feet per day) additional gas from Manzalai (Tal block) is expected to come online by September 2009 (we are assuming one month delay). Earlier, production was expected to commence in 4QFY09. At present, gas production from Tal block stands approximately at 52mmcf. Moreover, 45mmcf additional gas from Mamikhel is also expected in December 2009, but we have taken 25mmcf in our model. This would double gas production of the company. In our base case assumption, we have assumed average 185mmcf of gas from Manzalai during FY10 (stake adjusted: 39mmcf) while the full impact would be realized in FY11. According to our estimates, this will add up Rs5.5 per share to the bottom-line in FY10 (Rs10 per share in FY11).

With additional 200mmcf gas production from Tal Block, we believe POL's production mix will diversify, and to an extent reduce company's reliance on oil production from Pindori.

Production: Already bottomed out

During FY09, we saw overall volumes of the company post negative growth (oil: -26%, gas: -14%). According to the provisional numbers, average oil and gas production during FY09 stood at 3.8kbpd (FY08: 5.1kbpd) and 38mmcf (FY08:44mmcf). The major contributors behind this decline are Pindori and Pariwali. Average daily oil and gas production from Pindori is down 73% to 809bpd (FY08: 3.0ktons) and 72% to 2.5mmcf (FY08: 8.9mmcf), respectively while production from Pariwali also remained subdued at 1.5kbpd (down 23%YoY) and gas declined to 15.8mcf (down 18%YoY). We believe, the downside risk in volumes is minimal given the fact that production has already bottomed out. We expect overall volumes to grow by an average 31% during next 3 years.

Graph 7: POL's oil production profile (bpd)



Source: PPIS

Pindori: Forgotten but not lost

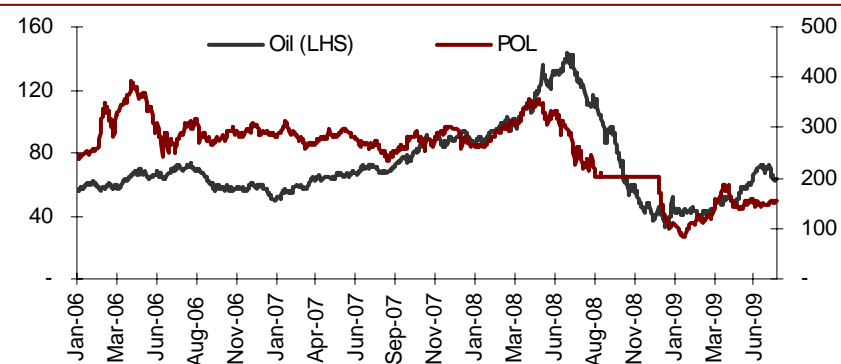
Pindori, which was the largest oil producing field for the POL, saw its production decline by an average 37% during last 5 years. Currently the field is producing approx.330bpd while average production in FY09 stood at 809bpd, down 73%YoY. Though the reserve size of the field is 32.8mn barrels, - enough for more than 50 years, the consistent decline in oil production is a result of significant drop in well head flow pressure and higher water levels. However, work over job at Pindori-3 for water shut-off is still in progress which is expected to recover additional 500bpd of oil. Going forward, we have assumed 1000bpd from Pindori.

Risks

1) Oil price: One question which normally fund managers relate to POL is 'what if oil price decline by US\$20bbl from here?! In worst scenario, assuming oil prices are at US\$40/bbl from here until next 4 years, POL would still remain attractive with average 4-year PE of 5.7 (FY10 PE would be 6.8) and average dividend yield of 12%. Even in this worst case, earnings are expected to grow by 4% CAGR during next 4 years (FY10-FY13) despite the fact that oil price in that case would be 26-48% lower than our average crude oil price assumption. The stability in earnings in worst case is only possible due to additional volumes coming from Tal block which will double its gas production. We believe POL share price is currently trading at an implied oil price of US\$40 per barrel (33% lower than current price).

In our base case scenario, we expect earnings to grow at 4-year (FY09-13) CAGR of 17%, assuming Arab light oil price at US\$54/bbl, US\$68/bbl and US\$77/bbl in FY10, FY11 & FY12, respectively. Our oil assumption is based on Reuters' oil poll. Just to get the readers aware how much the share price is sensitive to oil prices, we are presenting a historical trend of POL share price (adjusted) with international crude oil price (Arab light).

Graph 8: Arab light crude versus POL price (adjusted)



Source: Reuters

2) What if Manzalai is delayed?

There is a risk of delay in volume addition from Manzalai. To answer how much sensitive are FY10 earnings to volume additions, we ran the sensitivity analysis (see table below). In worst case, if we assume 6-months delay from our base case assumption, FY10 earnings would be Rs23.6 per share (down 15%). We have assumed 100mmcf/d addition in October 2009 while the remaining 100mmcf/d from January 2009.

Table: Impact of delay in production on FY10 earnings

	FY10 EPS (Rs)	Downward revision in earnings	Avg. gas production from Manzalai (mmcf/d)
Base case	27.6	0.0%	185
2-months delay	26.4	-4.3%	154
4-months delay	25.0	-9.4%	120
6-months delay	23.6	-14.5%	88

Source: JS Research

3) Circular debt

Power sector led circular debt is a major risk at the moment for the upstream companies. This could affect the dividend payouts going forward. However, there were rumors in the market that E&Ps are running out of cash due to non-payment of dues by gas marketing companies and refineries and hence there would be no cash payouts in 4QFY09. Even in worst case (assuming 100% of 4QFY09 sales remain unpaid), we believe POL would have been left with cash per share of Rs12-13 at the end of June 2009. We expect final cash dividend of Rs7 per share.

However, there is a risk that if this circular debt issue is prolonged, POL's cash paying ability would suffer. However, we expect the government will settle the issue within next 2 months to fulfill IMF conditionality.

Pakistan Oilfields Limited

(Rs mn)	FY07A	FY08A	FY09E	FY10F	FY11F	FY12F
Balance Sheet						
Paid up capital	1,971	1,971	2,365	2,365	2,365	2,365
Shareholders' equity	19,714	25,370	28,594	31,858	36,626	41,860
Liabilities & equity	25,360	32,868	37,154	41,131	46,958	52,695
Total assets	25,360	32,868	37,154	41,131	46,958	52,695
Income statement						
Net Sales	14,239	16,739	14,350	16,194	22,579	25,749
Operating Costs	3,311	3,351	3,378	3,659	4,969	5,661
Royalty	1,281	1,527	1,302	1,555	2,196	2,476
Expl, amort & decom Cost	1,838	2,140	2,624	2,826	3,080	3,465
EBITDA	9,296	13,252	11,052	11,959	16,367	18,383
PAT	5,943	8,616	5,863	6,528	9,535	10,467
Ratio Analysis						
Momentum						
Sales growth	-2.8%	17.6%	-14.3%	12.8%	39.4%	14.0%
EBITDA growth	-4.1%	42.6%	-16.6%	8.2%	36.9%	12.3%
Net profit growth	-3.0%	45.0%	-32.0%	11.3%	46.1%	9.8%
Profitability						
EBITDA margin	65.3%	79.2%	77.0%	73.8%	72.5%	71.4%
Net margin	41.7%	51.5%	40.9%	40.3%	42.2%	40.7%
Return on assets	23.4%	26.2%	15.8%	15.9%	20.3%	19.9%
Return on equity	30.1%	34.0%	20.5%	20.5%	26.0%	25.0%
Valuation						
Earning per share	25.1	36.4	24.8	27.6	40.3	44.3
Dividend per share	15.0	16.0	15.0	16.6	26.2	31.0
Book value per share	100.0	128.7	120.9	134.7	154.8	177.0
Price to earning ratio (x)	6.1	4.2	6.2	5.6	3.8	3.5
Dividend yield	4.5%	5.9%	9.7%	10.7%	17.0%	20.0%
Price to book value (x)	1.9	1.4	1.3	1.1	1.0	0.9
EV/EBITDA (x)	3.6	2.3	2.8	2.6	1.7	1.4

Source: Company Accounts, JS Research

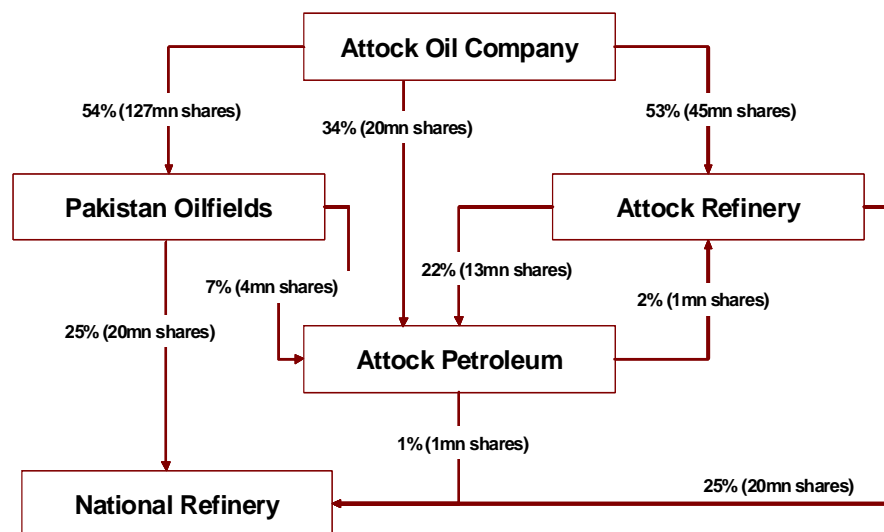
Company background

Pakistan Oil Fields (POL) is engaged in exploration, drilling and production of crude oil and gas in Pakistan. The company's top line is highly skewed towards oil (81% share) and that is the reason why unlike other gas rich E&P companies, its earnings are more sensitive to oil prices. The company has 12% share in country's overall oil reserves while it enjoys 6% market share in crude oil business. POL is a subsidiary of the Attock Oil Company Limited, UK which has investments in various sectors including oil exploration, refining & marketing and infrastructure. Other than exploration business, the bottom-line is also supported by regular dividend income from its associates including National Refinery Limited (25% stake) and Attock Petroleum Limited (7% stake).

Attock Oil Group

Attock Oil Company (AOC) is a fully diversified energy sector conglomerate, covering entire spectrum of oil & gas industry, ranging from upstream (Pakistan Oil Fields) to midstream (Attock Refinery & National Refinery) and downstream (Attock Petroleum). Apart from strong presence in the country's oil sector, the group is also engaged in manufacturing of cement under the flagship of Attock Cement. The Group is backed by Pharaon Investment Group which is internationally engaged in diversified entrepreneurial activities, such as hotels, oil exploration, refining, manufacturing of petroleum products, chemicals, cement manufacturing and real estate sector.

Chart 1: Cross holdings of Attock Group Companies



Source: JS Research

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ANALYST CERTIFICATION

I, Farhan Mahmood, the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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