August 2007

Oil & Gas
PAKISTAN

Pakistan Petroleum Limited

(Initiating Coverage)

Fair Value : PRs294/share

Recommendation : BUY

- Pakistan Petroleum Limited (PPL), the largest gas exploration company in Pakistan, has recently accelerated exploration and drilling activities. According to the company's 10year strategic plan, 100 new wells are going to be explored in the next 10years and licenses for 24 blocks have already been acquired.
- In our view, recently approved Petroleum Policy 2007 bodes well for E&P companies, particularly those having core focus on gas exploration. We believe that PPL, being the largest and oldest gas exploration company in Pakistan, would be one of the major beneficiaries of the policy.
- In 9month FY06-07, the company has reported a growth of 36.7%YoY in its bottomline. Result for the full year FY06-07 is scheduled to be announced on August 10, 2007. We expect the company to post an EPS of **PRs25.99** as against an EPS of PRs19.54 in FY05-06, translating into a growth of 33%YoY. The expected growth in the company's bottomline would be the utmost among its peers and the probability of the share price to bounce after the result announcement cannot be ruled out.
- Based on our EPS estimates for FY07-08, at existing levels, the stock trades at price earning multiple of **7.89x**, which is considerably lower than the market earnings multiple as well as 36.8% below the stock's 3year average PE multiple.
- Using DCF model, at a WACC of 16.4% and terminal growth rate of 5%, our fair value for the stock is **PRs294/share**. At existing levels, the stock offers potential upside of 13.8% from our fair value. The stock is expected to offer decent capital gain coupled with fairly reasonable dividend yield. Thus, we advise **BUY** at the prevailing levels.

KSE code	PPL
Bloomberg code	PPL PA
Reuters code	PPL KA
Market Price in PRs	258.4/share
Market Cap in PRs	177bn
Market Cap in US$	2.91bn
Outstanding Shares	685.82mn
Free Float	21.6%
Index Weight	5.4%

12 Month Price Data

High	PRs275.75/share
Low	PRs220.25/share
Average	PRs251.84/share

12 Month Volume Data

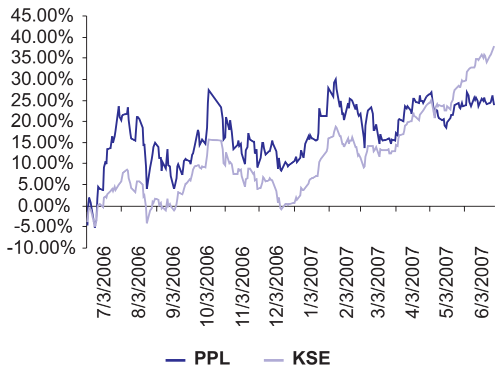
Max	40.69mn shares
Min	0.755mn shares
Average	8.05mn shares

Table 1: Valuation Statistics @ PRs258.4

	FY05A	FY06A	FY07E	FY08F	FY09F	FY10F
EPS (PRs)	12.38	19.54	25.99	32.75	35.87	36.68
P/E (x)	20.88	13.22	9.94	7.89	7.20	7.04
BVS (PRs)	18.24	44.02	58.50	77.25	98.12	119.81
P/BVS(x)	8.34	5.87	4.42	3.34	2.63	2.16
DPS (PRs)	2.50	9.00	11.50	14.00	15.00	16.75
Dividend Yield	0.97%	3.48%	4.45%	5.42%	5.80%	6.48%
Operating Profit Margin	58.7%	62.5%	66.0%	69.8%	70.0%	69.5%
Pre-tax Profit Margin	57.4%	63.6%	67.8%	70.0%	70.1%	69.9%
Net Profit Margin	36.4%	42.2%	44.1%	45.5%	45.6%	45.4%
Return on Equity	47.8%	52.1%	50.7&	48.2%	40.9%	33.7%
Return on Assets	29.8%	36.8%	38.8%	38.5%	33.3%	27.9%
Return on Capital Employed	34.5%	40.9%	41.4%	39.6%	34.1%	28.6%
EV/EBITDA (x)	12.04	7.70	5.71	4.42	3.78	3.41

Source: IGI Research

Chart 1: PPL-Relative Performance in FY06-07



Source: Bloomberg & IGI Research

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All prices are as of August 07, 2007

Focus on E&P Sector

Petroleum Policy 2007

Some amendments in gas pricing formula are pivotal feature of the Policy

The most recent development in the sector is the approval of much awaited Petroleum Policy 2007 by the ECC (Economic Coordination Committee). Some key amendments in gas pricing formula are the pivotal features of the Policy. According to the Petroleum Policy 2007, the country has been divided into four different zones and three separate gas pricing formulae are applicable on these zones. As per the policy, a Reference Crude Price (RCP) equal to the C&F price of a basket of Arabian/Persian Gulf Crude oil imported in Pakistan during the first six months of the seven months period immediately preceding the relevant price notification period will be used.

Gas Price Gradient (GPG) would be applicable when RCP goes above US$45/bbl

The key amendment in the gas pricing formula is the upward revision of cap on Reference Crude Price from US$36/bbl to US$45/bbl. Moreover, Gas Price Gradient (GPG) would be applicable when RCP goes above US$45/bbl. In our view, the probability of RCP to trade below US$45/bbl is almost unlikely atleast in the short to medium term and we believe that concept of GPG bodes extremely well for E&P companies. According to the concept of GPG, if RCP is above US$45/bbl, E&P companies would get additional benefit. GPG would be decided at the time of bidding for a particular field and would vary in the range of 0.20x-1.00x.

How GPG will work?

According to the Petroleum Policy 2007, gas pricing formula applicable on different zones shall be calculated using three linear formulae. In the following paragraphs we discussed how GPG will work on Zone III.

Reference Crude Price (RCP) is between US$10/bbl-US$20/bbl

- When RCP is equal to US$10/bbl (RC10) then gas price in this zone would be equal to US$1.50/MMBTU, which would also serve as Gas Price Floor (GPF).
- When RCP is equal to US$20/bbl (RC20) then gas price in the zone will be equal to US$2.50/MMBTU (GP20).
- When RCP is greater than US$10/bbl and less than US$20/bbl; then gas prices in Zone III will be equal to
  GPF + (RCP – RC10) x [(GP20 – GPF) / (RC20 – RC10)].

For example when RCP = US$15/bbl
Gas Price = 1.50 + (15 – 10) x [(2.50 – 1.50) / (20 – 10)];
Gas Price = 2.00US$/MMBTU

Reference Crude Price (RCP) is between US$20/bbl-US$45/bbl

- When RCP is equal to US$45/bbl (RC45) then gas price in this zone would be equal to US$ 3.00/MMBTU which would also serve as Gas Price Ceiling (GPC)
- When RCP is greater than US$20/bbl and less than US$45/bbl, then gas price in Zone III is equal to GP20 + (RCP – RC20) x [(GPC – GP20) / (RC45 – RC20)].

For example when RCP = USD 30/bbl
Gas Price = 2.50 + (30 – 20) x [(3.00 – 2.50) / (45 – 20)];
Gas Price = 2.70 US$/MMBTU

Reference Crude Price (RCP) greater than US$ 45/bbl

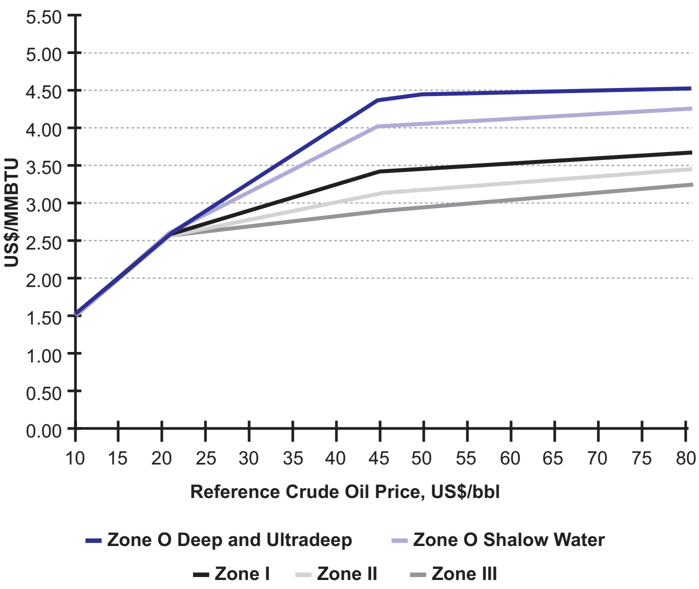
- When RCP is greater than US$45/bbl then gas prices in this Zone is equal to
  GPC + (RCP – RC45) x GPG x [(GPC – GP20) / (RC45 – RC20)]

Where GPG (gas price gradient) has a minimum value of 0.2 or as may be bid in the bidding stage for the petroleum exploration license, up to a maximum value of 1.0.

For example when RCP = USD 60/bbl and GPG = 0.20
Gas Price = 3.00 + (60 – 45) x 0.20 x [(3.00 – 2.50) / (45 – 20)]
Gas Price = US$3.06/MMBTU

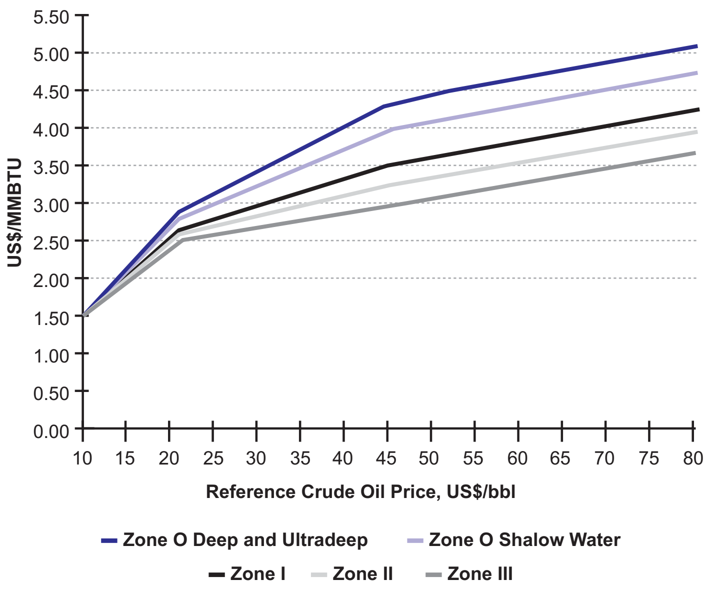
For example when RCP = US$60/bbl and GPG = 1.0
Gas Price = 3.00 + (60-45) x 1.0 [(3.00 – 2.50) / (45 – 20)]
Gas Price = US$3.30/MMBTU.

Chart 2a: Gas Price at maximum GPG (0.2)



Source: Petroleum Policy 2007

Chart 2b: Gas Price at maximum GPG (1.0)



Source: Petroleum Policy 2007

It is imperative to note that the Petroleum Policy 2007 would be applied on fields that would be discovered after the implementation of Petroleum Policy 2007. Thus, in our view, the upcoming Petroleum Policy would bode well for Oil and Gas Exploration & Production companies that have undertaken massive drilling and exploration activities such as OGDC and PPL.

Financial Highlights

The topline of listed E&P companies grew at a 5year CAGR of 24.81%

During the past five years, the cumulative profitability of the listed E&P companies have witnessed phenomenal growth. The topline of these companies grew at a 5year CAGR of 24.81% mainly on the back of significant growth in the volumetric sales and significant surge in crude oil prices. Moreover, during this period, the bottomline increased at a 5year CAGR of 28.42%. Besides the robust growth in the topline, another major contributing factor to the bottomline is massive jump in other income. The hike in interest rates, as a result of SBP tightening monetary policy, has substantially contributed to the profitability of the sector.

PPL reported a jump of 36.7%YoY in its bottomline, which is the highest in the sector

According to the 9month FY06-07 results unveiled by the listed E&P companies, net sales of the sector surged to PRs 117.3bn from PRs 105.9bn in the corresponding period last year, translating into an increase of 10.8%YoY. Among the three largest E&P companies (OGDC, PPL and POL) listed on KSE, PPL reported growth of almost 22% in its topline, which is the utmost among its peer. Other income of the sector reported an increase of 17.32%YoY, as it climbed to PRs 5.7bn from PRs 4.85bn in the comparable period last year. PPL reported an increase of 80% in its other income, which is the highest in the sector. Overall, the bottomline of the sector jumped to PRs 53.2bn from PRs 47.4bn during the same period last year, a jump of 12.31%YoY. Bottomline of PPL reported a jump of 36.7%YoY, which is again the highest in the sector.

Table 2: 9month Financial Snapshots of three largest listed E&P

	July-March FY06-07			July-March FY05-06		
	OGDC	PPL	POL	OGDC	PPL	POL
Sales	75	28	11.86	69.9	23	11
Operating Profit	48.62	18.2	6	48.6	14.4	5.96
Other income	2.88	1.8	0.69	3.1	1	0.52
Profit Before Taxes	47.9	19	6.7	48.4	14.7	5.85
Profit After Taxes	34.6	13.1	5.03	33.2	9.6	4.4
Earning Per Share	8.05	19.11	25.54	7.72	13.98	22.3
Operating Profit Margin	64.8%	65.0%	50.6%	69.5%	62.6%	54.2%
Net Profit Margin	46.1%	46.8%	42.4%	47.5%	41.7%	40.0%
Effective Tax Rate	27.8%	31.1%	24.9%	31.4%	34.7%	24.8%

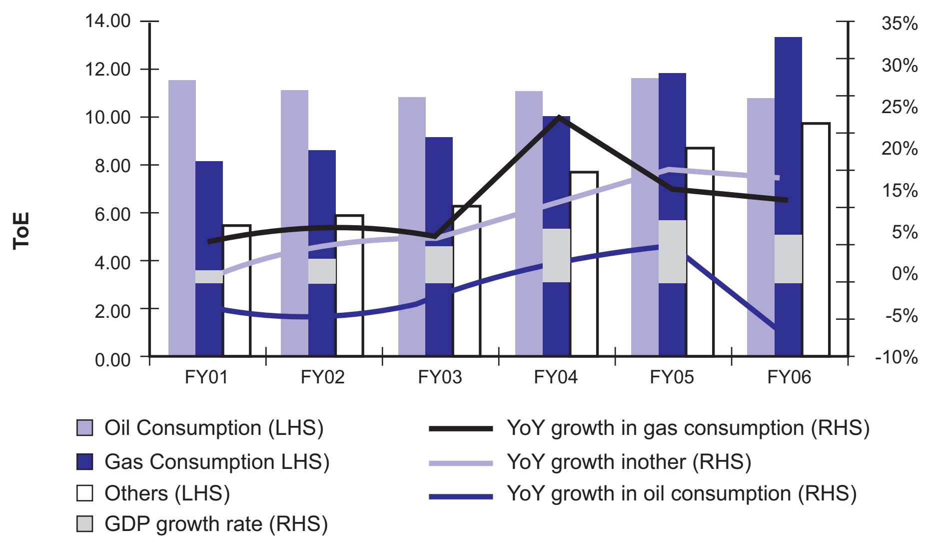
Source: Company Reports & IGI Research

Demand-Supply Scenario

Pakistan's energy consumption has grown at a CAGR of 5.4%

- During the past five years, Pakistan's energy consumption has grown at a CAGR of 5.4% (almost inline with the average GDP growth rate), which surged to 57.85mn TOE (tones of oil equivalent) in FY05-06. During FY01-06 demand for gas, coal, electricity and LPG grew at CAGR of 10.4%, 22.8%, 6.8%, and 17.6% respectively, however, oil consumption plunged 1.3%. According to the British Petroleum Statistical Review of World Energy 2006, the growth recorded in Pakistan's gas consumption during the past five years is the third highest in the Asian Pacific region, after Singapore and China.

Chart 3: Consumption Pattern of Energy Product Relative to GDP growth during FY01-06



Source: Energy Year book 2006 & IGI Research

Pakistan's overall energy requirement is expected to surge to 80mn TOE by FY10, increasing at a CAGR of 8.4%

- According to the government estimates, the country's overall energy requirement is expected to surge to 80mn TOE by FY10, increasing at a CAGR of 8.4%. In past years, gas consumption increased at a faster pace than the cumulative energy demand. Even if gas consumption would rise inline with overall energy demand, going forward, then the cumulative demand for the domestically produced gas would surge to 40.3mn TOE in FY009-10.

Pakistan has 32.58tcf natural gas and 324.5mn barrel of balance recoverable oil reserves

- As per the Energy Year Book 2006, Pakistan has 32.58tcf (612.4mn TOE) natural gas balance recoverable reserves and 0.53tcf (15.3mn TOE) associated gas balance recoverable reserves, which would be sufficient for almost 18years to satisfy the country's cumulative gas requirements, provided demand remains intact at present level. Moreover, the country has 324.5mn barrel (43.53mn tones) of balance recoverable oil reserves, which would be sufficient to satisfy total domestic oil requirements for merely another 4 years.

The probability of energy crisis in years ahead cannot be ruled out

- At present, Pakistan satisfies only 20% of its oil demand through domestic production. Moreover, the demand for gas is growing rapidly and in the near future, the country is likely to become a net gas importer. In such circumstances, the probability of energy crisis in years ahead cannot be ruled out. Nevertheless, the government is exploring all possible avenues to avoid any energy crisis and India-Pakistan-Iran (IPI) gas pipeline is one alternative in this regard. Moreover, the rational behind offering some major benefits to E&P companies in Petroleum Policy 2007 is to entice greater investment towards this largely untapped sector.

some E&P companies have already undertaken massive exploration activities

- On the back of favorable economic outlook, anticipated robust growth in demand for energy products and most importantly outstanding success ratio of new discoveries in the country (which currently stands at 1:4 as against the global success ratio of 1:10) some E&P companies have already undertaken massive oil and gas drilling & exploration activities.

E&P sector is one of the least vulnerable sectors to unanticipated economic fluctuations

- Aforementioned facts glaringly signify that even if things on the economic track derail going forward, the country's dependence on the domestically produced oil and gas would surely remain intact. Considering this fact, E&P sector is one of the least vulnerable sectors to unanticipated economic fluctuations and provides perfect hedge against any economic uncertainty.

The sector holds 22.5% weightage in KSE-100 index

- Presently the sector (which consists of only four listed companies) has cumulative market capitalization of PRs765bn. The sector holds 22.5% weightage in KSE-100 index. In the recent rally at domestic bourses, the sector has underperformed the KSE-100 index and is trading at very attractive valuations.

We hold positive stance on the sector

- Considering aforementioned facts, we hold **positive stance** on the sector. In our view, prudent fund managers should give relatively more weightage to this sector.

Company Overview

The company commenced its journey in 1952 with an unprecedented gas discovery at Sui gas field

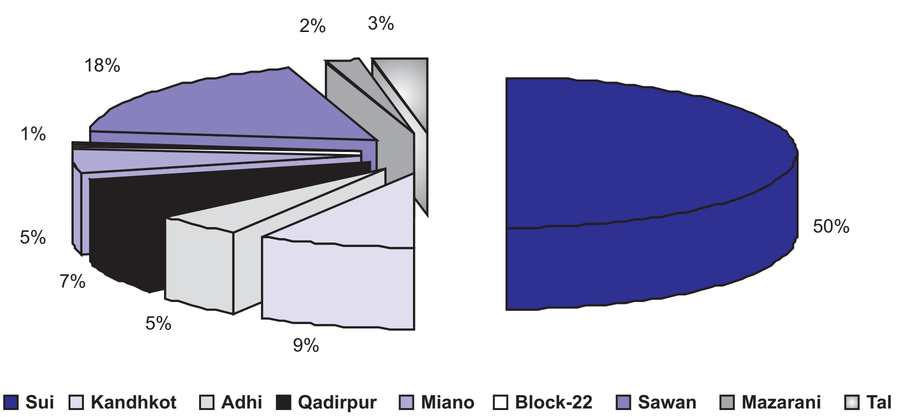
Pakistan Petroleum Limited (PPL) is the largest gas exploration company in Pakistan. The company commenced its journey in 1952 with an unprecedented gas discovery at Sui gas field. The discovery at Sui is still the largest gas discovery ever made in the country's history. Since 1952, a number of successful gas discoveries were made in the country but none of those can be compared to that of Sui gas field. In FY05-06, the company's average daily oil and gas production stood at 1,790bpd and 1,020mmcfd respectively. According to the Energy Year Book 2006, PPL has balance recoverable oil and gas reserves of 37.63mn barrels and 5.37tcf (these does not include company's share in non-operating fields), which are equivalent to 11.6% and 16.5% of the country's gas and oil balance recoverable reserves respectively. During FY06-07, in collaboration with joint ventures, three new wells were discovered by the company. Recently, PPL in collaboration with OMV, an Austrian oil & gas exploration company, has entered in Yemen to explore untapped potential reserves in offshore. According to the company's 10year strategic plans, 100 new wells (including offshore wells) would be explored and licenses for 24 blocks have already been acquired by the company.

■ Key Fields Analysis

In FY05-06, more than 50% of the company's revenue was contributed by the Sui gas field

Sui, Kandkot, Mazarani and Adhi, are the company's major operating fields. The latter three fields are key gas field while the former namely Adhi is a major oil field. In Sui and Kandkot the company has 100% ownership while in Mazarani and Adhi the company has 87.5% and 39% stakes respectively. In FY05-06, more than 50% of the company's revenue was contributed by Sui gas field. According to the Energy Year Book 2006, the field has original gas reserves of 12.625tcf and balance recoverable gas reserves of 3.735tcf which are equivalent to 62.5% and 11.5% of the country's original and balance recoverable gas reserves respectively. Presently, gas production from this field hovers around 640mmcfd. Kandkhot is another major operating gas field of PPL. Gas from this field is mainly supplied to WAPDA's Guddu Thermal Power Station. The field has balance recoverable gas reserves of around 1.07tcf. During past five years, gas production from the field has increased at a CAGR of 5.7%. Mazarani is another major operating gas field, which commenced production in June 2003. This is a developing field and production from this field could increase heavily, going forward.

Chart 4: Field Wise Contribution to Revenues in FY05-06

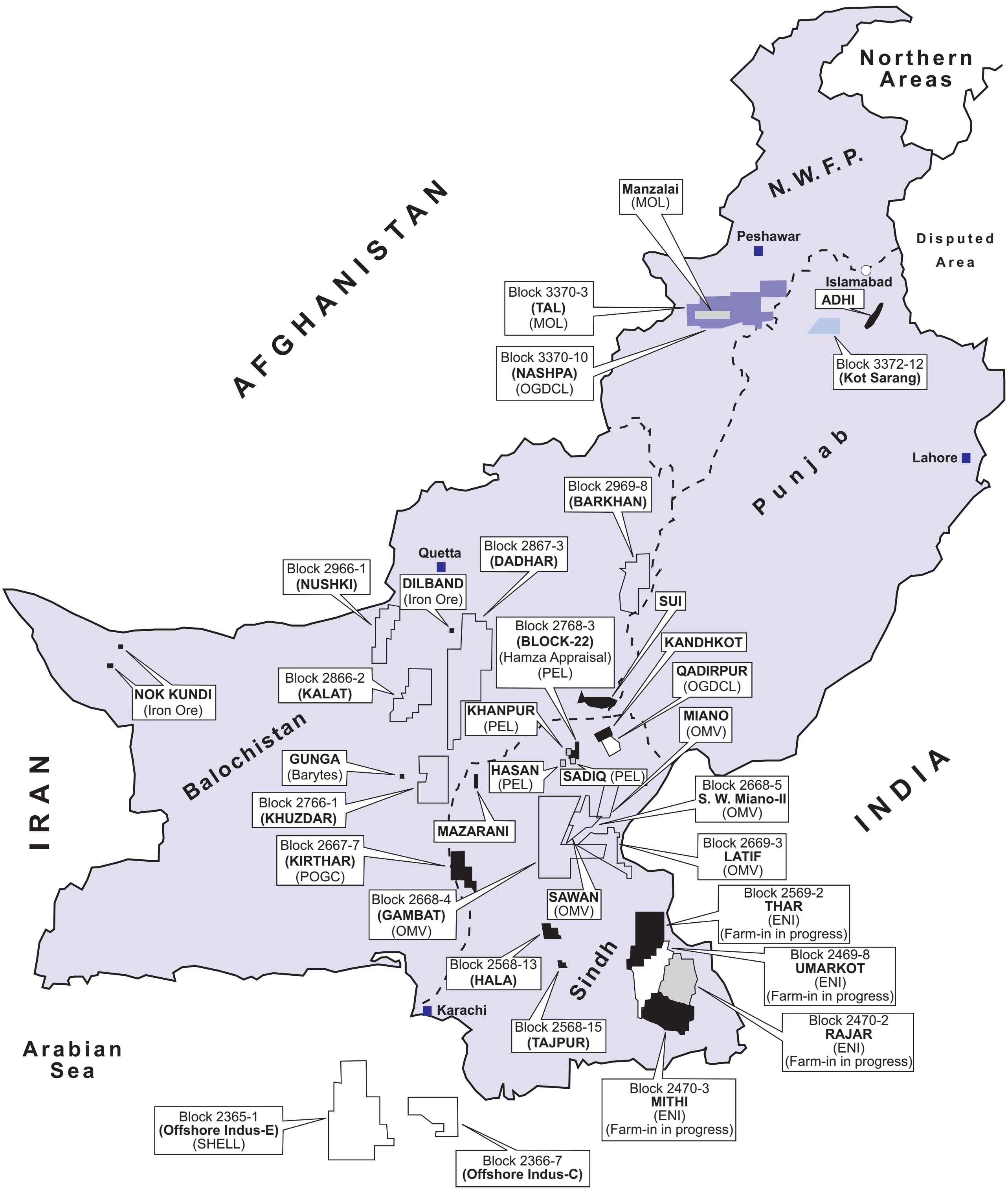


Source: Company Report & IGI Research

Earlier this year, production of gas, condensate and LPG from Adhi field has doubled

Adhi is considered to be the company's flagship oil field, which is the largest oilfield in Pakistan in terms of balance recoverable gas reserves and second largest field in terms of production. Earlier this year, production of gas, condensate and LPG from this field has been doubled. After this production enhancement, oil and condensate production from the field hovers around 4800bpd while gas and LPG production fluctuate around 40mmcfd and 135tones per day respectively. Besides, aforementioned operating oil fields, the company in collaboration with joint venture partners owns substantial holdings in some other fields. Sawan, Miano, Block-22 and Qadirpur are some major non-operating gas fields of the company. Moreover, the company has 27.763% stake in Tal Block, which is operated by MOL, a Hungarian Oil & Gas exploration company. The block has massive potential gas reserves and going forward gas production from this block is expected to contribute heavily to the company's topline.

Chart 5: Location of Pakistan Petroleum Limited's Operation



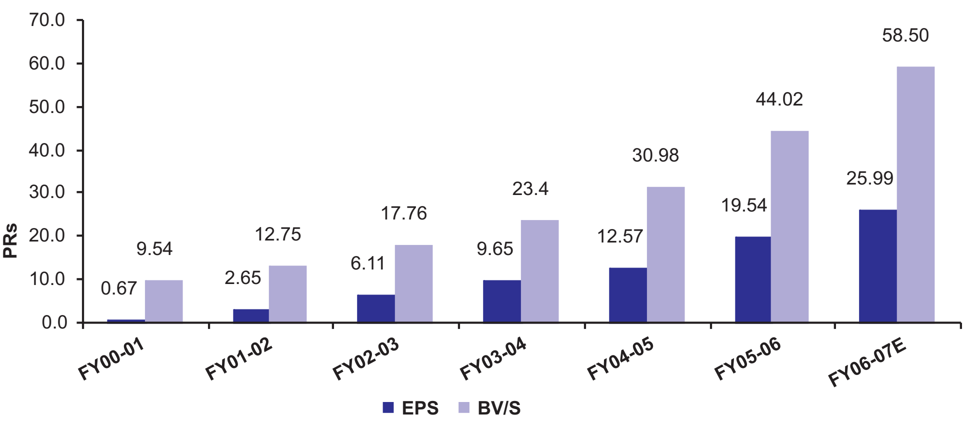
Source: Company Report & IGI Research

During the past five years, the topline of the company grew at a CAGR of 30.52%

Performance Flashback

Since FY01-02, the company has demonstrated significant improvements in its financial and operating performance. During the past five years, the topline of the company grew at a CAGR of 30.52%, which surged to PRs 43.6bn (in FY05-06) from PRs 11.5bn (in FY01-02). Moreover, during the period under review, the bottomline of the company climbed to PRs 13.4bn (PRs 19.54) from merely PRs 459mn (PRs 0.67), increasing at a CAGR of 96.37%. The Break up value of the company jumped to PRs 53.12 (9month FY06-07) from PRs 9.54 (in FY01-02) increasing at a CAGR of 15.77%.

Chart 6: Equity and Earnings Growth Trend

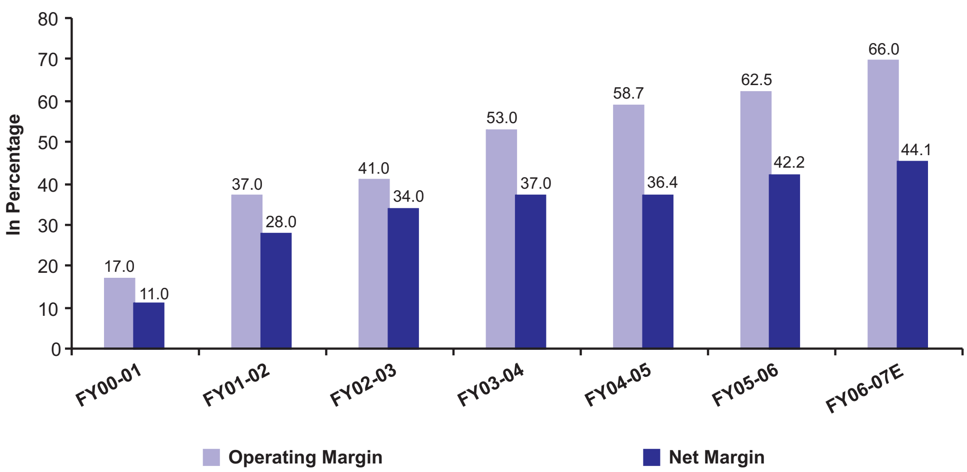


Sources: Annual Report 2006 & IGI Research

Operating profit margin improved from 17% to 65%

Profitability margins of the company also witnessed tremendous improvement over the years. Operating profit margin improved from 17% to 65% while pre-tax profit margin presently stands at 68% which was 28% in FY01-02. Besides improving operating performance, robust growth in other income, primarily on the back of rising interest rate scenario prevailing in the economy, was another key reason which boded well for the bottomline of the company.

Chart 7: Operating Performance at a glance



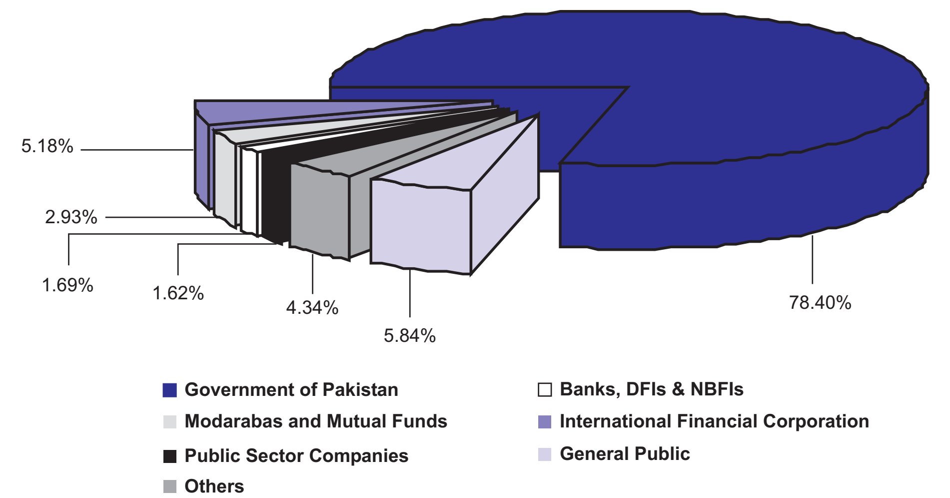
Sources: Annual Report 2006 & IGI Research

Privatization of this state owned entity is one of the top priorities of the Privatization Commission

Shareholding Pattern

Presently, the Government of Pakistan (GoP) is the largest shareholder in the company with 78.4% holding. Privatization of this state owned entity is one of the top priorities of the Privatization Commission (PC). In our view, this gas exploration giant is likely to be privatized in FY07-08, nonetheless, the outcome of the upcoming Federal Election could derail the privatization process, which may further delay the privatization process.

Chart 8: Shareholding Pattern in PPL as on June 30, 2006



Sources: Annual Report 2006 & IGI Research

Valuation and Recommendation

The company has the highest operating margin among its regional oil and gas exploration companies

Comparative Valuation

In the following table it can be seen glaringly that at existing levels, PPL appears to be one of the most attractive stocks among domestic as well as regional counterparts. The company has the highest operating margin among its regional oil and gas exploration companies. Moreover, the stock offers one of the highest return on equity (RoE) as well as return on assets (RoA) among its domestic and regional peers and appears to be one of the most inexpensive picks on the basis of EV/EBITDA. Nevertheless, the stock trades at a P/BV of 4.53times, which makes it comparatively somewhat expensive, but in our view, this key ratio should not be considered in isolation. Because of one of the highest RoE and RoA, it simply makes senses that prudent investors are willing to pay more for such an attractive play.

Table 3: PPL V/S Rest of Key Regional E&P Companies

Country	Name	PE Ratio (x)	Price/BV (X)	Dividend Yield (%)	EV/ Est EBITDA (x)	ROE (%)	ROA (%)	OPM (%)
Pakistan	**PAKISTAN PETROLEUM LTD**	**9.94**	**4.42**	**4.45**	**4.42**	**50.7**	**38.8**	**65.75**
	OIL & GAS DEVELOPMENT CO LTD	11.43	5.16	5.85	7.623	47.77	36.25	63.13
	PAKISTAN OILFIELDS LIMITED	9.32	4.13	4.48	4.544	51.65	34.25	55.95
INDIA	OIL & NATURAL GAS CORP LTD	10.65	3.34	3.44	4.871	29.22	17.91	32.9
HONG KONG	CNOOC LTD	12.18	3.58	3.51	6.464	34.1	22.91	48.69
	CNPC HONG KONG LIMITED	12.95	1.6	2.33	7.025	13.01	8.25	47.59
CHINA	CHINA PETROLEUM & CHEMICAL-H	12.51	2.56	2.08	6.006	22.13	9.29	8.18
	OUHUA ENERGY HOLDINGS LTD	2.92	2.71	2.86	4.354	29.61	9.68	3.77
	PETROCHINA CO LTD-H	13.58	3.27	3.23	7.414	25.81	17.24	28.96
INDONESIA	ENERGI MEGA PERSADA TBK PT	61.56	7.07	N/A	7.053	16.07	2.5	14.47
	MEDCO ENERGI INTERNASIONAL	35.68	2.53	N/A	4.109	7.14	2.26	22.72
JAPAN	SHOWA SHELL SEKIYU KK	12.85	1.87	2.63	7.42	15.37	3.97	2.43
	COSMO OIL COMPANY LTD	315	1.66	1.62	7.279	0.53	0.1	0.29
	NIPPON MINING HOLDINGS INC	51.39	2.97	1.57	6.097	4.73	3.26	56.12
	NIPPON OIL CORP	57.62	1.95	1.26	6.837	3.43	0.83	0.25
MALAYSIA	PETRONAS DAGANGAN BHD	13.02	2.39	N/A	4.862	19.66	10.09	4.6
PHILIPPINES	PETROENERGY RESOURCES CORP	71.86	1.9	8.55	N/A	3.92	3.74	15.51
	PETRON CORP	8.66	1.6	N/A	4.896	20.16	7.58	4.73
SINGAPORE	SINGAPORE PETROLEUM CO LTD	8.52	1.88	N/A	5.078	18.99	9.33	4.5
SOUTH KOREA	S-OIL CORPORATION	8.48	2.64	7.48	3.719	30.24	11.56	6.49
TAIWAN	FORMOSA PETROCHEMICAL CORP	17.96	3.71	N.A.	9.788	20.79	10.52	10.13
	PEICHI OIL CO LTD	17.25	1.25	1.83	N.A.	2.7	1.3	1.02
THAILAND	PTT PCL	8.99	2.73	N.A.	5.144	36.73	13.6	9.47
	RAYONG REFINERY PCL	9.72	1.51	N.A.	5.139	21.96	11.57	3.89
	PTT PCL/FOREIGN	9.94	3.02	N.A.	6.373	36.73	13.6	9.47
	PTT EXPLOR & PROD PUBLIC CO	15.03	4.48	N.A.	4.238	35.01	18.63	54.15
Average		**32.59**	**3.03**	**3.36**	**7.42**	**22.60**	**12.17**	**22.73**

Sources: Bloomberg & IGI Research

The stock offers potential upside of 13.8% coupled with the dividend yield of 5%

Valuation Snapshot : Buy @ 258.40

Using DCF model, at the WACC of 16.4% and terminal growth rate of 5%, our fair value for the scrip is PRs294 per share. At present level, the stock offers potential upside of 13.8% from our fair value and expected dividend yield of 5%. Therefore, we advice investors to **BUY** the scrip at existing levels.

Table 4: Free Cash Flow Highlights

	FY07F	FY08	FY09	FY10
EBIT	28,932	36,791	40,343	41,301
Adjustments				
Less: Taxes	9,596	12,094	13,247	13,546
Add: Depreciation	1,403	1,694	1,958	2,148
Cash from Operations	20,739	26,392	29,054	29,902
Capex	(6,972)	(8,792)	(7,586)	(7,333)
WC changes	(3,107)	(4,472)	(1,067)	(327)
FCF to firm	10,660	13,127	20,401	22,241

Sources: IGI Research

Table 5: DCF Valuation

Terminal Cash Flow	204,224
Present Value of Future Cashflows	$51,072
Present Value of Terminal Cashflows	$129,377
PV of Total Cashflow	$180,449
Beta	1.17
Risk free rate	10.00%
Market risk premium	5.50%
Market Return	15.50%
Cost of equity	16.44%
Expected Lending Rate (6months KIBOR+150bps)	12.00%
Tax Rate	35.00%
Cost of debt	7.80%
Average Equity FY07-10	60,641
Average Debt FY07-10	0.00
WACC	16.44%
Growth Rate	5.00%
PV of Total Cashflows	180,449
Less: Net Debt	(21,058)
Total Company's Worth	201,507
# of shares outstanding	685.82
Fair Value	**294**

Sources: IGI Research

Table 6: Sensitivity Analysis: Fair Value per Share (PRs/Share)

	Weighted Average Cost of Capital (WACC)				
Terminal Growth Rate	14.0%	15.0%	16.4%	17.0%	18.0%
2%	294	274	250	242	229
3%	313	290	263	254	239
4%	335	308	277	267	250
5%	363	331	**294**	282	263
6%	398	358	314	300	278
7%	442	392	338	321	296
8%	502	436	368	348	317

Sources: IGI Research

Result Review 9month FY06-07

For the nine month ended FY06-07, the company has posted an EPS of PRs 19.11 as against PRs 13.98 reported in the corresponding period last year, depicting an increase of 36.7%YoY. Key highlights of the result are discussed briefly in the following paragraphs.

- Volumetric sales of Crude Oil / Condensate and Liquefied Petroleum Gas (LPG) have increased by 41%YoY and 36%YoY, nevertheless, volumetric sales of natural gas have witnessed marginal decline of 2.22%YoY.

Table 7: Volumetric Sales

	Unit	July-March FY06-07	July-March FY06-07	%Chg YoY
Natural Gas	MMcf	244,413	249,955	-2.22%
Crude Oil / Condensate / NGL	Barrels	689,902	489,444	40.96%
Liquefied Petroleum Gas (LPG)	Tones	9,963	7,337	35.79%

Sources: Company Report and IGI Research

- The topline of the company surged to PRs 28bn from PRs 23bn reported in the comparable period last year, translating into an increase of 21%YoY. Natural gas contributed almost 92% to the company's revenues. Sales of natural gas increased 19%YoY. Sales of Condensate/NGL increased by 92%YoY while its contribution to the company's revenue stood at 5.21%. Moreover, LPG sales reported robust growth of 119%YoY, which surged to PRs 273mn from PRs 125mn in the comparable period last year.

Table 8: Sales Highlights (PRs mn)

	July-March FY06-07	July-March FY06-07	%Chg YoY	%Contribution to topline
Natural Gas	25,643	21605	18.69%	91.48%
Gas supplied to Sui	61	51	20.20%	0.22%
Gas internal consumption	79	65	21.73%	0.28%
Condensate/NGL	1,460	760	92.13%	5.21%
Crude Oil	517	561	-7.78%	1.84%
LPG	273	125	118.93%	0.97%
Total Sales	**28,033**	**23,165**	**21.01%**	**100.00%**

Sources: Company Report and IGI Research

- Despite the decline in volumetric sales of natural gas, revenue from the sales of natural has increased on year-on-year basis. The key reason behind this is the upward revision in the wellhead gas prices of the company's flagship gas fields namely Sui and Kandkot.

- Operating profit for the period under review stood at PRs 18.3bn from PRs 14.4bn posted in the comparable period last year, a jump of 26.5%YoY. Operating profit margins improved from 62% to 65%. Net profit margin also improved from 41.4% to 46.7%.

- Besides significant growth in the topline, another key factor contributing to the company's bottomline is a massive jump in other operating income. Increased cash & bank balance coupled with rise in interest rates was major reason behind the surge in other operating income. During the period under review, other operating income increased 75%YoY to PRs 1.8bn.

- Profit before taxation climbed to PRs 19bn up from PRs 14.7bn reported in the corresponding period last year, a jump of almost 30%YoY.

- Besides growth in topline and increase in other operating income, another factor positively affecting the bottomline was the decline in effective tax rate that reduced to 31.3% from 34.7% last year.

- Profit after taxation climbed to PRs13.1bn (EPS: PRs19.11) from PRs 9.6bn (EPS: PRs13.98) posted in the comparable period last year, an increase of 36.7%YoY.

Table 9: P&L Highlights **(PRs mn)**

	Jul-Mar FY06-07	Jul-Mar FY05-06	YoY Change
Sales-net	28,034	23,165	21.0%
Field expenditure	6,416	5991.5	7.1%
Royalties	3,333	2722	22.4%
Operating profit	18,285	14,452	26.5%
Share of profit in BME	46.5	12	287.5%
Other operating income	1793	1022	75.4%
Financial charges	38.5	22	75.0%
Other operating expenses	1001.9	772.6	29.7%
Profit before taxation	19,084	14,691	29.9%
Taxation	5978.8	5102.3	17.2%
Profit after taxation	13,105	9,589	36.7%
EPS-diluted (PRs)	19.11	13.98	36.7%
Operating profit margin (%)	65.22%	62.39%	
Net profit margin (%)	46.75%	41.39%	
Effective tax rate (%)	31.33%	34.73%	

Sources: Company Report and IGI Research

Earnings Expectations FY06-07

According to our forecast, for the entire FY06-07, the company is expected to post PAT of PRs 17.8bn **(EPS: PRs25.99)** as against PRs13.4bn (EPS: PRs19.54) in FY05-06, translating into a growth of 33%YoY. We expect the company to pay cash dividend in the range of 65-70% (DPS: PRs 6.50-7.00) in addition to already paid interim dividend of 45%, taking the total cash dividend for the year to 110-11.5% (DPS: PRs11.00-11.50).

The topline is expected to surge to PRs40.44bn as against PRs31.76bn reported in the corresponding period last year, an increase of 27.35%YoY. Key reason behind the topline growth is the upward revision in the well head gas prices of Sui and Khankot. Besides topline growth, massive jump in other income is expected to have a considerably favorable impact on the bottomline. As per our estimates, the cumulative other income for the period under review is expected to be PRs2.25bn as against PRs1.51bn last year, up 49%YoY.

Table 10: P&L Highlights (PRs mn)

	FY06-07E	FY05-06A	%Chg YoY
Net Sales	40,441	31,757	27.35%
Fields Expenditures	9,111	8,171	11.50%
Royalties	4,651	3,745	24.18%
	13,761	11,916	15.49%
Operating Profit	26,680	19,841	34.47%
Other Income	2,252	1,509	49.22%
Other Expenses	1,389	1,127	23.25%
Financial Charges	125	30	316.06%
Profit before tax	27,418	20,193	35.78%
Taxation	9,596	6,790	41.33%
Profit after tax	17,822	13,403	32.97%
Operating profit margin	66.0%	62.5%	5.59%
Net profit margin	44.1%	42.2%	4.41%
Effective tax rate	35.00%	33.63%	4.09%
Earnings per share	25.99	19.54	32.97%
Dividend per share	11.00	9.00	22.22%

Sources: Company Report and IGI Research

Key Assumptions

Volumetric growth in production, wellhead gas prices and terminal growth rate are few key assumptions that have significant impact on the company's bottomline and consequently on the fair value. These assumptions are briefly discussed in the following paragraphs.

Oil and LPG production is likely to increase at a CAGR of almost 20% and 25% respectively

■ Volumetric Growth

As per our estimates, production of gas is expected to increase at a CAGR of merely 2% while oil (including condensate) and LPG production is likely to increase at a CAGR of almost 20% and 25% respectively. The key reason behind the significant increase in oil (including condensate) and LPG production is the fact that earlier this year, production of condensate, gas and LPG have doubled from Adhi field and the full year impact of this massive achievement would be seen in FY07-08 and going forward. Nevertheless, the major reason behind nominal increase in gas production, despite the aforementioned fact, is the expected decline in production of gas from Sui and Kandkot.

Table 11: Actual and Expected PPL's share of oil , gas and LPG production

	FY04-05A	FY05-06A	FY06-07E	FY07-08F	FY08-09F	FY09-10F
Gas (mmcf)	349,580	371,714	344,413	379,485	393,892	396,725
Oil and NGL (bbls)	602,000	653,000	929,902	1,153,331	1,229,475	1,337,623
LPG (tones)	9,088	9,478	14,563	20,426	21,447	22,520

Sources: Company Report and IGI Research

Wellhead gas prices are expected to fluctuate in a band of 1-3% semi annually

■ Wellhead Gas Prices

Gradual phasing out of discount on Sui and Kandkot has been over in Jan CY07 and no more massive upward revision would be made going forward. As per the recently notified prices effective for 2HCY07 by OGRA (Oil & Gas Regulatory Authority), wellhead gas prices of Sui and Knadkot have been reduced by 3.84%, nonetheless, on year-on-year basis prices of these fields have increased by 7.18%. As per our estimates, wellhead gas prices of company's operating as well as non operating fields would move almost in line with movement in semi-annual average Arabian Crude Oil prices. According to our assumption, wellhead gas prices would fluctuate in a band of 1-3% semi annually.

Table 12: Wellhead Gas Prices

	Operating Fields				Major non Operating Fields	
Effective Price	Sui	Kandkot	Adhi	Mazarani*	Sawan*	Miano*
1/7/2007	**93.91**	**93.91**	**89.24**	**106.75**	**194.07**	**194.01**
1/1/2007	97.66	97.66	89.9	106.75	200.93	200.93
HoH %Chg	-3.84%	-3.84%	-0.73%	0.00%	-3.42%	-3.44%
1/7/2006	87.62	87.62	88.62	106.75	196.29	196.29
YoY%Chg	7.18%	7.18%	0.70%	0.00%	-1.13%	-1.16%

**Prices are notified in US$ but has been converted into PRs at current exchange rate.*

Sources: OGRA & IGI Research

the company is targeting to drill 100 exploratory wells in ten years

■ Terminal Growth Rate

In the past few years, the company has not undertaken any massive exploration and drilling activities. However, according to the 10year strategic plan, the company is targeting to drill 100 exploratory wells in ten years. During the forecasted years, this relatively major exploration target would result in higher exploration expenses, which would exert some pressure on the bottomline. Nonetheless, in our view, the aforementioned drilling target coupled with favorable demand-supply scenario would enable the company's bottomline to grow atleast inline with the GDP growth rate. Thus, we have assumed terminal growth rate of 5% in our base case scenario.

P&L Forecasts FY07-10

Wellhead gas prices are expected to fluctuate in a band of 1-3% semi annually

In the past few years, the company has witnessed phenomenal growth in its topline. Major reasons behind this are volumetric growth and upward revision in gas wellhead prices of the company's flagship gas field namely Sui and Kandkot. As per the Gas Pricing Agreement, (GPA) phases of upward revision have been completed in Jan CY07 and going forward wellhead gas prices would be revised inline with movements in average Arabian crude oil prices. In addition to this, we also expect trivial (1-2%) decline in gas production from Sui and Kandkot. Moreover, we do not expect any major jump in the company's other income going forward.

Despite the aforementioned facts and estimates, the company's revenues and earnings are expected to remain robust going forward. Production of condensate, LPG and gas from Adhi field has been doubled early this calendar year. Full year impact of this increase would be seen in FY07-08. Moreover, production from Tal Block is expected to witness major increase in the near future.

the topline of the company is expected to grow at CAGR at 15% till FY09-10

Keeping in view aforesaid factors, as per our estimates, the topline of the company is expected to grow at CAGR at 15% till FY09-10, which is expected to jump to PRs55.4bn from PRs31.8bn in FY05-06. Operating profit, are expected to grow at a CAGR of 18.04%. Overall, profit before taxes are expected to increase at a CAGR of 17.7%, which is likely to surge to PRs38.7bn in FY09-10 from PRs20.2bn reported in FY05-06. Profit after taxes in estimated to climb to PRs25.2bn (EPS: PRs36.68) in FY09-10 compared to PRs13.4bn (EPS: PRs19.54) posted in FY05-06, likely to grow at a CAGR of 17.05%. In our view, payout ratio is expected to remain over 43% translating into cash dividend of 110%-170% (DPS: PRs11.0-PRs17.0) during the forecasted years FY07-10.

Table 13: PPL Income Statement (PRs mn)

	FY05A	FY06A	FY07F	FY08F	FY09F	FY10F
Net Sales	23,294	31,757	40,441	49,329	53,966	55,388
Exploration expenses	(6,952)	(8,171)	(9,111)	(9,248)	(9,981)	(10,505)
Royalties	(2,673)	(3,745)	(4,651)	(5,673)	(6,206)	(6,370)
Operating Profit	13,669	19,841	26,680	34,408	37,779	38,513
Other Income	576	1,509	2,252	2,383	2,564	2,787
Other Charges	(851)	(1,127)	(1,389)	(2,064)	(2,267)	(2,311)
Financial Charges	(19)	(30)	(125)	(173)	(229)	(286)
Profit before tax	13,375	20,193	27,418	34,554	37,847	38,704
Taxation	4,887	6,790	9,596	12,094	13,247	13,546
Profit after tax	8,487	13,403	17,822	22,460	24,601	25,158
EPS (Adjusted)	12.38	19.54	25.99	32.75	35.87	36.68
DPS (Adjusted)	2.50	9.00	11.50	14.00	15.00	16.75
Operating Profit Margin	58.68%	62.48%	65.97%	69.75%	70.00%	69.53%
Net profit Margin	36.44%	42.21%	44.07%	45.53%	45.59%	45.42%
Effective tax rate	36.54%	33.63%	35.00%	35.00%	35.00%	35.00%

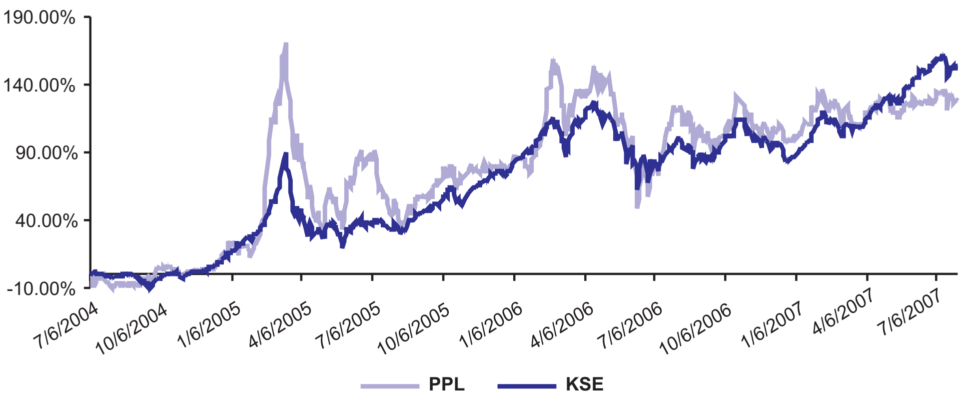
Sources: Company Report & IGI Research

Stock Performance

One percent change in the stock prices of PPL leads to almost 7.5 points movement in KSE- 100 index

Pakistan Petroleum Limited has total market capitalization of PRs177bn and has 5.38% weightage in the benchmark KSE-100index. As per our estimate at present index weight, one percent change in the stock prices of PPL leads to almost 7.5 points movement in KSE-100 index. In FY06-07, the stock has underperformed the benchmark KSE-100 index. Against total index return of 37.87%, the stock has offered total return of 28.6% (capital gain of 23.88% and dividend yield of 4.72%).

Chart 9: PPL & KSE Relative Performance

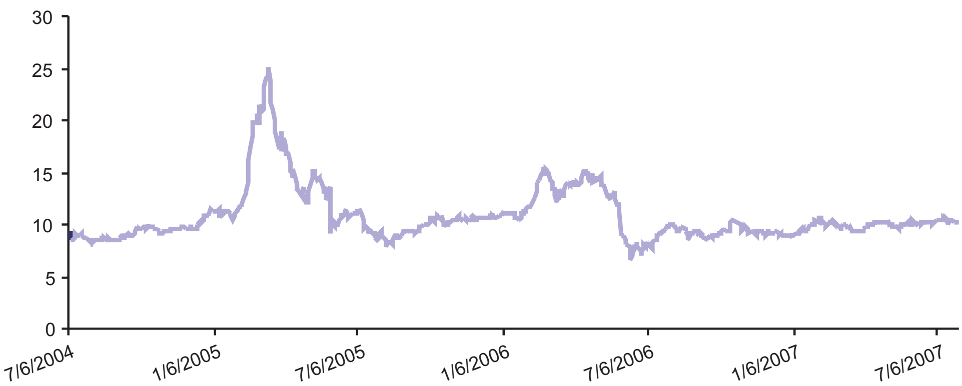


Sources: Bloomberg & IGI Research

Presently, the stock trades around earnings multiple of 10x

Since inception, the stock has usually traded in a PE band of 10x-12x with average prospective PE multiple standing around 10.8x. On 15th March 2005, (on closing basis) the stock traded at an all time high prospective PE multiple of 25.05x. Presently, the stock trades around earnings multiple of 10x on FY06-07 earnings estimates which is almost inline with the stock's 3year average PE multiple. Nevertheless, based on our FY07-08 earnings projections, the stock trades at prospective earnings multiple of 7.89times which is 36.8% lower than the stock's 3year average PE multiple.

Chart 10: Prospective PE Band



Sources: Bloomberg & IGI Research

■ The Bottomline: An Investment Perspective

The stock is expected to offer decent capital gain coupled with fairly reasonable dividend yield

We view this stock as an impressive long term growth play. The stock is expected to offer decent capital gain coupled with fairly reasonable dividend yield. In our view, PPL should be an integral part of a prudent investment portfolio.

Statistical Summary

Table 14: PPL Income Statement						(PRs mn)
	FY05A	FY06A	FY07E	FY08F	FY09F	FY10F
Net Sales	23,294	31,757	40,441	49,329	53,966	55,388
Exploration expenses	(6,952)	(8,171)	(9,111)	(9,248)	(9,981)	(10,505)
Royalties	(2,673)	(3,745)	(4,651)	(5,673)	(6,206)	(6,370)
Operating Profit	13,669	19,841	26,680	34,408	37,779	38,513
Other Income	576	1,509	2,252	2,383	2,564	2,787
Other Charges	(851)	(1,127)	(1,389)	(2,064)	(2,267)	(2,311)
Financial Charges	(19)	(30)	(125)	(173)	(229)	(286)
Profit before tax	13,375	20,193	27,418	34,554	37,847	38,704
Taxation	4,887	6,790	9,596	12,094	13,247	13,546
Profit after tax	8,487	13,403	17,822	22,460	24,601	25,158
EPS (Adjusted)	12.38	19.54	25.99	32.75	35.87	36.68
DPS (Adjusted)	2.50	9.00	11.50	14.00	15.00	16.75
Operating Profit Margin	58.68%	62.48%	65.97%	69.75%	70.00%	69.53%
Net profit Margin	36.44%	42.21%	44.07%	45.53%	45.59%	45.42%
Effective tax rate	36.54%	33.63%	35.00%	35.00%	35.00%	35.00%

Sources: IGI Research

Table 15: Balance Sheet						(PRs mn)
	FY05A	FY06A	FY07E	FY08F	FY09F	FY10F
Past prospecting exp.	625	943	1,610	2,340	3,140	4,017
Decommissioning cost	1,605	1,254	2,407	3,560	4,713	5,701
Fixed assets	9,045	10,672	13,738	18,170	20,957	23,115
Other LT assets	2,477	1,143	2,681	3,014	2,847	2,677
Current assets	18,040	27,054	30,429	38,729	50,446	62,700
Total Assets	31,792	41,066	50,865	65,813	82,104	98,211
Paid-up capital (common)	6,858	6,858	6,858	6,858	6,858	6,858
Preference shares	0.15	0.15	0.15	0.15	0.15	0.15
Reserves	14,387	23,330	33,265	46,123	60,437	75,307
Total Shareholders' Equity	21,245	30,189	40,123	52,982	67,295	82,165
LT loans & leases	62	79	105	121	127	122
Other LT liabilities	3,267	2,466	2,857	3,560	4,713	5,701
Current liabilities	7,217	8,333	7,779	9,150	9,968	10,222
Total Liabilities & Equity	31,792	41,066	50,865	65,813	82,104	98,211

Sources: IGI Research

Table 16: Cash Flow Statement						(PRs mn)
	FY05A	FY06A	FY07E	FY08F	FY09F	FY10F
Cash flow from operations	9,946	12,464	11,921	17,209	23,181	24,377
Cash flow from investing activities	(2,631)	(1,349)	(2,877)	(4,467)	(2,975)	(2,388)
Cash flow from financing activities	(3,423)	(6,148)	(7,851)	(9,576)	(10,272)	(10,282)
Net change in cash	3,892	4,967	1,193	3,167	9,934	11,707
Opening cash balance	6,538	10,430	15,397	16,590	19,757	29,691
Closing cash balance	10,430	15,397	16,590	19,757	29,691	41,398

Sources: IGI Research

Table 17: Momentum						(%)
	FY05A	FY06A	FY07E	FY08F	FY09F	FY10F
Gas production growth YoY	1.67%	6.33%	-7.34%	10.18%	3.80%	0.72%
Oil & NGL production growth YoY	17.58%	8.47%	42.40%	24.03%	6.60%	8.80%
LPG production growth YoY	0.00%	4.29%	53.65%	40.26%	5.00%	5.00%
Sales growth YoY	31.8%	36.3%	27.3%	22.0%	9.4%	2.6%
Operating profit growth YoY	44.6%	45.1%	34.5%	29.0%	9.8%	1.9%
PAT growth YoY	30.2%	57.9%	33.0%	26.0%	9.5%	2.3%
Fixed assets growth YoY	7.9%	18.0%	28.7%	32.3%	15.3%	10.3%
Total assets growth YoY	26.0%	29.2%	23.9%	29.4%	24.8%	19.6%

Sources: IGI Research

Trend Highlights

Chart 11a: Earnings Per Share (PRs)

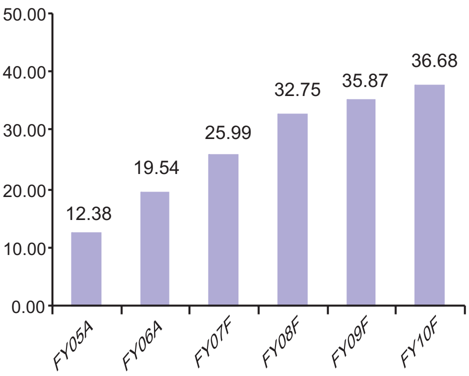


Chart 11b: Book Value Per Share (PRs)

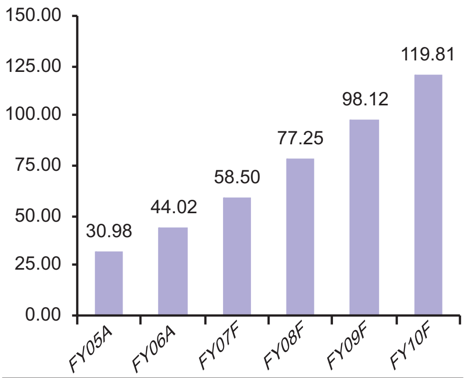


Chart 11c: Dividend Per Share (PRs)

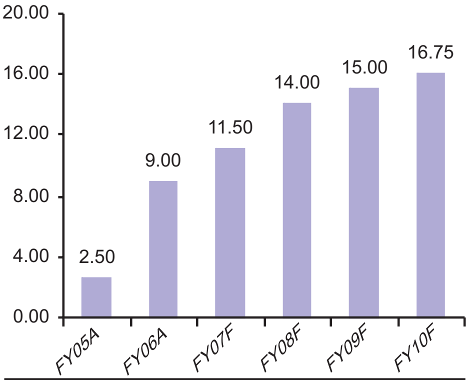


Chart 11d: Operating Profit Margin (%)

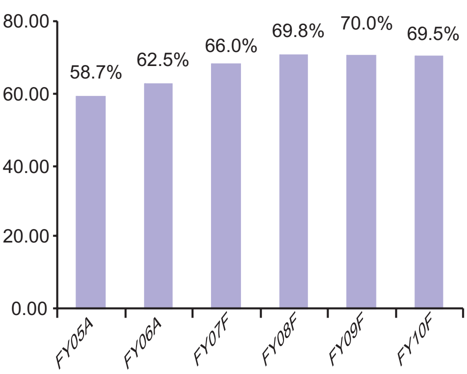


Chart 11e: Pre-tax Profit Margin (%)

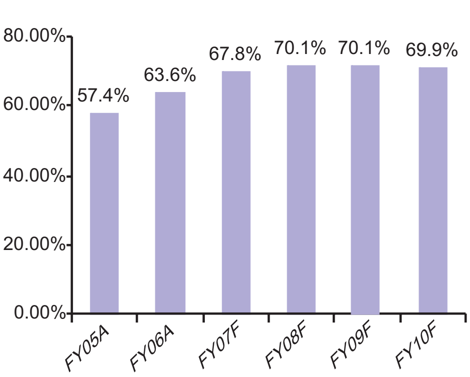


Chart 11f: Dividend Yield (%)

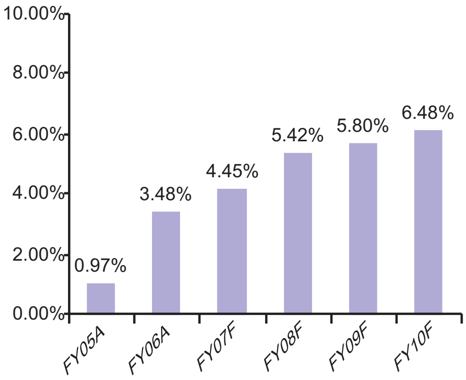


Chart 11g: Return on Assets (%)

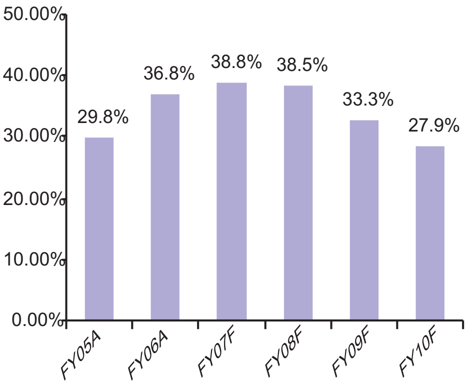


Chart 11h: Return on Equity (%)

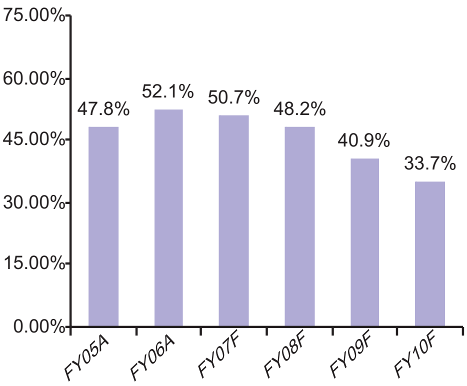


Chart 11i: Return on Capital Employeed (%)

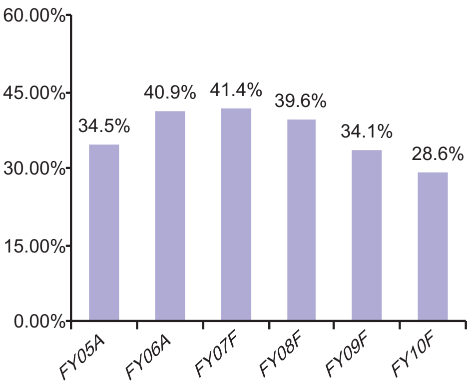


Chart 11j: Price Earnings Multiple (times)

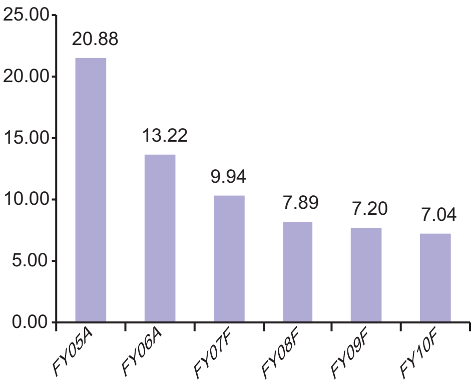


Chart 11k: Price to Book Value (times)

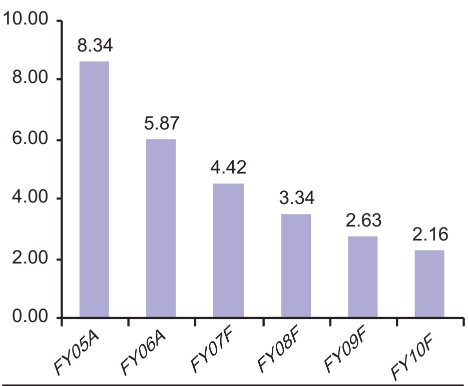
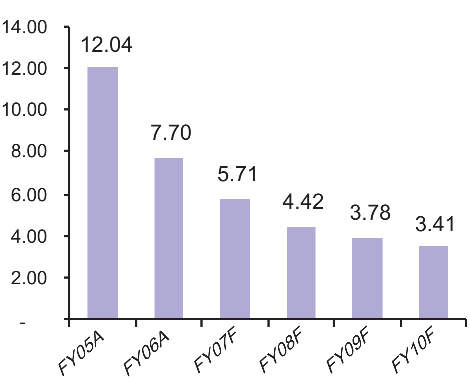


Chart 11l: EV/EBITDA (times)



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I, Tahir Hussein Ali, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject, securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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