November 2007

Oil & Gas
PAKISTAN

Pakistan State Oil

(Initiating Coverage)

Fair Value : PRs463/share

Recommendation : BUY

- Pakistan State Oil (PSO) the largest oil marketing company in Pakistan has annual turnover of over US$6.8bn and a market share of more than 80% in Black Oil and 59% in white oil.

- According to the recently unveiled financial results for the 1QFY08-09, the bottomline of the company has witnessed a growth of 271.2%YoY which jumped to PRs2.1bn (EPS: PRs12.26) from PRs566mn (EPS: PRs3.30) in the comparable quarter last year. Moreover, the management has also recommended first interim cash dividend of 50% (DPS: PRs5.00)

- The massive jump in earnings for the quarter ended September 30, 2007, glaringly indicates that the worst is over now and the company is heading towards regaining its robust financial performance.

- According to our forecast the topline of the company is expected to surge to PRs537bn by FY09-10 from PRs411bn last year translating into a 3year CAGR of 9.36%. The bottomline is expected to grow at a 3year CAGR of 29.42% which is expected to surge to PRs10.16bn (EPS of PRs59.26) by FY09-10 from PRs4.69bn in FY06-07.

- Based on our forecasted EPS of PRs46.17 for the ongoing fiscal year FY07-08, at existing market price, the stock is trading at earnings multiples of merely 8.62times which is 16.60% lower than the stocks' three year average earnings multiple and significantly below market as well as sector earnings multiple.

- Using DCF model, at the WACC of 15.45% and terminal growth rate of 4%, our fair value for the scrip is **PRs463 per share**. At existing level, the stock offers potential upside of almost 16.33% from our fair value and offers expected dividend yield of 9%. At prevailing levels we hold **Positive** stance on the scrip and recommend investors to **Over-Weight** the stock in their portfolio.

KSE code	*PSO*
Bloomberg code	*PSO PA*
Reuters code	*PSO KA*
Market Price in PRs	*398/share*
Market Cap in PRs	*68bn*
Market Cap in US$	*1.12bn*
Outstanding shares	*171.52*
Free Floot	*35%*
Index Weight	*1.86%*

12months price data

max	*425/share*
min	*283/share*
average	*354/share*

12months volume data

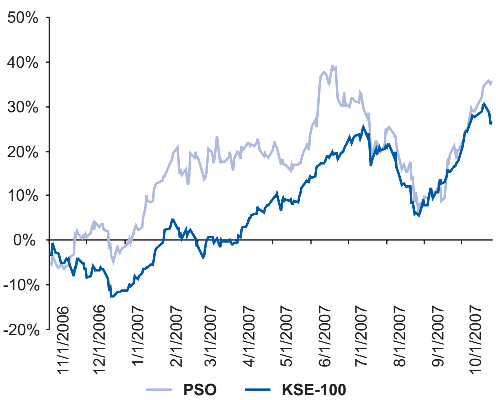
max	*9.787mn*
min	*0.135mn*
average	*2.03mn*

Table 1: Valuation Statistics @ PRs398

	FY06A	FY07A	FY08F	FY09F	FY10F
EPS (Rs)	43.87	27.34	46.17	52.04	59.26
DPS (Rs)	34.00	21.00	36.00	41.00	47.00
Book Value (PRs)	121.35	122.08	131.31	141.72	153.57
PE Ratio(times)	9.07	14.56	8.62	7.65	6.72
PBV (times)	3.28	3.26	3.03	2.81	2.59
Gross Profit Margin (%)	4.88%	2.98%	4.02%	3.91%	3.87%
Operating Profit Margin (%)	3.13%	1.83%	2.95%	2.94%	2.97%
Net Profit Margin (%)	2.13%	1.14%	1.82%	1.85%	1.89%
Dividend Yield (%)	8.54%	5.28%	9.28%	10.46%	11.91%
Earning Yield (%)	11.02%	6.87%	11.60%	13.07%	14.89%
Return on Equity (%)	36.16%	22.40%	35.16%	36.72%	38.59%
Return on Capital Employed (%)	49.76%	34.04%	52.41%	53.44%	55.03%

Source: IGI Research

Chart 1: Relative Performance



Source: Bloomberg & IGI Research

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All prices are as of October 30, 2007

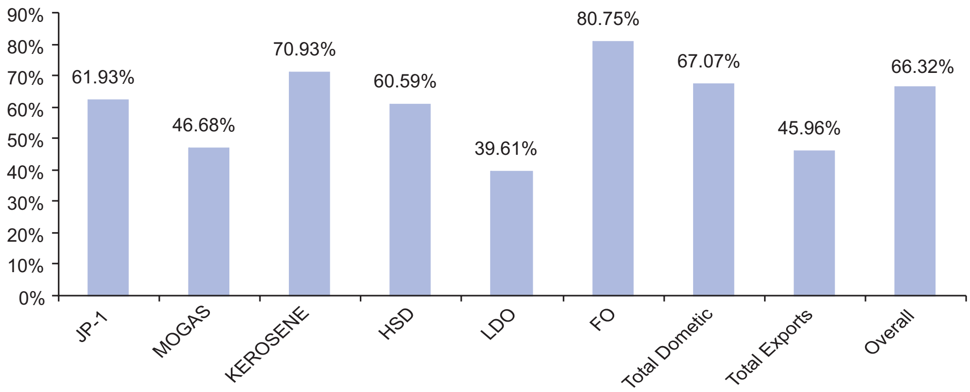
Company Snapshot

Brief Overview

The extensive storage capacity gives the company a competitive advantage over other OMCs...

Pakistan State Oil (PSO) is the largest oil marketing company in Pakistan with a turnover of over US$6.8bn and a market share of more than 80% in Black Oil and 59% in white oil. PSO is the first public company to become member of the World Economic Forum (WEF). The company has around 3,700 retail outlets across the country, including 1,609 New Vision Outlets (NVO) commissioned within seven years. The company has vast infrastructure of 9 installations and 23 depots from south to north. The extensive storage capacity (almost 81% of the total national storage, i.e. around 860 thousand metric tons) gives the company a competitive advantage over other OMCs. PSO is the first oil marketing company (OMC) in the country to introduce the concept of Mother/Daughter CNG dispensing facility. During FY06-07 significant growth was witnessed in the demand for Furnace Oil (FO) which surged to 7.39mn tones from 5.06mn tones a year earlier, showing an increase of 46%YoY. PSO having largest market share in this segment was the key beneficiary of the massive growth in FO consumption.

Chart 2: PSO market share in Key POL products in FY06-07



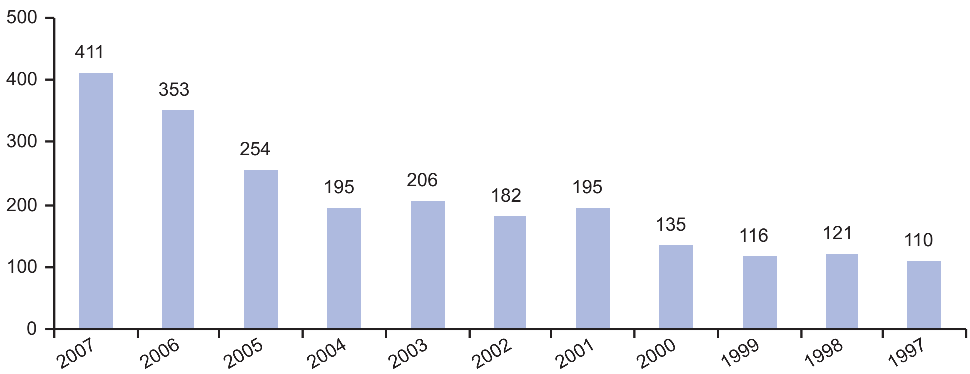
Source: Company Reports & IGI Research

Performance Flashback

Sales Revenue has increased consistently over a decade...

During past 10years, PSO has demonstrated robust growth in its operating as well as financial performance. Sales Revenue has increased consistently over a decade which surged from PRs109bn in FY96-97 to PRs411bn in FY06-07 translating into CAGR of almost 15%. Despite the generous payout record the company's equity witnessed significant growth which surged to PRs20.9bn in FY06-07 from PRs5.95bn in FY96-97, translating into a CAGR of 13.4%.

Chart 3: Sales Revenue **(PRsbn)**

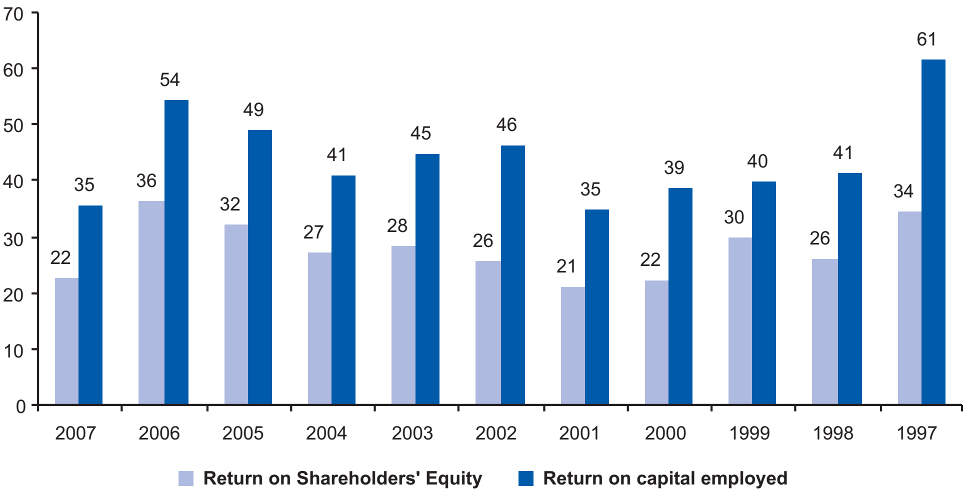


Source: Company Reports & IGI Research

During past ten years, average Return on Equity (ROE) stood slightly over 27%...

The break up value of the company grew consistently during last decade and jumped to PRs122 per share from PRs72 per share in FY96-97. During past ten years, average Return on Equity (ROE) stood slightly over 27% while average Return on Capital Employed (ROCE) was 44.2%. Despite the fact that FY06-07 was a lackluster year for the entire industry but the company still managed to keep its ROE and ROCE above 22% and 35% respectively. Over the years, the company's payout ratio has improved considerably which stood at 76.8% in FY06-07 as against 40.5% in FY96-97.

Chart 4: Key Return Ratios (%)



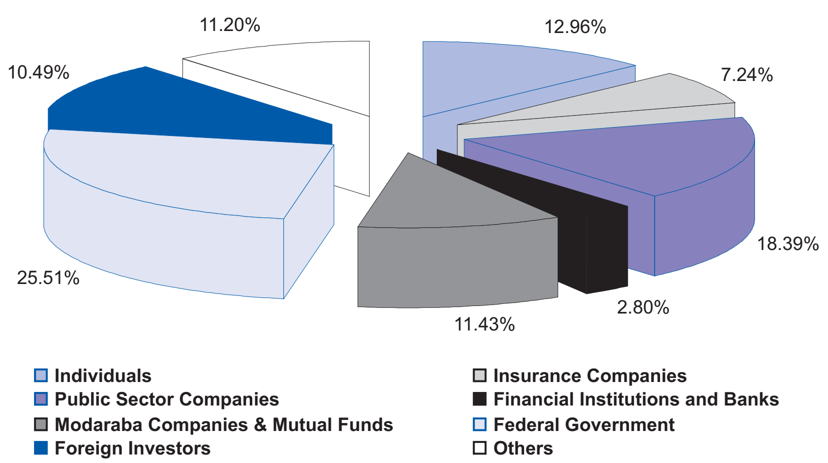
Source: Company Reports & IGI Research

Shareholding Pattern

It is indeed in the best interest of many stakeholders that this company would get privatized...

Presently the Government of Pakistan (GoP) is the majority shareholder of the company with 25.51% ownership in the company. The privatization of this strategic asset has been top priority of the Privatization Commission (PC) for almost a decade. Recently, the privatization process of PSO has entered final stages, nevertheless could not be completed. In our view, it is indeed in the best interest of many stakeholders that this company would get privatized; however, due to its strategic importance the Privatization Commission face some resistence to get this state owned oil marketing giant privatized.

Chart 5: Shareholding Pattern as on June 30, 2007 (%)



Source: Company Reports & IGI Research

Recent Developments & Future Plans

In FY06-07, the company initiated few key projects as well as made some significant progress towards achievements of some major goals. Highlights of some significant developments made during last financial year are as follows:

- In FY06-07, the company introduced Green Station concept to incorporate state of the art technology in its New Vision retail outlet system. With this concept, the company is heading towards environmental friendly, maintenance free retail outlets with substantial savings in years to come.

- The company acquired new refueling contract of Air Arabia for Karachi and Peshawar airports for an estimated volume in the range of 200,000-500,000 USG/year.

CNG market is extremely competitive and PSO holds around 25% share in the segment...

- Keeping in view the increasing demand for CNG, the company is in the process of setting up unconventional Mother/Daughter CNG stations on National Highways where piped gas is presently not available. Through Mother/Daughter CNG dispensing system, CNG is stored in large pressure vessels/containers and these storage are moved through trailers from the Mother stations to Daughter stations situated on the highways or in small towns where piped gas is not available. CNG market is extremely competitive and PSO holds around 25% share in the segment. In our view, the Mother/Daughter CNG dispensing system would enable the company to establish its dominance in this much untapped segment.

In addition to aforementioned developments, the company is heading towards achievements of some key goals going forwards. Some key future plans of the company are follows:

There is high probability that the company will get the supply contract to the upcoming power projects...

- Some mega power projects are currently underway which are expected to come online within next couple of years. The company is in negotiations with few IPPs for supply of Furnace Oil. There is high probability that the company will get the supply contract to the upcoming power projects which is expected to enhance guaranteed FO sales by 1.50-2.50mn tones going forward.

- Looking at refinery constraints at regional as well as global levels and incentives offered by the government for setting up refineries in the country, the company does have plans to get into backward integration and the probability of setting up a refinery can not be completely ruled out.

- The company is intending to enhance its non fuel revenues. In this regard, the company is planning to rent out some of the company owned billboards across the country. Furthermore, there is a probability that the network of Shop Stops nation-wide would be rented out to some professional or even multinational retail chain stores.

Analyzing aforementioned developments and future plans, we believe that the company would maintain its dominance in the industry. Furthermore, the probability of implementing few aforesaid future plans is less likely anytime before privatization.

Result Review FY06-07

Financial Year 2006-07 proved out to be a lackluster year for the entire Oil Marketing Sector. Despite the massive increase in demand for Furnace Oil, the profitability of the industry witnessed heavy decline on Year-o-Year basis. Inventory losses due to significant fluctuations in global crude oil prices, massive increase in financial charges and amendments made by the Government in OMC's margin calculation last year have adversely affected the earnings of OMCs. For the full year ended June 30, FY06-07, the company reported an EPS of PRs27.34 as against PRs43.87 posted a year earlier, translating into a decline of 37.5%YoY. Key highlights of the result are discussed briefly in following paragraphs.

- The topline of the company surged to PRs411bn from PRs352bn last year, showing an increase of around 16.6%YoY. Major reason behind the growth in sales was considerable increase in demand for Furnace Oil.
- Massive surge was witnessed in cost of product sold, which climbed to PRs337bn from PRs281bn last year. Operating income, mainly because of lower base effect, grew almost 35%YoY.
- Financial cost increased by 31%YoY. The key reason behind the significant jump in financial charges was massive bank borrowings mainly due to delay in payments by the Government on the account of Price Deferential Claims. The Government still owes more than PRs10bn to PSO alone.
- Despite increase in operating income and decline in worker's provident participation fund and worker's welfare fund by 36%YoY and 39%YoY respectively, the bottomline of the company dropped 37.5%YoY.
- Inventory losses, massive surge in financial charges and amendments made by the government in calculating OMCs margins last year were major factors behind the decline in earnings.
- The company reported profit after taxes of PRs4.69bn as against PRs7.62bn posted last year. For the entire FY06-07 the company paid cumulative cash dividend of 210% (DPS: PRs21.00). This translates into payout ratio of 76.8%.

Table 2: Income Statement Snapshot **(PRsbn)**

	FY06-07	FY05-06	%Chg YoY
Sales	411	352.5	16.60%
Sales tax and IFEM	61.35	54.3	12.98%
Net Sales	349.71	298.2	17.27%
Cost of product sold	337.45	281	20.09%
Gross profit	12.26	17.2	-28.72%
Other operating income	1.28	0.95	34.74%
Operating costs	5.5	6.53	-15.77%
Worker's Profit Participation Fund	0.36	0.57	-36.84%
Worker's Welfare Fund	0.14	0.23	-39.13%
	7.54	10.82	-30.31%
Other income	0.424	0.442	-4.07%
Profit from operations	7.96	11.26	-29.28%
Finance cost	1.16	0.88	31.22%
Share of profit of associates	0.33	1.04	-68.27%
Profit before taxation	7.13	11.42	-37.52%
Taxation	2.43	3.89	-37.53%
Profit after taxation	4.70	7.53	-37.51%

Source: Company Reports & IGI Research

Key Assumptions

Our fair value for the script using discounted cash flow (DCF) financial model is based on few assumptions. Following are some of our key assumptions having considerable impact on the company's core earnings and consequently on the fair value.

- **Furnace Oil Sales:** Despite the fact that sales of Furnace Oil has increased significantly during last fiscal year, nevertheless, in our financial model we have assumed that the company's Furnace Oil (FO) sales is expected to increase at a CAGR of 10%. The key reason behind moderate growth is higher base effect. Secondly, we have only partially incorporated the impact of possible increase in FO sales from the upcoming power projects.

- **Volumetric Sales of POL products:** As per our estimates, the cumulative sales of regulated products are likely to increase at a CAGR of 6.84% till FY10. The major reason behind somewhat nominal growth in sales is because of increase in CNG demand driven by the higher oil prices which would continue to exert downward pressure on the consumption of Motor Sprit (MS). Nevertheless, the increase in CNG sales and non fuel revenues would increase other operating income which would compensate for the expected nominal decline in MS sales going forward.

- **Product Prices:** According to our assumptions, we believe that POL (Petroleum, Oil and Lubricant) prices in domestic markets are expected to rise at a CAGR of 2-5% till FY10. Due to expected nominal increase in prices, the likelihood of inventory gains during the forecasted period is relatively high. Nevertheless, due to fluctuations in crude oil prices, the probability of inventory losses can not be ruled out.

- **Terminal Growth Rate:** Sales of POL products particularly of Furnace Oil are vulnerable to the overall economy performance. Keeping this in view, we have assumed the terminal growth rate of 4% to be appropriate for the industry as well as for the company. Nevertheless, fair value of the stock on different growth rates can be seen in the sensitivity table given on given in the table # 8 on page # 10.

- **Dues Payment by Government:** On account of price differential claims (PDC) the government owe more than PRs10bn to PSO. This has resulted in higher financial charges on the back of increased bank borrowings. However, in our financial model we have assumed that some portion (around 20%) of the due will be paid by the Government during the forecasted period. This would decrease company's bank borrowings to some extent and thus would result in lower financial charges.

- **OMC Margin:** As per our assumption, the present pricing formula for calculating OMC's margins is expected to remain intact going forward. The recent amendments in pricing formula would definitely have some adverse impact on the profitability of Oil Marketing Companies and would make only the survival of the fittest possible in the industry. PSO because of its economy of scale and significant presence in the FO segment would be relatively less affected from recent amendments in POL pricing formula. At present, OMC margins for Motor Sprit hovers around 2.4% which was 2.83% before the recent amendments in pricing formula and 3.50% before April 16, 2006.

Table 3: OMC Pricing Formula (%)

Before April 16, 2006	(Ex-refinery prices + Exercise Duty + Petroleum Development Levy + Inland Freight + Sales Tax) X 3.5%
After April 16, 2006	(Ex-refinery prices + Exercise Duty + Petroleum Development Levy + Inland Fright) X 3.5%
Present Formula	(Ex-refinery prices + Exercise Duty + Inland Freight) X 3.5%

(Please note: The aforementioned pricing formula is applicable only on regulated products. Historically, the Government has charged very nominal Exercise Duty which is around PRs0.88 and since June 01, 2007, the Government is not charging any Exercise Duty)

Forecasted Financials

In the following paragraphs we present key highlights of our forecasted financial statement.

- According to our forecast the topline of the company is expected to surge to PRs537bn by FY09-10 from PRs411bn last year translating into a 3year CAGR of 9.36%. Gross profit is likely to grow at a CAGR of 19.32% which is expected to climbed to PRs20.8bn from PRs12.26bn in FY06-07.

- Other operating income is expected to increase at a 3year CAGR of 25% mainly on the back of penetration into the CNG segment and higher non fuel revenues. As per our estimates, other operating income is expected to surge to PRs2.5bn in FY09-10 from PRs1.6bn last year.

- Operating expenses are likely to increase at a 3year CAGR of 7.01%. Operating profits are expected to surge to PRs15.96bn in FY09-10 from PRs7.52bn last year which translates in to a CAGR of 28.47%. Financial charges on account of decline in bank borrowings are expected to fall at a CAGR of 17.51%.

- During forecasted period, profit before taxes are expected to grow at a CAGR of 30.31% which is expected to jump to PRs15.77bn in FY09-10 from PRs7.12bn last year. Furthermore, the bottomline is expected to grow at a 3year CAGR of 29.42% which is expected to surge to PRs10.16bn (EPS of PRs59.26) by FY09-10 from PRs4.69bn (EPS: PRs27.34) in FY06-07.

- In next 3years, as per our forecast, the cumulative balance sheet size (total assets) is expected to surge to PRs92bn which translates into 3year CAGR of 7.18%. The key reason behind this nominal growth is based on the assumption that some portion (around 20%) of PDC due on the government will be paid back to the company which would reduce the company's bank borrowing and current portion of asset and liabilities respectively.

- Shareholders' equity is expected to surge to PRs26.3bn in FY09-10 from PRs20.9bn in FY06-07 translating into a 3year CAGR of 7.95%. The key reason behind the marginal growth is the company's generous payout policy which we believe would remain intact going forward.

Table 4: Forecasted Income Statement **(PRsmn)**

	FY07-08	FY08-09	FY09-10
SALES	434,718	483,395	537,622
Govt levies	66,947	74,443	82,794
Net sales	367,771	408,952	454,828
Cost of products sold	350,294	390,069	434,003
GROSS PROFIT	17,477	18,883	20,825
Other operating income	1,599	1,998	2,498
Transportation	406	447	492
Administrative and marketing	4,111	4,347	4,834
Depreciation	1,095	1,165	1,235
Other Operating expense	652	725	806
Total Operating Expense	6,264	6,685	7,367
Operating profit	12,812	14,197	15,956
Other income	425	453	453
Financial charges	960	813	650
Profit Before Taxation	12,277	13,838	15,759
Provision For Taxation	4,358	4,912	5,594
Profit After Taxation	7,919	8,925	10,165

Source: Company Reports & IGI Research

Valuation and Recommendation

Comparative Valuation

PSO appears to be one of the attractive plays at prevailing levels...

In the following table, it can be seen that among some regional as well as global major Oil Marketing Companies (OMCs) PSO appears to be one of the attractive plays. At prevailing levels, the company is trading at earnings multiple of 8.62 times which is second lowest among OMCs mentioned in the following table and considerably lower than the average earnings multiple.

In our view, PEG is relatively a better investment ratio as it incorporates the expected future growth factor. Based on this key ratio, PSO appears to be one of the most attractive picks among major global OMCs given in the table below. PSO trades at a PEG of 0.29x which is the lowest among OMCs given in the table below after Petro Canada. Based on EV/EBITDA the company appears comparatively fairly attractive.

Table 5: PSO V/S Major Global and Regional OMCs

Codes	Avg	PSO	MRL IN	SOL SJ	883 HK	PCA CN	OXY US	SNP RO	MUR US	ORG AU	MOH GA
	Average	Pakistan State Oil	Chennai Petroleum	SASLA LTD	CNOOC LTD	Petro Canada	Ocidental Petroleum	SNP Petrrom SA	Murphy Oil Corp	Origin Energy Ltd	Murphy Oil Corp
Valuation Overview											
Price/Earnings (x)	15.09	8.62	7.88	13.86	21.57	11.04	15.29	14.2	21.23	21.54	15.02
PEG Ratio (x)	1.40	0.29	0.45	1.05	n/a	0.24	0.85	0.88	n/a	6.02	n/a
Price/Sales (x)	2.06	0.23	0.18	3.35	7.6	1.28	3.43	1.92	0.88	1.25	0.48
EV/EBITDA (x)	8.83	6.04	n/a	n/a	13.53	3.90	n/a	7.85	n/a	11.83	9.8
1year Sales Growth (%)	13.72	40.35	16.85	-7.79	-2.51	7.42	-0.63	39.92	14.47	6.24	22.85
Debt/Equity (%)	56.20	40.33	120.44	31.34	19.24	20.56	8.91	25.41	24.46	54.85	216.42
ROA (%)	10.58	12.31	6.39	10.79	18.64	11.57	14.56	9.56	8.59	3.90	9.50
ROE (%)	23.73	39.47	22.44	20.71	27.27	24.24	24.16	14.61	16.00	10.66	37.7

Source: Company Reports & IGI Research

Despite the highest expected 12month sales growth, the stock trades at the lowest Prices/Sales ratio among major OMCs mentioned in the table above. Furthermore, keeping in view other key investment ratios particularly Return on Equity and Return on Assets, PSO appears reasonably attractive on both these key ratios which makes the script the most attractive play among prominent OMCs given in the table above.

Valuation Snapshot: BUY @ PRs398

Using Discounted Cash Flow (DCF) model, at the WACC of 15.45% and terminal growth rate of 4%, our fair value for the scrip is **PRs463 per share**. At existing level, the stock offers potential upside of almost 16.33% from our fair value and offers expected dividend yield of 9%. At prevailing levels we hold **Positive** stance on the scrip and recommend investors to **Over-Weigh** the stock in their portfolio.

Table 6: Cash Flow Snapshot

	FY08	FY09	FY10	Terminal Value
Profit before taxes	12,277	13,838	15,759	
Add: depreciation	1,095	1,165	1,235	
financial charges	960	813	650	
less: taxes paid	4,358	4,912	5,594	
	9,974	10,903	12,050	
Less: Capex	(743)	(1,000)	(1,000)	
Change in WC	(79)	(488)	(907)	
FCF to firm	9,152	9,416	10,142	92,092

Source: Company Reports & IGI Research

Table 7: DCF Valuation

Beta	0.909
Risk free rate	10.00%
Market Return	16.00%
E(R)	15.45%
Cost of equity	15.45%
Cost of debt	7.15%
Debt	0%
Equity	100%
WACC	15.45%
Present Value of Cash flows (PRsmn)	84,400
Net Debt (PRsmn)	4,977
Net companies worth (PRsmn)	79,423
Shares (mn)	171.519
Fair Value (PRs)	**463/share**

Source: Company Reports & IGI Research

Table 8: Sensitivity Analysis (PRs pershare)

Growth Rates	Discount Rates				
	14.00%	15.00%	15.45%	16.00%	17.00%
2%	605	418	403	387	360
3%	490	448	431	412	381
4%	533	483	**463**	441	406
5%	585	525	501	476	435
6%	651	576	548	517	469
7%	735	641	606	568	509

Source: Company Reports & IGI Research

Recent Result Review: Worst is over now

Recently the company has unveiled financial results for the first quarter ended September 30, 2007. The company has posted significant improvements in its operating and financial performance. Key highlights of the result are discussed briefly in following paragraphs.

Profit & Loss Highlights

Gross profit recorded a massive growth of 153.74%, largess of inventory gains...

The topline of the company grew 21.29%YoY as it surged to PRs122bn from 101bn in the corresponding quarter last year. Cost of sales increased 18.6%YoY which stood at PRs100bn as against PRs84bn in the same quarter last year. Gross profit recorded a massive growth of 153.74%, thanks to inventory gains, which jumped to PRs4.6bn from PRs1.8 in the comparable quarter last year. Operating costs recorded a growth of 33%YoY. Other income declined 22%YoY. Overall, operating profit recorded a jump of 247% YoY.

The bottomline depicted a growth of 271.2%YoY which surged to PRs2.1bn (EPS: PRs12.26)...

Financial cost declined 11.78%YoY. Profit before taxation surged to PRs3.2bn from PRs827mn in the corresponding quarter last year translating into a robust growth of 288%YoY. Overall the bottomline depicted a growth of 271.2%YoY which surged to PRs2.1bn (EPS: PRs12.26) from PRs566bn (EPS: PRs3.30) in the comparable quarter last year. The massive jump in the financial performance glaringly indicates that the worst is over now and the company is heading towards regaining its robust financial performance. Moreover, the management has also recommended first interim cash dividend of 50% (DPS: PRs5.00)

Table 9: P&L Highlights (PRsmn)

	FY06-07	FY05-06	%Chg YoY
Gross Sales	**122,390**	**100,906**	**21.29%**
Less:			
Sales tax	(15,515)	(12,815)	21.07%
Inland freight equalization margin	(2,134)	(1,835)	16.31%
	(17,649)	(14,649)	20.47%
Net Sales	**104,741**	**86,257**	**21.43%**
Cost of products sold	(100,138)	(84,443)	18.59%
Gross profit	4,603	1,814	153.74%
Other operating income	314	302	3.80%
	4,917	2,116	132.32%
Operating costs			
Transportation costs	(86)	(80)	7.39%
Distribution and marketing expenses	(713)	(623)	14.54%
Administrative expenses	(251)	(225)	11.79%
Depreciation and amortisation	(284)	(277)	2.62%
Other operating expenses	(338)	(54)	529.71%
	(1,672)	(1,258)	32.95%
Other income	75	96	-21.95%
Profit from operations	**3,320**	**955**	**247.57%**
Finance costs	(208)	(236)	-11.78%
	3,112	719	332.75%
Share of profit of associates	97	108	-10.52%
Profit before taxation	**3,209**	**827**	**287.87%**
Taxation	(1,105)	(261)	324.09%
Profit after taxation	**2,103**	**567**	**271.21%**
Gross profit margin	4.39%	2.10%	
Operating profit margin	3.17%	1.11%	
Net profit margin	2.01%	0.66%	
Effective tax rate	34.45%	31.51%	
Annualized Return on Equity	39.50%	10.82%	
Annualized Return on Assets	11.04%	3.03%	
Earnings per share (PRs)	**12.26**	**3.30**	
Dividend per share (PRs)	5.00	Nil	

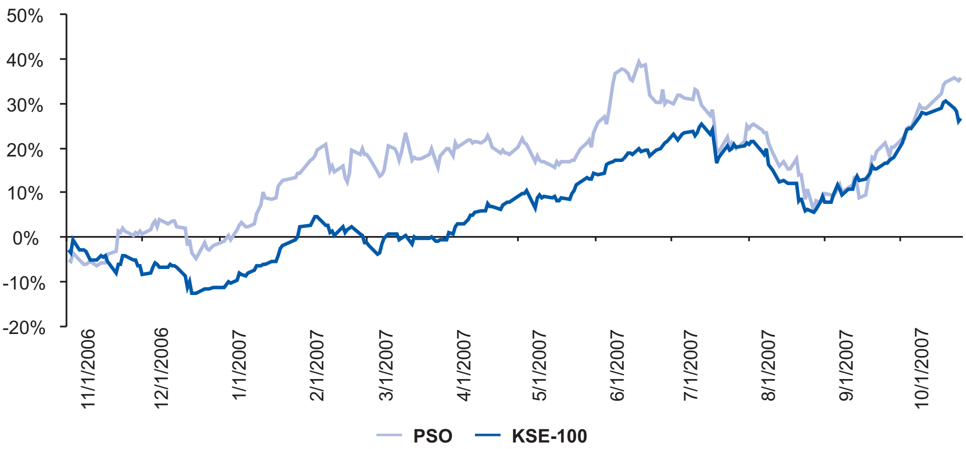
Source: Company Reports & IGI Research

Stock Performance

Five percent (5%) fluctuation in the stock price of PSO leads to 13.46 points movement in the KSE-100 index...

Pakistan State Oil (PSO) has cumulative market capitalization of PRs68bn and has 1.86% weightage in the benchmark KSE-100index. According to our estimates, at current index weight, five percent (5%) fluctuation in the stock price of PSO leads to 13.46 points movement in the KSE-100 index. During past one year the stock has marginally outperformed the benchmark KSE-100 index. Against a total index return of 26.8% the stock has offered a return of 35.67%, thus outperforming the index by 8.9%.

Chart 6: Relative Performance

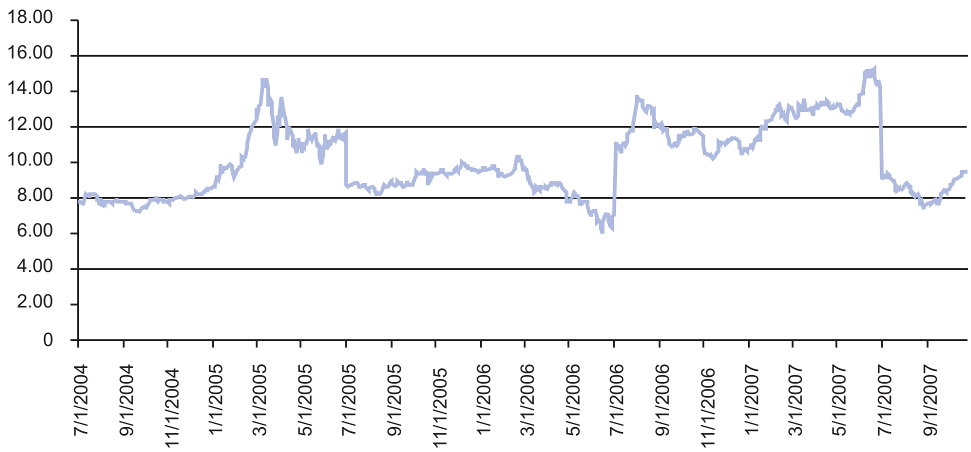


Source: Bloomberg & IGI Research

3years average PE ratio standing at 10.05x...

During past 3years (since FY04-05), the stock has usually traded in a prospective PE band of 9.5x and 11.5x with average PE ratio standing at 10.05x. Based on our earnings forecast for FY07-08, the stock is presently trading around 8.621times earnings multiple which is 16.45% lower than the stocks' 3year average earnings multiple.

Chart 7: 3years Prospective P/E Band



Source: Company Reports & IGI Research

Bottomline: An Investment Perspective

*Prudent investors can go for **Overweight** the stock*

We view this stock as a defensive long term growth play. The stock is expected to offer decent capital gains coupled with reasonably good dividend yield. In our view, prudent investors can go for **Overweight** the stock in their portfolio. At prevailing levels we hold **Positive** stance on the stock.

Statistical Summary

Table 10: PSO Income Statement (PRsmn)

	FY06A	FY07A	FY08F	FY09F	FY10F
Net sales	298,512	349,706	367,771	408,952	454,828
Cost of sales	281,043	337,447	350,294	390,069	434,003
Gross Profit	17,207	12,259	17,477	18,883	20,825
Operating expenses	3,794	4,117	4,517	4,794	5,326
Other operating income	951	1,279	1,599	1,998	2,498
EBITDA	14,364	9,421	14,559	16,087	17,998
Depreciation and amortization	3,307	1,895	1,747	1,890	2,042
EBIT	11,057	7,525	12,812	14,197	15,956
Other income / (expenses)	1,482	755	425	453	453
Financial charges	884	1,158	960	813	650
Profit before tax	11,655	7,122	12,277	13,838	15,759
Taxation	4,129	2,432	4,358	4,912	5,594
Profit after tax	7,525	4,689	7,919	8,925	10,165
EPS (PRs)	43.87	27.34	46.168	52.037	59.262
Gross profit margin	5.76%	3.51%	4.75%	4.62%	4.58%
EBITDA margin	4.81%	2.69%	3.96%	3.93%	3.96%
Net profit margin	2.52%	1.34%	2.15%	2.18%	2.23%
Effective tax rate	35.43%	34.15%	35.50%	35.50%	35.50%

Source: IGI Research

Table 11: Balance Sheet (PRsmn)

	FY06A	FY07A	FY08F	FY09F	FY10F
Current assets	58,119	62,513	65,283	72,295	80,132
Fixed assets	7,484	8,012	7,660	7,494	7,259
Other assets	4,565	4,212	4,192	4,402	4,622
Total assets	70,168	74,737	77,134	84,191	92,013
Current liabilities	47,056	51,385	51,875	56,779	62,196
Long term liabilities	2,299	2,412	2,736	3,104	3,477
Shareholder's equity	20,813	20,939	22,523	24,308	26,341
Total equity and liabilities	70,168	74,737	77,134	84,191	92,013

Source: IGI Research

Table 12: Cash Flow Statement (PRsmn)

	FY06A	FY07A	FY08F	FY09F	FY10F
Net cash from operations	1,633	3,691	9,156	9,862	10,794
Cash flows from investments	(174)	(708)	(743)	(1,000)	(1,000)
Cash from financing	(4,104)	(1,566)	(7,297)	(7,031)	(8,060)
Net change in cash	(2,645)	1,418	934	1,621	1,513
Beginning cash balance	(192)	(2,837)	(1,420)	(485)	1,136
Ending cash balance	(2,837)	(1,420)	(485)	1,136	2,649

Source: IGI Research

Table 13: Momentum (PRsmn)

	FY06A	FY07A	FY08F	FY09F	FY10F
Sales Growth	40.47%	17.15%	5.17%	11.20%	11.22%
Gross Profit Growth	27.08%	-29.82%	42.56%	8.04%	10.28%
EBIT Growth	24.87%	-39.75%	79.51%	8.79%	10.32%
Earnings Growth	32.27%	-42.21%	129.82%	9.61%	10.68%
Growth in Current Assets	42.67%	7.56%	4.43%	10.74%	10.84%
Growth in Fixed Assets	6.24%	1.45%	-2.01%	0.37%	-0.12%
Growth in Current Liabilities	43.61%	9.20%	0.95%	9.45%	9.54%
Growth in Long term Assets	15.01%	4.93%	13.41%	13.46%	12.00%
Growth in Total Assets	34.73%	6.51%	3.21%	9.15%	9.29%
Growth in Shareholder's Equity	20.22%	0.61%	7.56%	7.93%	8.36%

Source: IGI Research

Trend Highlights

Chart 8a: Earnings Per Share (PRs)

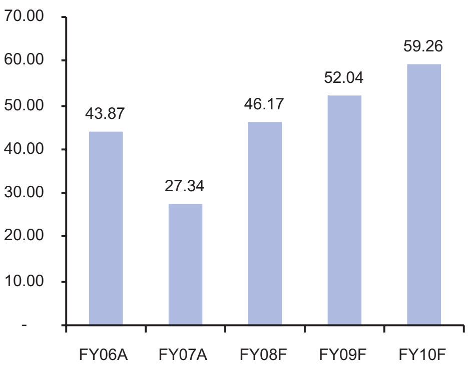


Chart 8b: Book Value Per Share (PRs)

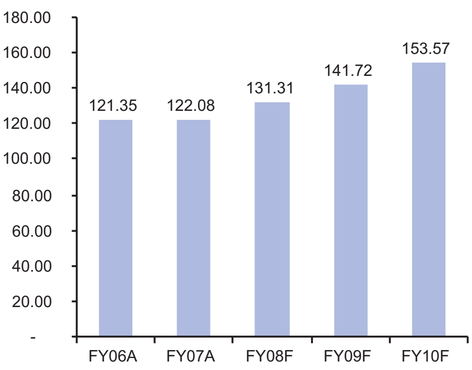


Chart 8c: Dividend Per Share (PRs)

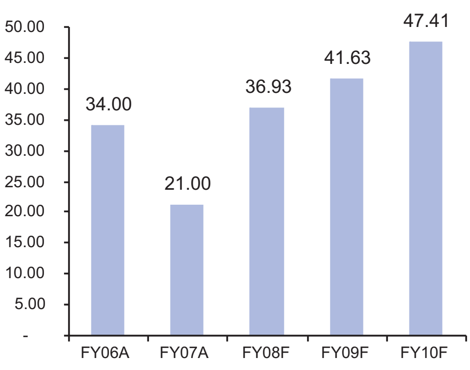


Chart 8g: Gross Profit Margin (%)

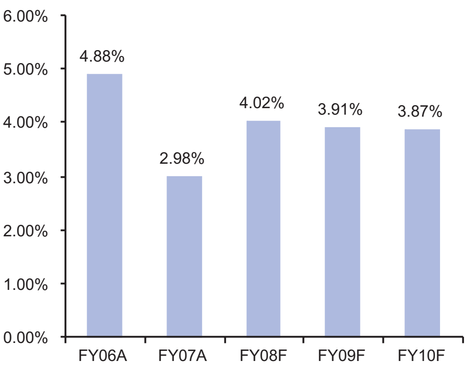


Chart 8d: Operating Profit Margin (%)

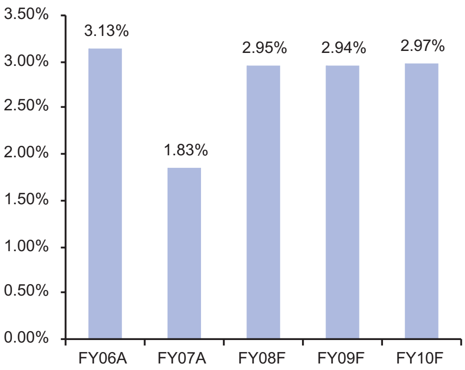


Chart 8e: Net Profit Margin (%)

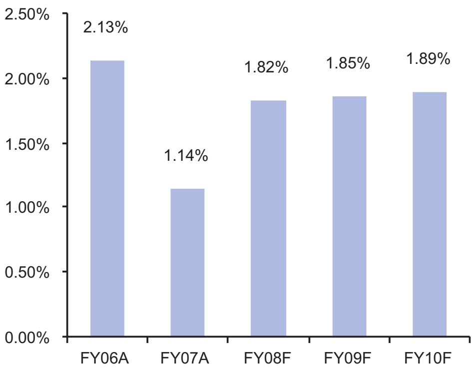


Chart 8f: Dividend Yield (%)

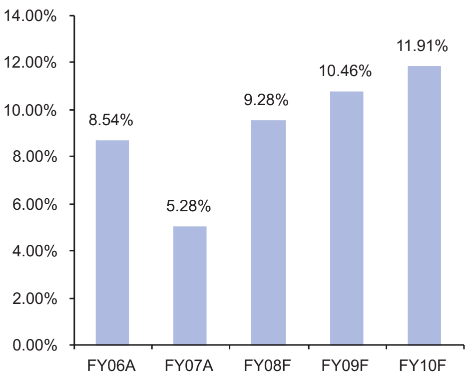


Chart 8h: Return on Equity (%)

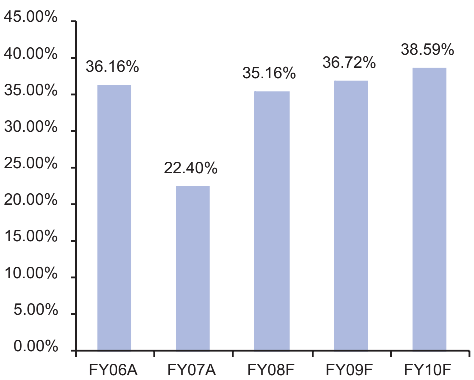


Chart 8i: Return on Capital Employeed (%)

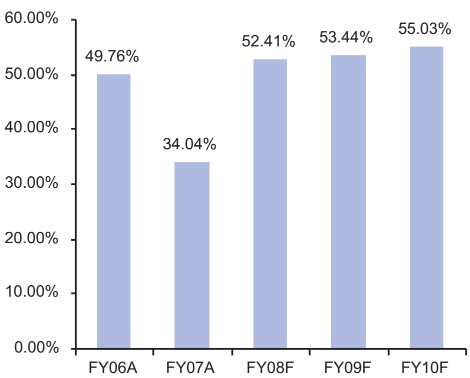


Chart 8j: Price Earnings Multiple (times)

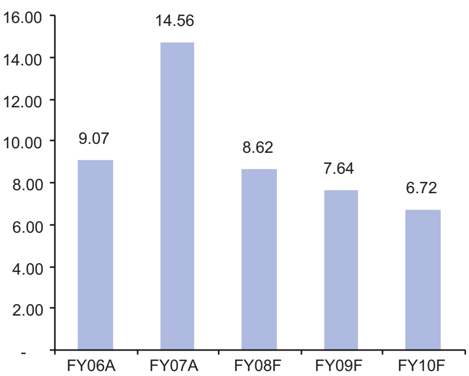


Chart 8k: Price to Book Value (times)

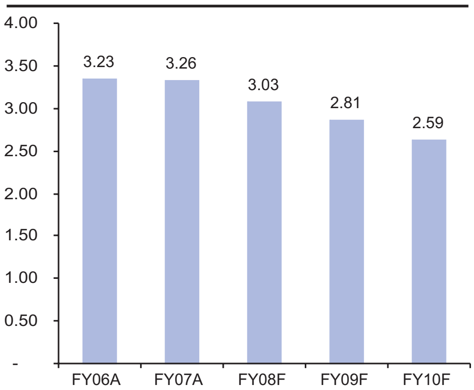
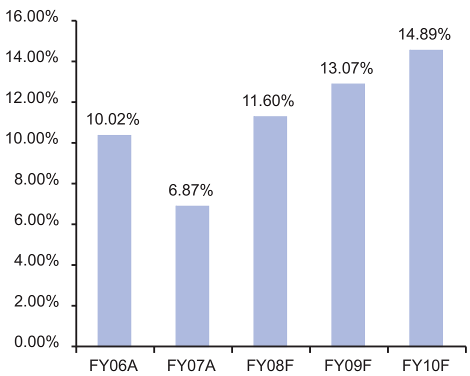


Chart 8l: Earnings Yield (%)



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Analyst Certification

I, Tahir Hussein Ali, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject, securities and issuers. I also certify that no part of our 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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