



Strategy Outlook 2012



The Right Moves

January 2012

## STRATEGY 2012: THE RIGHT MOVES

A year of challenges has passed and yet another waits. 2012 will be a year of consolidation with respect to corporate profitability, as we expect earnings to grow by a mere 9% as against an average of 21% in FY03-11. However, the following select sectors are expected to outperform the broader Index:

- Exploration and Production (E&P) – due to higher oil & gas prices
- Oil Marketing Companies (OMCs) – on back of growing offtakes, improved margins
- Fertilizer – because of higher retention margins

### POLITICS: AT A CRUCIAL JUNCTURE

Despite recent hiccups and saber rattling, both political and military circles have made a commitment to uphold democracy – this will go a long way in maintaining investor confidence.

Several incidents in 2011 strained Pak-US ties. However, the fact remains that US requires Pakistan's assistance in Afghanistan, both in terms of key supply routes as well as vital intelligence; US economic and military aid lends support to the external account and helps further development spending. Consequently, we expect this relationship to remain stable in the long term.

### ECONOMY: TOUGH TIMES DON'T LAST

GDP growth clocked in at 2.4% in FY11 due to destruction of major crops caused by the floods. However, with flood waters now receded, crop yields have improved and resultantly, GDP growth is expected to rise to 3.4% in FY12.

Despite rising remittances, deterioration in the external account amidst a rise in international oil prices led to PKR depreciation of 4.6% during 2011. Moving forward, IMF Stand-by Agreement repayments commencing 2HFY12 is a key concern with regard to deterioration of foreign exchange reserves. Though the World Bank's debt sustainability analysis reiterates a stable outlook for Pakistan, a clean report from IMF remains imperative to seek aid from other bilateral donors this year.

### VALUATIONS: BE SELECTIVE

Our KSE100 index target for CY12 is 13,290; which reflects a 17% upside from current levels. Furthermore, we also highlight 8% dividend yield for the index (using BMA Universe stocks as our basis).

E&P, OMCs, fertilizer and electricity sectors are expected to remain insulated from economic challenges and are likely to outperform the broader market. Coming to specific stocks, our top picks are: ENGRO, FFC, HUBC, PSO, APL, POL and OGDC.

BMA Sector Stance	Theme	Stance	Top Picks
OMCs	Growing off-take and improved margins	Overweight	PSO, APL
Electricity	Guaranteed and USD indexed returns	Overweight	HUBC
E & P	Higher oil & gas prices	Market weight	POL, OGDC
Fertilizer	Unabated demand and stable margins	Market weight	ENGRO, FFC
Cement	Underutilization and regulatory risk	Underweight	-
Commercial Banks	Shrinking net interest margins	Underweight	-
Autos	Appreciating Yen and regulatory risk	Underweight	-
Refinery	Regulatory risk on deemed duty	Underweight	-

Source: BMA Research



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## PAK EQUITIES: 2011 AND 2012

**2011** – A year full of challenges has passed and yet another waits. Pakistani equity market has suffered on many counts, including domestic political and economic uncertainty, tense geo-politics, strained ties with the US and global liquidity crunch. Consequently KSE100 closed 2011 at 11,348, down 6% (in PKR terms) for the year; encouragingly though, the KSE100's decline of 10% (in USD terms) represents outperformance against the MSCI FM and MSCI EM which declined 22% and 20%, respectively.

Market liquidity remained tight as average daily turnover declined to decade's low of 81mn shares thus restricting price discovery. The Karachi Stock Exchange (KSE) has proposed various measures to revive trading activity; relaxing Capital Gain Tax (CGT) regulations being one of it. The current suggestion by KSE & SECP on CGT is that the collection of this tax should be made hassle free for the investors with minimum interaction with tax authorities. The response from Federal Board of Revenues (FBR) is positive so far, as they have accepted in principle that the current status is not benefitting any of the stakeholders. Hence, a way out will not only bring depth in trading volumes and price discovery but it will also broaden the tax base; in addition to promoting documentation of economy and generating higher revenues.

**2012** - During 2012, a lot will depend on how the domestic political landscape is shaped especially with respect to stabilization of ties with the US. On the global economic front, liquidity crunch emanating from fears of recession in the Euro zone, if materializes, is going to adversely impact the entire world. Hence, in the scenario when economic indicators are signaling further weakness, we expect investor confidence to remain shaky. However investors by being selective can protect themselves from the negatives and earn good returns even in these difficult times. Investment focus should thus be limited to stocks which not only remain largely insulated from economic uncertainty, but which are also poised to benefit from indigenous demand in consumption arising from favorable demographics. Our top picks are: ENGRO, FFC, HUBC, PSO, APL, POL and OGDC.

**Our KSE100 index target for CY12 is 13,290: reflecting 17% upside for the year**

We have employed four methodologies, giving equal weightage to each, in order to arrive at our year-end estimate. These methods are:

### Weighted Average Index Target

Methodology *	Weight	Index Target
Earnings Growth Valuation	25%	12,369
PER Mean Reversion Method	25%	13,022
Regional Discount Convergence Method	25%	13,394
Target Price Mapping	25%	14,371
<b>Weighted average Index Target</b>		<b>13,290</b>

Source: BMA Research

\* For calculation purposes, we have used BMA Universe stocks as a proxy for the broader index, as it represents 72% of KSE100 market capitalization. The stocks representing remaining 28% of the market capitalization, given low liquidity and volatility are expected to have negligible impact on the KSE100.

## BMA MODEL PORTFOLIOS: REITERATING THE NEED FOR CONCENTRATED PORTFOLIOS WITH FOCUS ON ENERGY CHAIN

We have constructed two model portfolios, "Aggressive" and "Defensive" to cater to the two separate risk/return profiles. The Aggressive basket consists of stocks with a primary focus on growth while the Defensive portfolio is characterized by low beta and high dividend-yielding picks.

In either case however, energy chain remains the highlight, given that a rising energy deficit is likely to boost revenues as well as profitability.

Ticker	Symbol	Price (PKR)	Target Price	Upside	BMA Recommendation		
		30-Dec-11	Dec-12		Aggressive Portfolio	Defensive Portfolio	KSE 100 Index Weightage (%)
<b>Oil and Gas Exploration</b>					<b>Marketweight</b>		
OGDC	Oil & Gas Dev. Co.	138	168	22%	20%	17%	23%
POL	Pak Oilfields Ltd.	346	472	36%	15%	22%	3%
<b>Oil and Gas Exploration</b>					<b>35%</b>	<b>39%</b>	<b>35%</b>
<b>Fertilizer</b>					<b>Marketweight</b>		
ENGRO	Engro Corp.	96	231	140%	7%	5%	1%
FFC	Fauji Fertilizer	157	212	35%	8%	10%	5%
FATIMA	Fatima Fertilizer	23			5%	3%	2%
<b>Fertilizer</b>					<b>20%</b>	<b>18%</b>	<b>10%</b>
<b>Oil &amp; Gas Marketing Companies</b>					<b>Overweight</b>		
PSO	Pak State Oil	230	422	83%	5%	5%	2%
APL	Attock Petroleum	415	532	28%	8%	10%	1%
<b>Oil &amp; Gas Marketing Companies</b>					<b>13%</b>	<b>15%</b>	<b>3%</b>
<b>Power</b>					<b>Overweight</b>		
HUBC	Hub Power Co.	34	50	46%	10%	16%	2%
<b>Power</b>					<b>10%</b>	<b>16%</b>	<b>3%</b>
<b>Commercial Banks</b>					<b>Underweight</b>		
NBP	National Bank of Pak	44	65	47%	4%	2%	3%
MCB	MCB Bank Ltd.	145	256	77%	6%	4%	4%
<b>Commercial Banks</b>					<b>10%</b>	<b>6%</b>	<b>20%</b>
<b>Refineries</b>					<b>Underweight</b>		
NRL	National Refinery	221	371	68%	4%	2%	1%
<b>Refineries</b>					<b>4%</b>	<b>2%</b>	<b>1%</b>
<b>Cement</b>					<b>Underweight</b>		
LUCK	Lucky Cement	78	157	101%	2%	2%	1%
DGKC	D.G. Khan Cement	20	45	127%	1%	0%	0%
<b>Cement</b>					<b>3%</b>	<b>2%</b>	<b>2%</b>
<b>Food Producers</b>					<b>Marketweight</b>		
EFOODS	Engro Foods	23	35	54%	3%	2%	0%
<b>Food Producers</b>					<b>3%</b>	<b>2%</b>	<b>7%</b>
<b>Industrial Transportation</b>					<b>Overweight</b>		
PICT	Pak. Int. Cont. Ter.	70	123	76%	2%	0%	0%
<b>Industrial Transportation</b>					<b>2%</b>	<b>0%</b>	<b>0%</b>
<b>Model Portfolio Weightage</b>					<b>100%</b>	<b>100%</b>	

Source: BMA Research

## **POLITICS: AT A CRUCIAL JUNCTURE**

### **DOMESTIC: DEMOCRACY TO PERSIST**

2012 is an election year – Senate elections have been announced and will be conducted in March where the current ruling coalition is likely to secure a majority. National Assembly elections, previously scheduled for 2013 could also take place later this year. Encouragingly, despite recent uncertainty, both political and military circles seem committed to uphold democracy.

### **PAK-US TIES: MENDING FENCES**

The trust deficit between Pakistan and the US widened significantly during 2011; however, Pak-US co-dependence is an undeniable fact. Pakistan provides access to US supply lines in Afghanistan as well as intelligence on the ground and in return receives economic support. The Pakistan supply route is the only viable and cost effective way of transportation for the US, and prolonged disruption of this route would boost the cost of fuel for coalition forces to as high as USD400/gallon, which is not economically feasible. On the other hand, military and general aid received from the US goes a long way in boosting forex reserves and promoting public sector development in the country.

We believe that political as well as military forces on both sides completely understand the ramifications of a prolonged status quo (i.e. supply lines remaining shut) and therefore, will pan out a viable and mutually acceptable solution soon. We expect that the relationship between these allies will remain stable over the long term.

The Pak-Iran gas pipeline which is imperative for country's growth has been de-railed for the last 10 years under US pressure. Any headway on this issue, on grounds of concessions given to the European countries in respect of crude oil purchase from Iran, is likely to provide relief to the energy deficiency of the country.

### **IMF REPORT CARD: A POTENTIAL TURNAROUND**

Pakistan entered the IMF SBA Program back in 2008 amidst a balance of payment (BoP) crisis, stemming from significant increase in international crude oil prices. We face the same BoP situation in 2012 as well.

The 2008 program came to an unsuccessful and early end in September 2011. As a result, other international bilateral donors also withheld their financial support. In the wake of rising crude oil prices Pakistan faces considerable strain on the balance of payments front.

A clean IMF report under article IV would highlight a turnaround and would help strengthen the deteriorating reserve position. According to our estimates, this could yield an inflow of USD2.0–2.5bn. Additionally, it will also help bolster international investor confidence.

## **PAK ECONOMY: TOUGH TIMES DON'T LAST**

Pakistan weathered multiple exogenous shocks in 2011. Major floods in September ravaged almost 25% of the standing crops, particularly cotton and rice. On the other hand, hike in international oil prices pressured the external account. Given that the USA and EU are mulling economic sanctions and a ban on import of crude oil from Iran, hence the pressure on external account is not likely to ease in the near future.

Given lack of structural reforms, the country today faces a severe gas shortfall and high levels of circular debt; both are having an adverse impact on industrial output and growth.

Economic challenges are here to stay for now and hence, convergence towards average GDP growth rate of 5% is unlikely; at least in the near-mid term. We expect GDP growth of 3.4% in FY12, mainly supported by the agricultural sector. The industrial sector over the past ten years has grown on average by 5.6% annually; this year growth in the sector is expected to remain subdued at mere 2.2%. The services sector, which accounts for 53% of the GDP, grew by 4.1% in FY11 due to 50% hike in salary for government employees; in FY12 this growth is likely to scale back to 3.6%.

## **BALANCE OF PAYMENTS: SUPPORT CONTINGENT ON IMF**

The external account is under considerable stress - trade imbalance continues to widen in face of the double set-back of higher oil and lower cotton prices. Additionally, starting 2HFY12 repayments associated with IMF SBA program will further add to this burden. While remittance flows are expected to increase to USD12.1bn during FY12, we project a current account deficit of USD3.6bn or 1.8% of GDP.

A positive surprise could also emerge from improving Pak-US ties; the US has withheld Coalition Support Fund (CSF) payments to the tune of USD2.5bn which, if released, would lend much needed support.

Debt sustainability analysis conducted by the World Bank on multiple time frames has marked Pakistan in a stable position; however, immense significance is attributed to the report card due to be issued by IMF for gauging medium term outlook. The result of IMF Article IV inspection is expected at the end of January 2012.

## **FISCAL DISCIPLINE: THE BIG CHALLENGE**

The government has set a tax revenue collection target of PKR 1,955bn along with a fiscal deficit target of 4.0% of the GDP for FY12. With elections around the corner, we believe that un-populist measures like subsidy elimination are unlikely and hence fiscal slippages may arise. We estimate the fiscal deficit to clock in at 6.4%, which incorporates the PKR 391bn PIB/MTB issue.

Given the prevailing international liquidity crunch, we believe it would be difficult for GoP to raise money through convertible bonds and Ijarah Sukuk. With energy shortages and excessive government borrowing from the banking system adversely affecting industrial growth, we also remain skeptical on materialization of any additional tax revenues.

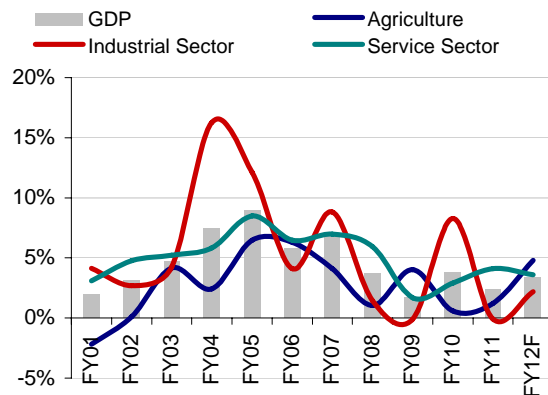
**INFLATION: MONETIZATION TO RESULT IN HIGHER INFLATION AND WEAK PKR**

During FY12 calculation methodology for the Consumer Price Index (CPI) was changed along with rebasing it from FY01 to FY08. Effective Jul11 weightage for the food basket in the CPI was trimmed to 34.83% from the previous 40.34%. These changes along with the high base effect from the previous year brought down inflation to an average of 10.87% in 1HFY12. We expect inflation for FY12 to remain within 11.5%-11.7%, thus staying within government's inflation target of 12%.

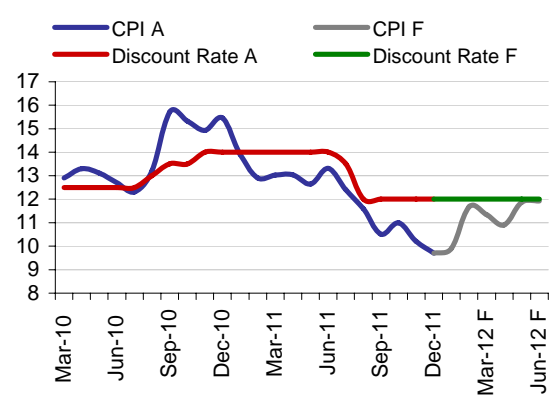
Over 2HFY12, inflation is likely to resurge due to price escalation in the energy basket, imposition of gas cess and subsequent hike in urea prices, and increase in the wheat support price. The risk of inflation also stems from monetization as government borrowing from the central bank again rears its head. We believe that the central bank should adopt a wait-and-watch approach and maintain the discount rate at 12% in FY12.

Government borrowing from central bank as of Dec11 stands at PKR221bn. If this persists, the PKR which has already weakened by 4.6% during 1HFY12, will further devalue by 2.5%-3.0%, that is decline to PKR90.5/USD to PKR92.5/USD.

**GDP Growth**

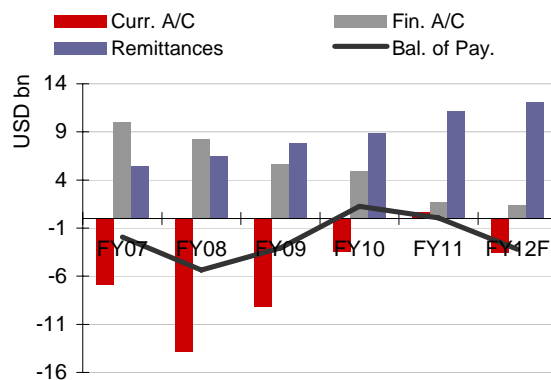


**Inflation vs Discount Rate**

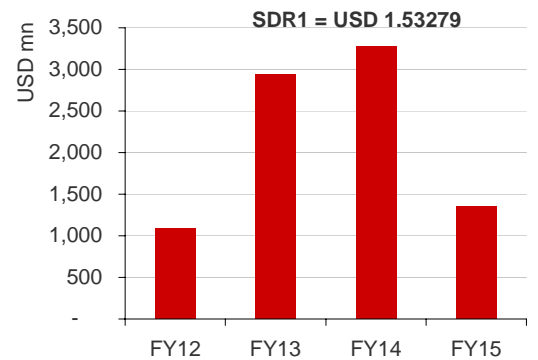


Source: SBP, BMA Research

**Balance of Payments**



**IMF Repayment Schedule**



Source: SBP, BMA Research

**FERTILIZER**

**FERTILIZER: EVERGREEN DEMAND**

**MARKETWEIGHT**

- Complete capacity utilization for fertilizer sector remains a distant prospect as we anticipate shortage of natural gas to continue in CY12E-13E.
- Fertilizer producers have seen a radical increase in cost of production starting CY12 due to hike in gas prices.
  - ✓ Effective from Jan12, feed-stock gas prices for all except two fertilizer manufacturing units (Engro Enven and Fatima Fertilizer) increased from PKR102/mmbtu to PKR313/mmbtu.
  - ✓ Additionally, fuel-stock gas costs were raised by 14% to PKR495/mmbtu for all plants.
- Impact of gas tariff hike and cess implementation on urea per bag (incl. GST):
  - ✓ Fauji Fertilizer (FFC) PKR303/bag
  - ✓ Fatima Fertilizer's PKR17/bag
  - ✓ Engro old plant PKR320/bag
  - ✓ Engro Enven PKR17/bag

As per our base case model, assuming only four months of operation for Engro's new plant in CY12 leads to an overall impact of PKR241/bag for Engro Fertilizer.

- Domestic urea prices swelled by over 74% in CY11 to PKR1600/bag due to production losses faced by manufacturers sourcing gas from SNGPL network, which was curtailed by more than 50% over the year. Therefore already soaring urea prices, shrinking gap between local and international urea prices (Yuzhny current month falling to USD380/ton by 13<sup>th</sup> Jan 2012) and regulatory actions are the hindrances in the way of complete pass through of costs to the farmer. So far, urea prices have increased by PKR210/bag to PKR1,810/bag in response to hike in gas costs.

**STOCK IDEAS**

Stock picks	Theme
<b>ENGRO</b>	<p>Largest urea producer of Pakistan with an effective capacity of 2.3mtpa. The company offers exposure to sectors immune to economic cycles. It is a diversified conglomerate with different business lines: fertilizer, polymer, chemical handling, dairy and related products and energy.</p> <p>The company faces yet another difficult year with gas supply prospects hardly expected to improve; however, presently depressed stock price and expectations of earnings bottoming out by 1QCY12 makes the company attractively placed to enter. At current stock price levels, Engro's fertilizer business is available virtually free.</p>
<b>FFC</b>	<p>FFC offers attractive valuations at present urea price levels. FFC is the safest bet in the fertilizer sector due to uninterrupted and dedicated gas supply from Mari network; stable business model and decades of management experience.</p> <p>It has also ventured into wind power project, which enjoys a guaranteed 17% USD indexed IRR. This will bolster the future bottom-line.</p> <p>FFC Dec12 TP of PKR212/share offers an upside of 42% from current levels, while it reflects dividend yields of 15% and 16% for CY12 and CY13 respectively.</p>

**ELECTRICITY**

**OVERWEIGHT**

**ELECTRICITY: It's HEDGED, it's GUARANTEED**

- Pakistan's current installed capacity is estimated to be 21,383MW with thermal, hydel and nuclear accounting for 68%, 30% and 2%, respectively. Net utilizable capacity after discounting for generation unit age-related outages and circular debt inefficiencies is 16,000 MW – this further drops to 13,000 MW in winter given seasonal availability of hydel resources
- Demand since 2001-2010 has grown at an annual average of 6%.
- The demand-supply gap currently averages at 3,500 MW.
- The government provides attractive incentives to private sector Independent Power Producers (IPPs). 15% sovereign guaranteed USD IRR for oil and gas based thermal IPPs and a PKR depreciation hedge with USD based indexation factor and US CPI scalability.
- Incentives are even more lucrative for alternate sources; an indicative USD based IRR of 17% is offered for hydel generation; while for generation based on coal obtained from the vast reserves in Thar (Sind), the government is willing to offer an IRR of 21%.
- Given the well protected nature of this sector, investment in IPPs naturally becomes defensive and offers high dividend yields. We affirm our OVERWEIGHT stance on the sector.
- Hub Power Company (HUBC) is our top pick based on:
  - ✓ favorable agreement with GoP (Power policy 1994) on its older plant and
  - ✓ 84MW hydel generation plant (through Laraib energy) which enjoys a high IRR.

**STOCK IDEA**

Stock picks	Theme
<b>HUBC</b>	<p>HUBC has made significant progress towards expansion through its 225 MW oil fired power plant in Narowal. Earnings will further augment from HUBC's hydel power project – the 84MW Laraib Energy.</p> <p>The company by way of its PPA is also entitled for incremental bonus on dispatches above 6,791GWh and is likely to book PKR300mn (PKR0.26/share) generation bonus in 1HFY12.</p> <p>Post Narowal project coming online, there were concerns of additional interest charges amid higher working capital requirement due to three fold increase in furnace oil prices. Nonetheless, GoP has increased the interest cost pass through limit of working capital for Narowal project to PKR8bn from ~PKR2bn previously; thus addressing concerns regarding potential adverse impact on HUBC's bottomline from additional interest cost.</p> <p>HUBC with a Dividend Discount Model based Dec12 TP of PKR48/share offers an upside of 41% from current levels, while it reflects dividend yields of 15% and 16% for FY12E and FY13E respectively.</p>

**OMC**
**OVERWEIGHT**
**OMC: VALUE WITH GROWTH**

- The Oil Marketing industry has posted volumetric growth at a 4.5% CAGR over the past 6 years, led by Furnace Oil (FO) and Motor Gasoline (MoGas). As of FY11, Pakistan State Oil (PSO) commands a 69% market share followed by 16% for Shell Pakistan (SHEL) and 8% for Attock Petroleum Limited (APL)
- Recently, PSO and SHEL have lost market share to new entrants due to flood related FO supply disruptions for PSO and decline in number of retail outlets for SHEL. Market share is expected to decline further for the two, especially in High Speed Diesel (HSD) and MoGas by 8% and 5% respectively, as new OMCs (including APL) aggressively expand their retail network.
- PSO, SHEL and APL derive a significant chunk of their profits from deregulated products. From a gross profit perspective, FO contributes 40% for PSO, Lubes provide 50% for SHEL and Asphalt accounts for 45% for APL.
- Recently, OMC margins on MS and HSD were revised upwards – SHEL is the major beneficiary with CY12E earnings expected to rise by 26% followed by a 12% and 5% increase for PSO and APL in FY12E, respectively.
- Circular debt, which currently amounts to PKR180bn, continues to be a risk to PSO's profitability; resolution of the same will lead to an 85% decline in finance costs while improving PSO's dividend payout. On the other hand, SHEL and APL have a significantly smaller share of FO sales and hence remain insulated from this issue.
- Currently PSO, APL and SHEL trade at EV/trailing 12-months EBITDA of 3.0x, 3.3x and 5.7x respectively, compared to the regional peers median of 4.6x. On a trailing PER basis, they register 2.5x, 6.4x and 4.9x respectively, versus 10.6x for the region.
- Growing FO and MoGas offtake, recent margin revision and the favorable impact of a gas crisis (CNG to MoGas substitution for vehicles) form the crux of our OVERWEIGHT stance on OMCs; we highlight a BUY on PSO and APL with Dec12 target prices of PKR422 and PKR532 which reflect upside potential of 86% and 29%, respectively.

**Regional Valuations**

Name	Curr EV/T12M EBITDA	P/E	Dividend Yield
Pakistan State Oil Co. Ltd	3.00	2.45	4.26
Attock Petroleum Ltd	3.34	6.41	10.00
Shell Pakistan Ltd.	5.66	4.86	7.75
BYCO Petroleum Pakistan Ltd.	8.16	2.45	-
Shandong Shengli Co.	NA	9.91	1.21
Mitsuuroko Holdings Co. Ltd	3.55	28.96	3.42
Kamei Corp	4.17	484.47	2.06
Shenzhen Guangju Energy Co.	NA	36.43	-
China Aviation Oil Singapore	23.27	8.32	1.97
SK Gas Co. Ltd	8.19	6.26	2.05
Zhejiang Haiyue Co. Ltd	NA	231.78	-
Sinanen Co. Ltd	1.86	16.98	4.41
Sinopec Kantons Holdings	9.31	20.22	0.77
E1 Corp	NA	5.72	2.85
New Zealand Refining Co. Ltd	4.98	12.95	6.59
Itochu Enex Co. Ltd	3.36	11.32	3.70
Sala Corp	10.83	24.95	2.18
<b>Median</b>	<b>4.57</b>	<b>10.62</b>	<b>2.51</b>

**STOCK IDEAS**

Stock picks	Theme
<p><b>PSO</b></p>	<p>Pakistan State Oil (PSO) is the dominant player in the market. In terms of volume, the company accounts for 69% of total market share. The company dominates in almost all product segments particularly in High Speed Diesel (HSD) and Furnace Oil (FO) with market shares of 55% and 78% respectively. The Ministry of Petroleum and Natural Resources has recently revised OMC margins upwards on previously regulated POL products by PKR0.48/ltr for Motor Spirit and PKR0.41/ltr for High Speed Diesel to PKR1.98/ltr and 1.76/ltr respectively. Owing to working capital issues arising from circular debt, PSO reported colossal finance costs of PKR12bn during FY11.</p> <p>The company accounts for penal interest expense to refineries on accrual basis while penal interest income is treated on cash basis. As a result net penal interest income (markup - expense), not presented on books, currently stands at PKR14bn; thus, resolution of circular debt will not only result in better cash flows but will also allow for materialization of the amount on income statements.</p>
<p><b>APL</b></p>	<p>Attock Petroleum Limited (APL) accounts for 7.0% of the total market share. During the last 3 years APL has increased its retail outlets at a CAGR of 18% and now operates 326 outlets.</p> <p>APL is the only OMC which markets Asphalt and hence it holds significant share in the market. It has significant synergies with the Asphalt producing refineries associated with Attock Group of Companies, which places it in an even more attractive position.</p> <p>The prevailing gas crisis will continue to benefit OMCs in the form of increased volumetric off-takes on back of power and transport sector increasing their reliance on petroleum products.</p> <p>We also expect sales volumes of MoGas for APL to cross 120,000 MT by FY12 due to persistence in power outages, continued growth in transport sector and expansion in its retail network.</p>

**E&P**
**MARKETWEIGHT**
**E&P: HIGH EXPECTATIONS FROM FY12**

- Oil and gas production in CY11 remained largely flat at 65,000 bpd and 4bcf/day, respectively; this is attributed to delays in project commencement such as KPD-TAY, Majori East-1 and Nashpa-02 for oil and delay in installation and commissioning of compressors at Qadirpur for gas.
- However, CY12 oil production is expected to rise YoY by 15%. Nashpa-02 has already started contributing 5,000 bpd, Makori East and Manzalia-09 are expected to add 5,500 bpd and several other additions are expected from Ashi, Domial, Sinjhora, Halini and KPD-Tay.
- Gas production will again remain flat in CY12 with high value projects expected to come online in FY14
- Pakistan's oil producers are benchmarked against Arab Light crude oil prices which averaged USD108/bbl during CY11, a YoY increase of 38%. Iran-US tensions have kept prices buoyant and we expect Arab Light to average USD110/bbl during CY12.
- Eventual revenue for E&P companies is generated in PKR and hence, currency depreciation bodes well for them; annual PKR depreciation has averaged 7% over the past 20 years and our Balance of Payments estimates imply further 5-7% erosion during CY12.
- Currently OGDC, POL and PPL trade at EV/trailing 12-months EBITDA of 5.5x, 3.4x and 4.0x respectively, compared to the regional peers median of 6.1x. On a trailing PER basis, they register 9.2x, 7.0x and 6.7x respectively, versus 15.0x for the region.
- We like OGDC and POL based on their aggressive stance towards exploration & development activity and high potential for production growth. Our Dec12 target prices for OGDC, POL and PPL stand at PKR168/share, PKR472/share and PKR238/share, respectively.

**Regional Valuation**

Name	Curr EV/T12M EBITDA	P/E	Div. Yield
Oil & Gas Development Co. Ltd	5.45	9.16	3.76
Pakistan Oilfields Ltd.	3.43	6.97	9.87
Pakistan Petroleum Ltd.	3.97	6.73	6.35
Occidental Petroleum Corp	6.08	12.24	1.90
Premier Oil Plc	10.59	17.53	-
Santos Ltd	11.62	13.12	3.11
Kazmunaigas Exploration Production	4.33	4.18	5.67
Inpex Corp	2.70	11.73	1.21
Japan Petroleum Exploration	2.75	12.13	1.29
Linn Energy LLC-Units	15.78	15.03	7.23
NEXEN Inc.	3.37	16.35	1.18
South Western Energy Co.	7.41	18.56	-
Pengrowth Energy Corp	8.14	21.75	7.43
Encana Corp	5.65	43.89	4.20
Noble Energy Inc	9.09	19.72	0.89
Progress Energy Resources Co.	13.64	24.72	3.00
APCO Oil and Gas International Inc.	55.88	75.03	0.10
<b>Median</b>	<b>6.08</b>	<b>15.03</b>	<b>3.00</b>

Source: BMA Research

**STOCK IDEAS**

Stock picks	Theme
<p><b>OGDC</b></p>	<p>OGDC is Pakistan's largest oil and gas company, dominating 30% of the country's hydrocarbon reserves. It has 28% stake in Tal block which has been a major discovery with recoverable oil and gas reserves currently estimated at 63mn bbls and 2.3tcf respectively. The company has also undertaken huge investment in six development projects including Sinjhor, Kunnar Pasakhi Deep and Tando Allah Yar (KPD-TAY). These shall add significant volumes to OGDC's production from FY13 onwards.</p> <p>An equal split between oil and gas in OGDC's revenues protects it against a fall in international oil prices below USD80/bbl. With price capping in place on most of OGDC's gas fields, any oil price decline till USD 65/bbl would not dent the company's top line.</p>
<p><b>POL</b></p>	<p>POL has a 21% stake in Tal Block. Ongoing production additions have turned around the company's profile. Oil and gas production from the field increased by 14x and 8x compared to production in FY09.</p> <p>POL being the exploration arm of Attock group derives part of the strength of its business model through an inherent shield against the system's circular debt. This should thus allow the company to deliver on its recently revived exploratory program for which at least 4 wells (including JVs) are already in the drilling phase.</p> <p>In a nutshell the company offers a robust EPS growth of 21% for FY12E. POL not only stands to benefit from its core growth but also has the most compelling valuations amongst its peers – FY12E PER of 6.3x and dividend yield of 12%. BUY.</p>

**DISCLAIMER**

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**ANALYST CERTIFICATION**

We, Nurali Barkatali, Furqan Punjani and Farid Aliani, hereby certify that this report represents our personal opinions and analysis of information. All views are accurately expressed to the best of our knowledge. We certify that no part of our remuneration is linked either directly or indirectly to recommendations or analysis covered in this report.

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# BMA STOCK PICKS

## BUY

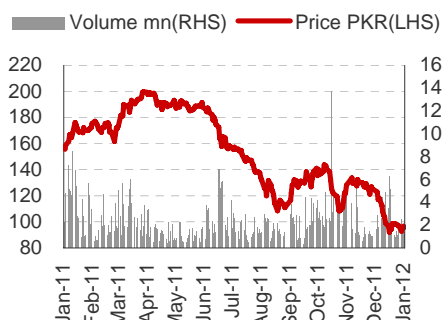
TP Dec-12: PKR 231

Current Price: PKR 93

### Stock Statistics

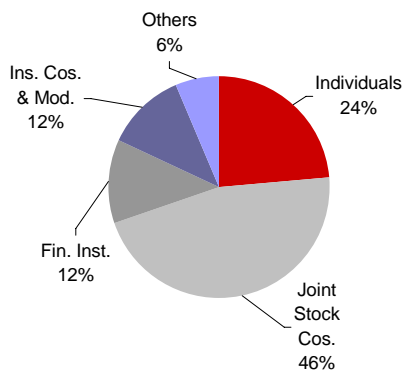
		ENGRO
Ticker		ENGRO
3-month	High/ Low	143.8/ 92.0
Mkt Cap	USD mn	410
12M ADT	mn sh	2.3
Beta		1.16

### Price and Volume Graph



**ENGRO Profile:** ENGRO is the largest Urea producer in Pakistan with a name plate capacity of 2.3mtpa. The company has followed an aggressive growth strategy and now operates in various business lines such as FMCG, chemical handling, energy and polymer production

### Shareholding Pattern as of Dec-10



## ENGRO: BOTTOMING OUT IN 1QCY12

### INVESTMENT SUMMARY

- **Diversification & synergies:** ENGRO benefits from risk spread-out across a vast array of business lines ranging from fertilizer to energy. The company has investments in sectors which are delinked to economic cycles; fertilizer, energy and foods. It has a strong foot-hold, is a market leader in fertilizer and has over 44% share in UHT milk segment. It operates in protected markets; energy business with guaranteed returns. ENGRO benefits directly and indirectly from synergies existing between its business units. Chemical handling and polymer generate supply chain links, while EXIMP acts like a trading arm for the fertilizer operations and potentially for other subsidiaries.
- **Earnings to bottom out in 1QCY12:** We expect ENGRO's earnings to stay depressed for 4QCY11 since the new fertilizer plant operated for only one month in the quarter. For 1QCY12, we expect the gas supply to stay shut because of gas shortage. Coupled with high feedstock gas costs at old plant, earnings for 1QCY12 will be on the lower side compared to the last four quarters. However, the same are expected to bottom out in the first quarter of 2012. Post resumption of gas expected in Apr12, earnings will recover and hence the current stock price presents an attractive opportunity to accumulate the stock for medium to long term.
- **Fertilizer business virtually discounted in share price:** Amidst gas supply concerns, not only has the market completely written off ENGRO Corporation's fertilizer business (which also includes the company's older plant facing no gas supply issues and functioning properly) but also has disregarded expected cash flows from the company's other stable and growing businesses to the tune of at-least ~PKR10/share.
- **Hefty leverage overplayed:** Engro carries PKR113.6bn debt on its balance sheet of PKR180.5bn as of 9MCY11. As per our estimates, the company's cash flow position is comfortable and it has the ability to meet debt and finance cost obligations courtesy of urea pricing power. The company also has stable businesses that generate positive earnings. For example, annual bottom-line from Engro Energy is PKR1.8bn-2.0bn, Engro Foods is a fast growing business expected to contribute about PKR1.0bn to bottom-line in CY12, and annual dividends from VOPAK Terminal are in between PKR500-600mn. Engro Polymer & Chemical completed its backward integration project in CY11, and is expected to generate positive earnings CY12 onwards.

### Financials

	CY09A	CY10A	CY11E	CY12E	CY13E
EPS (PKR)	9.5	16.4	17.0	21.9	25.8
Price to Earnings (x)	9.8	5.7	5.5	4.2	3.6
Dividend Yield (%)	5	5	6	6	6
EPS Growth (%)	-12	73	4	29	18
Return on Equity (%)	13	19	18	20	20
Return on Assets (%)	3	4	5	6	7

Source: BMA Research

## BUY

TP Dec-12: PKR 212

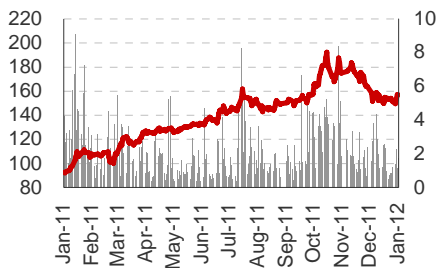
Current Price: PKR 150

### Stock Statistics

Ticker	FFC	
3-month	High/ Low	192.4/149.5
Mkt Cap	USD mn	1,425
12M ADT	mn shares	2.2
Beta	0.89	

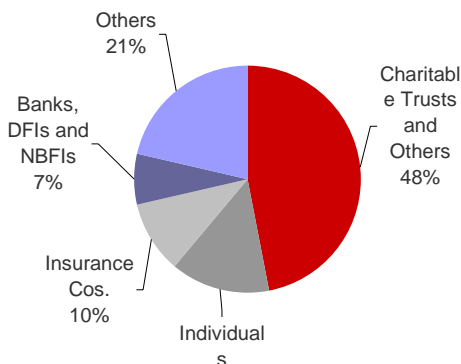
### Price and Volume Graph

Volume mn(RHS) Price PKR(LHS)



**FFC Profile:** FFC produces and markets urea, the most popular fertilizer in Pakistan under the brand name "Sona Urea". The company also holds 51% stake in Fauji Fertilizer Bin Qasim (FFBL), which is the sole producer of Di-Ammonium Phosphate (DAP) in Pakistan. Dividend payout from FFBL is a major source of income for FFC. Both the companies pay out over 95% of their earnings.

### Shareholding Pattern as of Dec-10



## FFC: ATTRACTIVE AT PRESENT LEVELS

### INVESTMENT SUMMARY

- Safest Fertilizer Bet:** Fauji Fertilizer is the lowest risk investment in the sector because of uninterrupted and dedicated gas supply from the Mari network. Amidst the severe gas crisis, SNGPL and SSGC based plants have been facing and are expected to face curtailment and supply interruptions; whereas Mari based plants stand safe from these issues due to exclusivity of natural gas from this field to fertilizer manufacturing.
- Attractive Dividend Yield:** The stock came off by ~22% from its Oct11 high to PKR150/share by CY11 year-end, on the back of expectations of eroding urea margins going into CY12. Incorporating slightly depressed margins compared to 4QCY11 due to lower then proportional hike in urea prices (PKR210/bag compared to cost impact of PKR300/bag), CY12 profitability of the company is expected to mimic the CY11 earnings.
- At these levels, the stock offers an attractive yield of 15%. This yield is appealing when considering that benchmark rate has come off by 200 basis points to now stand at 12%.
- Valuation:** Our Dec12 TP for the company stands at PKR212/share, offering potential upside of 30%. However, assured dividends with dividend yield of 15% for CY12E and CY13E; and possible upside resulting from further urea price action (in the event of gas supply to SNGPL based plants exacerbating) make FFC a safe bet with limited downside from these levels.

### Financials

	CY09A	CY10A	CY11E	CY12E	CY13E
EPS(PKR)	10.4	13.0	24.6	22.5	23.2
Price to Earnings (x)	14.4	11.5	6.1	6.6	6.5
Dividend Yield (%)	7	7	15	15	15
EPS Growth (%)	35	25	89	-9	3
Return on Equity (%)	67	71	45	96	96
Return on Assets (%)	23	26	45	38	39

Source: BMA Research

## BUY

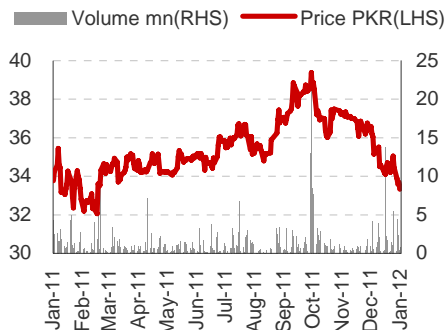
TP Dec-12: PKR 48

Current Price: PKR 34

### Stock Statistics

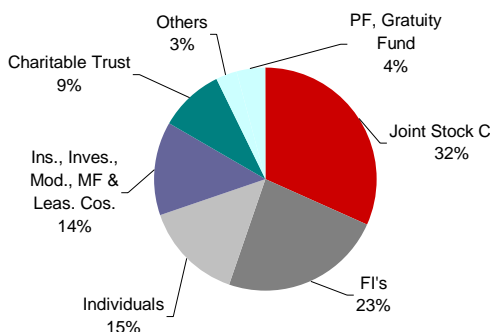
Ticker	HUBC	
3-month High/ Low	39.4/ 34.1	
Mkt Cap	USD mn	445
12M ADT	mn shares	1.4
Beta		0.88

### Price and Volume Graph



**HUBC Profile:** Hub Power Company Limited (HUBC) was incorporated in Pakistan in 1991. It is the second largest furnace oil based independent power producer (IPP) in Pakistan. With inclusion of Narowal Project in Apr11 the company's capacity has been enhanced to 1,400MWh (12,264GWh), shares about 7.0% load of total electricity generation of Pakistan. It is a publicly owned company listed on all three stock exchanges of Pakistan.

### Shareholding Pattern as of Jun-2011



## HUBC: HEDGE AGAINST ALL ODDS

### INVESTMENT SUMMARY

- Strengthening bottom-line through expansion:** HUBC has made significant progress towards expansion through its 225 MW oil fired power plant in Narowal, which achieved COD in Apr10. The final tariff of the Narowal project is yet to be announced by NEPRA, which will augment earnings. Preliminary analysis indicates that the project will add PKR1.26/share to the bottom line.
- Earnings will be further augmented by the hydel power project – 84MW Laraib Power;** which enjoy a 17% USD IRR guaranteed by the government. The plant is expected to come online in FY13.
- Tariff and indexation factors; hedged bets:** With Project Company Equity (PCE) component reaching its trough in FY08, PCE will show a rising trend from FY09-FY27. The tariff is indexed to USD, thus any depreciation in PKR is projected to translate into a proportional increase in bottom-line, translating into cash payouts for the investors.
- HUBC, by way of its Power Purchase Agreement (PPA), is entitled for incremental bonus on dispatches above 6,791GWh;** and is likely to book PKR300mn (PKR0.26/share) generation bonus in 1HFY12.
- The fuel supply to the senior plant is guaranteed by the government (under 1994 PPA), and is made through a 78 km long pipeline from Pakistan State Oil.**
- Circular debt concern – relatively resolved:** Hub power has remained relatively insulated from circular debt. However, post Narowal project coming online, there were concerns of additional interest charges amidst higher working capital requirement due to three fold increase in furnace oil prices. Nonetheless, GoP has increased the interest cost pass through limit of working capital for Narowal project to PKR8bn from ~PKR2bn previously; thus addressing concerns regarding potential adverse impact on HUBC's bottomline from additional interest costs.
- Dividend payout - fit as a fiddle:** HUBC is our favorite pick as the company remains relatively insulated from circular debt and pays stable dividends, with profitability hedged against PKR devaluation. The company has an inherent growth story on back of expansion through Laraib which keeps room open for further upside. We recommend a BUY on HUBC with a Dividend Discount Model based Dec12 TP of PKR48/share. The stock offers upside of 41% from current levels while it reflects dividend yields of 15% and 16% for FY12E and FY13E respectively.

### Financials

	FY09A	FY10A	FY11A	FY12E	FY13E
EPS(PKR)	3.3	4.8	4.7	6.4	7.6
Price to Earnings (x)	10.5	7.1	7.3	5.3	4.5
Dividend Yield (%)	10	15	16	15	16
EPS Growth (%)	45	47	-2	37	18
Return on Equity (%)	13	19	18	25	28
Return on Assets (%)	4	5	4	11	13

Source: BMA Research

## BUY

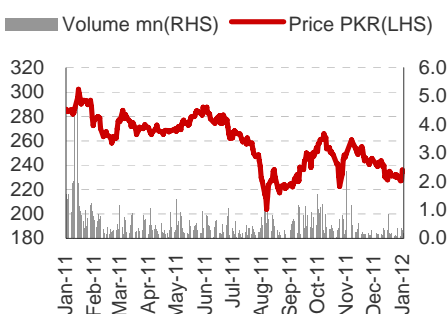
TP Dec-12: PKR 422

Current Price: PKR 227

### Stock Statistics

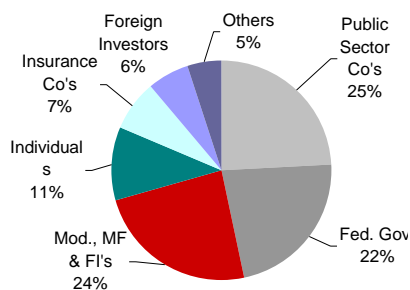
Ticker	PSO	
3-month High/ Low	265.8 / 222.4	
Mkt Cap	USD mn	438
12M ADT	mn shares	0.4
Beta		1.08

### Price and Volume Graph



**PSO Profile:** Pakistan State Oil (PSO) is the market leader in Pakistan's energy sector. The company has the largest network of retail outlets to serve the automotive sector and is the major fuel supplier to aviation, railways, power projects, armed forces and agriculture sector. PSO also provides Jet Fuel to Refueling Facilities at 9 airports in Pakistan and ship fuel at 3 ports. The company is currently engaged in storage, distribution and marketing of various POL products. The company's current market share of 83% in the black oil market and 58% share in the white oil market, alone speak volumes about its success.

### Shareholding Pattern as of June-11



## PSO: ATTRACTIVE ON VALUATIONS

### INVESTMENT SUMMARY

- Revision in OMC Margins:** The Ministry of Petroleum and Natural Resources has recently revised OMC margins upwards on previously regulated POL products by PKR0.48/ltr for Motor Spirit and PKR0.41/ltr for High Speed Diesel. Previously OMC Margins on MS and HSD stood at PKR1.50/ltr and PKR1.35/ltr respectively. According to our estimates the recent revision in margins will have a positive EPS impact for PSO of PKR9/share (12% increase) in FY12E.
- Attractive valuations despite its leadership position:** PSO is currently trading at an attractive FY12E PER of 2.9x and offers potential upside of 79% to our DCF based Dec12 Target Price of PKR422/share.
- It is the leading OMC in Pakistan with the largest distribution network comprising 3,626 outlets and 80% of the country's total storage capacity. PSO holds a market share of 69% and dominates in almost all product segments particularly in High Speed Diesel (HSD) and Furnace Oil (FO) with market shares of 55% and 78% respectively. PSO is also the major importer of POL products and has about 90% market share in imports.
- Strong FO demand from the power sector:** During FY11, PSO held sizable market share of 78% in FO sales with contribution from the product accounting for 45% towards gross profit of the company. PSO therefore continues to benefit the most from increasing FO demand from the power sector. We expect FO demand surge to continue with total demand expected to grow by 10% in FY12.
- The trigger to look for - circular debt resolution:** Owing to working capital issues arising from circular debt, PSO reported colossal finance costs of PKR12bn during FY11, a YoY rise of 20%. The company accounts for penal interest expense to refineries on accrual basis while penal interest income is treated on cash basis. As a result net penal interest income (markup - expense) not presented on books currently stands at PKR14bn; thus, resolution of circular debt will not only result in better cash flows but will also allow for materialization of the amount on income statements.

### Financials

	FY09A	FY10A	FY11A	FY12E	FY13E
EPS(PKR)	(39.1)	52.8	86.2	78.2	91.3
Price to Earnings (x)	NM	4.3	2.6	2.9	2.5
Dividend Yield (%)	2	4	4	2	7
EPS Growth (%)	NM	NM	63	-9	17
Return on Equity (%)	NM	31	35	25	23
Return on Assets (%)	NM	4	6	5	6

Source: Company Reports, BMA Research

## BUY

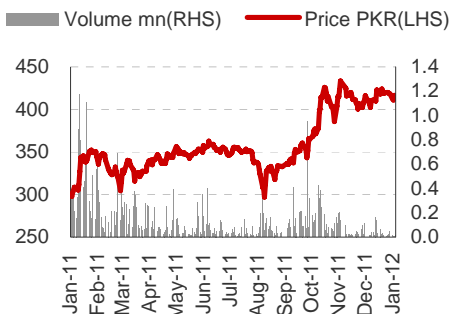
TP Dec-12: PKR 532

Current Price: PKR 413

### Stock Statistics

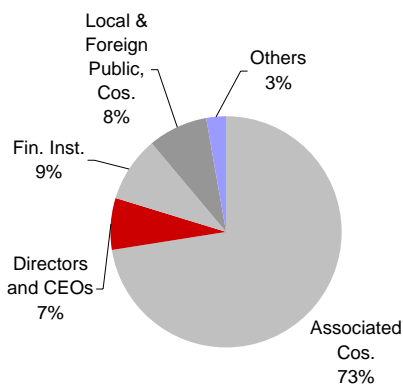
Ticker	APL	
3-month	High/ Low	433.6 / 368.3
Mkt Cap	USD mn	320
12M ADT	mn shares	0.1
Beta	1.00	

### Price and Volume Graph



**APL Profile:** Attock Petroleum Limited (APL) is the 4th largest Oil Marketing Company (OMC) in Pakistan. During the last 3 years APL has increased its number of retail outlets with CAGR of ~15% and now operates 277 retail outlets. APL deals in various POL products and is the sole OMC to deal in Asphalt. In terms of volumetric sales, APL accounts for 7.0% of total market share. The rapid growth in its volumetric off-takes and retail network speaks its success story.

### Shareholding Pattern as of June-11



## APL: GROWTH MOMENTUM TO CONTINUE

### INVESTMENT SUMMARY

- Expanding market share:** Attock Petroleum Limited (APL) is the fourth largest Oil Marketing Company (OMC) in Pakistan. During the last 3 years APL has increased its retail outlets at a CAGR of 18% and now operates 326 retail outlets. In terms of volumetric sales, APL accounts for 7.0% of total market share. It witnessed rapid volumetric growth in sales during FY11 of around 42% for Motor Spirit (MS), compared to industry average of 17%.
- Market leader in Asphalt:** Currently APL is the only OMC which markets Asphalt and hence it holds significant share in the market which contributes 45% towards APL's total gross profit. APL has significant synergies with Asphalt producing refineries associated with Attock Group of Companies, which places it in an even more attractive position.
- Revision in OMC Margins:** Ministry of Petroleum has recently revised OMC margins upwards on Motor Spirit and High Speed Diesel by PKR0.48/ltr and PKR0.41/ltr respectively. According to our estimates, the revision in margins will have a positive EPS impact of PKR3/share, a 5% increase for FY12E.
- Relative hedge from circular debt:** Being a non-government entity, APL chose to keep itself away from circular debt. APL had to pay the cost for this choice by losing market share by 280bps (from 7% in FY07 to 4% during FY11) in furnace oil (FO) segment. However, benefits obtained were prevention of rising financial charges and increased concentration on retail network expansion. Nonetheless, as circular debt issue eases off, APL can benefit by regaining its market share in the segment, thus providing upside risks to our future volumetric projections.
- Outlook:** On a broader level, we expect prevailing gas crisis to continue benefiting OMCs in the form of increased volumetric offtake, as power and transport sector will incrementally rely on petroleum products. We also expect sales volumes of MoGas for APL to cross 120,000 MT by FY12 due to persistence in power outages, continued growth in transport sector and expansion in its retail network.
- Compelling Valuations:** APL currently offers upside potential of 27% to our DCF-based Dec12 Target Price of PKR532/share and is attractively valued with an FY12E PER of 6.9x. The stock remains amongst our High Conviction Ideas.

### Financials

	FY09A	FY10A	FY11A	FY12E	FY13E
EPS(PKR)	44.6	52.0	61.6	60.1	63.5
Price to Earnings (x)	9.2	7.9	6.7	6.9	6.5
Dividend Yield (%)	5	6	10	10	10
EPS Growth (%)	17	17	18	-2	6
Return on Equity (%)	44	39	37	32	29
Return on Assets (%)	17	17	17	15	14

Source: BMA Research

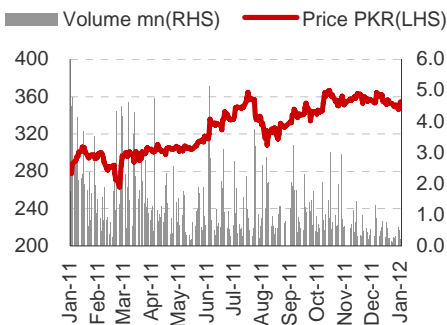
## BUY

TP Dec-12: PKR 472

Current Price: PKR346

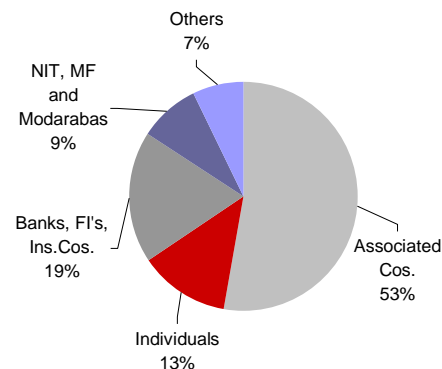
Stock Statistics			
Ticker			POL
3-month	PKR	366.4 / 341.5	
Mkt Cap	USD mn	921	
12M ADT	mn	1.3	
Beta		1.12	

### Price and Volume Graph



**POL Profile:** POL is engaged in oil and gas exploration in the country and has been investing independently and in joint venture with various other exploration and production companies. In addition it is also involved in manufacture of manufacture of LPG, solvent oil and sulphur. The company is part of The Attock Oil Company Limited (OCAC) and holds 25% ownership stake in National Refinery Limited.

### Shareholding Pattern as of June-11



## POL: VALUABLE PICK FROM THE SECTOR

### INVESTMENT SUMMARY

- Amidst materialization of production growth from TAL Block:** Tal has been a major recent discovery benefiting all the three listed E&P companies, with recoverable oil and gas reserves currently estimated at 63mn bbls and 2.3tcf, respectively. POL has a 21% stake in Tal Block. Ongoing production additions have turned around the company's profile. Central Processing Facility came online during 2QFY10 at Manzalai field, enhancing its oil and gas production to over 200mmcf/d and around 4,000bpd, respectively. As a result, FY11 oil and gas production from the field increased by 14x and 8x compared to production in FY09. Moreover, Manzalai-9 well in the TAL block was recently developed which yielded flow of 1,296bbl/day of oil and 30mmcf/d of gas.
- Furthermore, Mamikhel and Maramzai (part of Tal block) are projected to come online during CY12 with cumulative production of 85mmcf/d of gas and 3,000bpd of oil.** We thus project POL to deliver impressive oil production growth of 9% for CY12 while gas production is likely to see growth of 14% over the same period. We estimate Tal block to account for 39% of company's revenues and 46% of production in FY12.
- Ikhlas Block proving to be a gold mine:** In 4QFY11 POL announced that initial production testing carried out on its exploratory well Domial-1 yielded a flow of 942bpd of oil and 11mmcf/d of gas. POL is currently producing oil from this field at an average of 403bpd while gas flows are expected soon. Further upside from the Ikhlas block remains contingent on the status of development well Domial-2, while prospects of discovery from this well remain strong.
- Relative immunity from circular debt to allow aggressive exploration activity:** POL being the exploration arm of the Attock group derives part of the strength of its business model through an inherent shield against the system's circular debt. It should thus allow the company to deliver on its recently revived exploratory program for which at least 4 wells (including JVs) are already in the drilling phase.
- Double-digit EPS growth, Prospective Dividend Yield of 12% for FY12E:** Offering robust EPS growth of 21% for FY12E, the company not only stands to benefit from its core growth but also reflects the most compelling valuations amongst its peers – FY12E PER of 6.3x and dividend yield of 12%. BUY.

### Financials

	FY09A	FY10A	FY11A	FY12E	FY13E
EPS(PKR)	23.8	31.4	45.7	55.2	54.3
Price to Earnings (x)	14.6	11.0	7.6	6.3	6.4
Dividend Yield (%)	5	7	10	12	12
EPS Growth (%)	-35	32	45	21	-2
Return on Equity (%)	22	26	32	34	29
Return on Assets (%)	16	19	23	25	22

Source: BMA Research

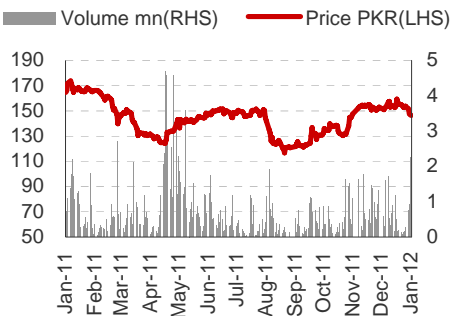
## BUY

TP Dec-12: PKR 168

Current Price: PKR 152

Stock Statistics		
Ticker		OGDC
3-month	High/ Low	159.4/ 131.7
Mkt Cap	USD mn	7,327
12M ADT	mn shares	0.7
Beta		1.09

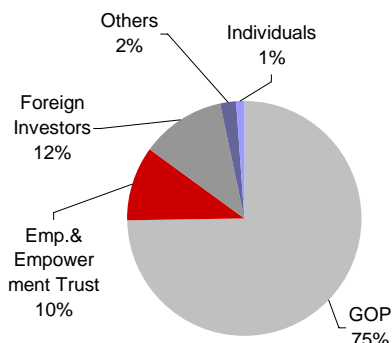
### Price and Volume Graph



**OGDC Profile:** OGDC is Pakistan's largest oil and gas company dominating 30% of the country's hydrocarbon reserves. The company has a presence in and knowledge of all four provinces.

The company's exploration and drilling strategies include maintaining balanced portfolio of exploration blocks, accelerating exploration activities in offshore and extending exploratory efforts to unexplored and frontier areas.

### Shareholding Pattern as of June-2011



## OGDC: AGGRESSIVE AGAIN!

### INVESTMENT SUMMARY

- Rising production from TAL Block to compensate for falling volumes in other wells:** OGDC's production performance has lately been dismal. Oil production has come off by 2% in FY11 – the result of natural decline from Bobi, Kunar, Sono and Buzdar fields. However, Tal has been a major recent discovery benefiting all the three listed E&P companies, with recoverable oil and gas reserves currently estimated at 63mn bbls and 2.3tcf respectively. OGDC holds 28% stake in Tal Block. Oil production from this field increased by 14x in FY11 and gas production by 8x compared to that of FY09. Manzalai-9 well in the TAL block was recently developed which yielded flow of 1296bbl/day of oil and 30mmcf of gas.
- Upside potential in Qadirpur gas field is likely to ease concerns:** Gas production on the other hand increased by 4% YoY in FY11. The Qadirpur field which contributes 40-50% towards company's total gas production is currently producing ~400-500mmcf of raw gas. Management plans to install three more compressors and drill two extended reach wells (ERW) in FY12 to enhance gas production by 650mmcf.
- Aggressive stance towards exploration and development:** The company has also undertaken huge investment in six development projects including Sinjhora and Kunrar Pasakhi Deep. Tando Allah Yar (KPD-TAY) and Uch II shall add significant volumes to OGDC's production from FY13 onwards. We expect incremental oil and gas production from these projects of about 9,000bpd and 520MMCFD respectively, adding ~PKR25bn to the topline annually. Furthermore, Nashpa-02 has already started production of ~5,000bpd oil and 13mmcf of gas, taking total oil production to more than ~10,000bpd of oil, making it the largest oil producing field of Pakistan. Commencement of production from Mela – 03 and Tolanj fields in FY12 is expected to increase oil and gas production for the company by 6% and 5%, respectively.
- OGDC is currently involved in several exploration projects.** The company is either an operator or has a stake in 8 exploratory wells that are in various stages of drilling.
- Partially hedged against oil price decline:** An equal split between oil and gas in OGDC's revenues protects it against a fall in international oil prices below USD80/bbl. Furthermore, with price capping in place on most of OGDC's gas fields, any oil price decline till USD 65/bbl would not dent the company's topline. Moreover, PKR depreciation versus the USD bodes well; we estimate that PKR depreciation of 1% will increase the company's earnings by 0.8%.

### Financials

	FY09A	FY10A	FY11A	FY12E	FY13E
EPS(PKR)	12.9	13.8	14.8	16.9	17.4
Price to Earnings (x)	11.7	11.0	10.3	9.0	8.7
Dividend Yield (%)	5	4	4	5	6
EPS Growth (%)	25	7	7	15	3
Return on Equity (%)	44	38	32	34	29
Return on Assets (%)	31	26	24	27	25

Source: BMA Research