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Proceed with caution; multiple risks exist

The first half of 2010 was choppy, but the second half of the year was bullish despite the severe floods that took place during July/August and the poor macroeconomic performance. The positive foreign portfolio inflows especially in selective heavyweight Index stocks such as OGDC led to a remarkable comeback for the market during 2H CY10. It can be argued that the attractive valuations namely PEx which has been trading at a sizeable discount to the regional average has acted as a catalyst for foreign investor activity. However, there are risks emanating from the economic, political and geopolitical fronts that could adversely impact the equity market performance during 2011.

The average PEx for the Pakistan market over the last 10 years comes to 9.29 while the 12-month forward PEx stands at 8.13. This suggests a potential upside of 14% for the KSE-100 Index to reach 13,737 during 2011. However, this may be an optimistic view given the current state of the economy. During the periods of high PEx levels during 2004 to 2007, the real GDP growth during this period was averaging near 7% per annum.

The precarious macroeconomic situation could receive another shock if Pakistan does not receive the next tranche from the IMF, as the GoP has been granted an extension of up to 9 months in order to meet IMF conditionalities such as implementation of RGST. The continuation of foreign portfolio flows is the main presumption that would drive the equity bourses upwards during 2011, but if the situation worsens on the economic or political front, the foreign portfolio money could exit the country despite the attractive valuations.

We expect that the KSE-100 index would continue to climb on the back of foreign portfolio inflows during the early part of 2011, which could lead to the Index touching the 13,000-level. However, the risk of a formation of an asset bubble remains high and a boom-bust period could come into fruition. Therefore, **we advise investors to sell on strength and to wait for corrections to re-enter the equity market.** A bottom-up approach would be needed and companies with little or no leverage with steady cashflows would be preferred. We would recommend accumulation on weakness selective stocks from the oil and gas, chemicals, cement, fertilizer and power.

PAKISTAN OUTLOOK 2011

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Pakistan Market Review & Strategy

2010 Market Review

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The KSE-100 Index experienced a dull first half of the year in 2010 but a bullish second half on the back of foreign fund inflow despite the devastating floods, poor macroeconomic performance and political uncertainty. Overall, the KSE-100 Index gained 28.1% or 2,635 points for the year ended December 31, 2010 to 12,022 points on an average daily volume of 121.11m shares as compared to 170.93m during CY09. The KSE-30 Index increased by 17.6% or 1,738 points to close the year at 11,588. According to the NCCPL figures, the net foreign portfolio inflow in the equity bourses came to US\$ 526.37m during CY2010. Looking back at the last 12 months, the market can be segmented into 5 distinct phases: 1) bullish start; 2) slump and pre and post budget activity; 3) July recovery; 4) floods and Ramadan activity and; 5) the bell lap.

Bullish start

During the first three and half months of 2010, the KSE was mostly bullish with a short period during mid-January to February that saw some dullness in the market owing to activity in lower tier stocks and uncertainty on the political front due to the judicial crisis in February over judges appointments and announcement of capital gains tax expected in the federal budget in June. The KSE-100 Index gained 1,290 points or 13.75% with an average daily turnover of 180.98m shares to close at 10,677 on April 15. The main factors behind the bullish sentiments during this period were:

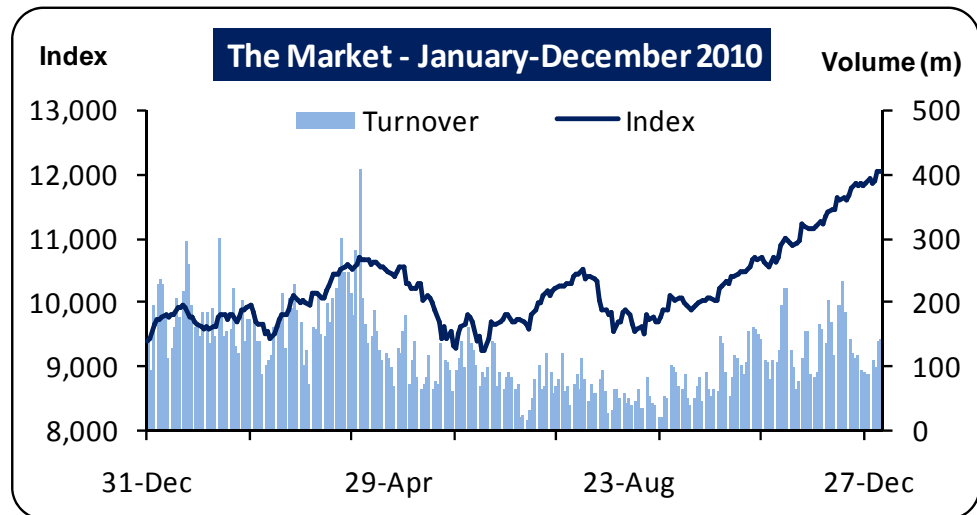
- Foreign buying interest in KSE-100 Index heavy weight stocks such as OGDC, PPL and PTCL;
- Improvement in selected macroeconomic indicators such as continued declining trend in inflation, trade deficit and higher overseas remittances;
- There was positive news flow regarding the Pakistan-U.S. strategic dialogue that was held in Washington during the third week of March;
- Passage of the 18th Amendment Bill in the National Assembly in April and;
- Moody's affirmation of Pakistan's sovereign rating with a stable outlook, yields on Pakistan Eurobond falling below 8% for the first time in nearly 2 years and slight recovery in banking credit to the private sector.

Slump and Pre and Post Budget activity

From April 15 to June 1, the KSE experienced a slump during the run-up to the budget session in June. Subsequently to the federal budget on June 5, the market became lacklustre and range bound. The KSE-100 Index shed 955 points on average daily volume of 108.59m shares to close at 9,721 on June 30. The key developments behind the slump and sluggishness in the market during this period were:

- Sporadic foreign fund flow;
- Compliance problems between the GoP and the IMF over the approval of the fifth tranche;
- Rising inflationary trend in the months of March and April;
- News reports that the Finance Ministry was re-evaluating the capital gains tax mechanism expected for FY11 that was agreed upon between the then Finance Minister Shaukat Tarin and the KSE back in February;
- Continuing circular debt crisis impacting the energy sector;

- The Greek economic crisis may have had a negative spill over effect among foreign investors;
- Worsening law and order situation in parts of the country, especially in Punjab and;
- There was vagueness in the budget regarding the modalities of the newly introduced Capital Gains Tax.



July Recovery

The market posted a recovery during the month of July albeit on thin turnover which was likely attributed to the induction of the Capital Gains Tax on July 1. The KSE-100 Index gained 797 points or 8.20% on average daily turnover of 67.76m shares to end the month at 10,519. The sentiments turned positive on the back of foreign buying and news of leverage product approval on the cards. Foreign buying interest in Oil and gas E&P stocks, especially OGDC led to the sharp rise in the Index. Other developments during the month were:

- PSO announcing its due-diligence for the acquisition of additional 30% stake in PRL;
- OGDC finding an additional 1200bpd oil and 1.5mmcf/d gas reserves in Rajan field;
- Faysal Bank's acquisition of RBS was given the go ahead by the central bank;
- U.S. Secretary of State Hillary Clinton announcing a US\$500m aid program for Pakistan and;
- Fauji Group was stirring excitement on account of Merger and Acquisition activity regarding Agritech Ltd.

Floods and Ramadan Activity

From August 2 to 16, the KSE went into a bearish cycle in which the KSE-100 Index plunged by 981 points or 9.3% to close at 9,537. After a bullish July, the market was mainly bearish due to the possible adverse economic impact of the floods throughout the country and the delay in the implementation of a margin trading system.

The market began August on a negative note as the SBP raised the policy rate by 50 bps to 13% on July 31 which caught most investors on the back foot and thus, the immediate reaction on the bourses was bearish. In addition, the negative sentiments were further

exacerbated by target killings in Karachi, especially of an MQM MPA, leading to decline in market volumes. Adding to the despair of investors was the news of potential delays in the re-introduction of a leverage product because of a letter of dissent by the Chairman of the KSE Board of Directors reported by the media despite approval by the KSE Board of Directors.

From August 16 to the end of September, the KSE-100 Index gained 476 points or 5.0% to close at 10,013 on September 30. The Index became relatively flat during most of the Ramadan period due to concerns about the extent of the flood damage as 20% of the total land area of Pakistan was affected along with 20m people being homeless, but began a slight recovery post-Ramadan till the end of September. On the macroeconomic front, the government announced revised GDP growth target of 2.5%, inflation forecast of 15-20% and fiscal deficit of 6-7% of GDP for FY11, reflecting the impact of the current floods. In addition, the continued delay in the introduction of the margin financing product and news reports of dissention among the KSE Board members did not bolster investor sentiments during this period.

The KSE-100 Index began to rebound after Ramadan because of the SECP Policy Board approval of the concept paper of the margin trading system but with added risk management measures on September 15. The SBP at the end of September raised the policy rate again by 50 bps to 13.5%.

The Bell Lap

Despite the political uncertainty arising from the RGST issue and the PPP-led government having a falling-out with coalition partners, the market gained momentum during the last quarter of the year mainly on the back of foreign inflow with buying activity in oil and fertilizer stocks due to rising international crude oil prices and domestic fertilizer prices. The last 2 weeks of December witnessed some dullness in the market in terms of volume because of year-end profit taking activity and political uncertainty. The KSE-100 Index in the final quarter gained 2,009 points or 20.1% to close at 12,022 on December 31.

The major news flow during this period was:

- The news of EU duty relief on goods imported from Pakistan including textiles;
- Rising cement prices in the north zone;
- Ogra notifying higher wellhead gas prices for 1HFY11 period;
- Additional oil and gas discovery at Tal Block coupled with the decision by the GoP to accede to the request of the OMC and other sectors to reduce the turnover tax from 1% to 0.5%;
- The government introduced in the Senate and National Assembly the Reformed Goods and Services Bill, flood surcharge of 10% and proposed hike in the Special Excise Duty from 1% to 2% in order to reduce the fiscal gap and to meet IMF conditions for release of the next tranche of US\$ 1.7bn under the SBA;
- Non-performing loans of the industry recorded its highest quarterly increase in six quarters of PKR 32bn to PKR 494bn as of September 30;
- The SBP decided to hike the policy rate by 50 bps at the end of November to 14%;
- Rising fertilizer prices for both urea and DAP and;
- IMF approved a nine-month extension of the SBA loan facility (remaining tranches of US\$3.6bn) with Pakistan to September 2011.

Comparative Performance

2010 was another good year for most equity markets around the world. Similar to last year, the Asian markets generally posted higher returns relative to the European and North American markets, which may be due to increasing fund flows into emerging markets. The best performing markets were Sri Lanka, Indonesia, The Philippines and Pakistan. The poorer performing markets were China, France, Japan and Thailand.

Performance of Selected Markets during 2010

Index	Country	Period		YoY
		31-Dec-09	31-Dec-10	Change
Sri Lanka All Share	Sri Lanka	3,385.55	6,635.87	96.01%
Jakarta Composite	Indonesia	2,534.36	3,703.51	46.13%
PSEi	Philippines	3,052.68	4,201.14	37.62%
KSE-100	Pakistan	9,386.92	12,022.46	28.08%
KRX 100	South Korea	3,578.76	4,386.97	22.58%
FTSE Bursa Malaysia KLCI	Malaysia	1,272.78	1,518.91	19.34%
Sensex	India	17,464.81	20,509.10	17.43%
Nasdaq Composite	USA	2,269.15	2,652.87	16.91%
DAX	Germany	5,957.43	6,914.19	16.06%
S&P 500	USA	1,115.10	1,257.64	12.78%
DJIA	USA	10,428.05	11,577.50	11.02%
Strait Times	Singapore	2,897.62	3,190.04	10.09%
Taiwan Taiex	Taiwan	8,188.11	8,972.50	9.58%
FTSE 100	UK	5,412.88	5,899.94	9.00%
Hang Seng	Hong Kong	21,872.50	23,035.40	5.32%
Bangkok SET	Thailand	734.54	720.19	-1.95%
Nikkei 225	Japan	10,546.44	10,228.90	-3.01%
CAC-40	France	3,936.33	3,804.78	-3.34%
SSE Composite	China	3,277.14	2,808.08	-14.31%

Source: Business Recorder, Bloomberg

Looking Ahead to 2011

Political factors

Domestic

The New Year is likely to begin with speculation regarding the stability of the PPP-led government at the Centre because of upset allies such as the JUI-F which left the government in December 2010 and the MQM. However, we do not expect any major change in the current dispensation in the immediate term. A realignment of the governing coalition is possible in the event of the MQM leaving it. We believe that most of the major players do not desire a mid-term election at this time for their own self interests. Any no-trust motion against the government cannot succeed if the PML-N is not a willing player, as it appears by the statements of its leader Mian Nawaz Sharif. The PML-N will not rock the boat in the fear of losing its government in the Punjab and also, it still does not enjoy the trust of the Pakistan military/security establishment and the U.S. government.

Judiciary-government relations were rocky during the previous year. Tensions between the 2 pillars of state could remain as the NRO decision will be undergoing judicial review and the outcome of this review could determine the future stability of the current political set-up. We expect that the judiciary will still be in the spot light in 2011 and be a major player in the current political environment.

We expect a military operation in North Waziristan is likely to begin within the first few months of 2011 because of continued American pressure to tackle the militants such as the Haqqani network enjoying sanctuary there. We do not expect any negative fall-out on the capital markets to such an operation unless there is blow back by the militants into major urban areas of the country.

We expect the domestic political situation to be fluid and fascinating during 2011.

Geopolitical

We expect that the U.S. would continue to use a 'carrot and stick' approach with Pakistan to achieve its strategic objectives in Afghanistan. During its first review of U.S. strategy in Afghanistan, President Obama stated that rate of progress has not been satisfactory and thus, the U.S. will continue to insist to Pakistani leaders to deal with the terrorist safe havens present within Pakistan. President Obama continued to state that the U.S. would continue to support the economic and political development that's critical to Pakistan's future.

With the U.S. Presidential election around the corner in November 2012, it is critical for President Obama to show success in Afghanistan and withdraw U.S. troops as quickly as possible in order to retain the anti-war vote back. However, the death of Special Envoy Richard Holbrooke has strengthened the hand of General Petraeus advocating more of a military solution to the Afghanistan situation rather than diplomacy. It is conventional wisdom that there can be no peace in Afghanistan without Pakistan being part of the solution. Due to U.S. domestic political dynamics, we expect the 'Do More' mantra on Pakistan to continue from the U.S. government. This is the reason we believe that a North Waziristan operation by the Pakistan military will begin sometime in 2011.

It remains to be seen if both the GoP and the Pakistan military establishment can resist American pressure for only military engagement and to what extent Pakistan can convince the U.S. to pursue dialogue with the Afghan Taliban with Pakistan also part of any dialogue. With the U.S. and India geopolitical interests converging, there is a fear that any solution to the Afghanistan issue could shut out Pakistani interests of having a friendly government in place in Kabul in favour of Indian interests in Afghanistan. This would lead to continued support to Afghan Taliban by the Pakistani military/intelligence establishment.

There is a possibility that there could be a renewal of Indo-Pak dialogue prodded by the U.S. to allay Pakistan's security concerns regarding existential threat of being squeezed by India from the North as well as the south via an Indian friendly government in Afghanistan. The incentive for India would be a more peaceful region and possible attainment of a permanent UN Security Council seat.

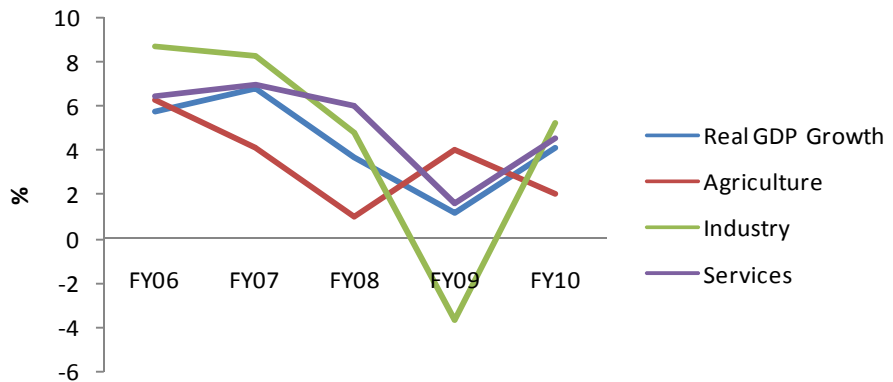
We feel that the geopolitical scenario would remain intriguing for the country and the region heading into the New Year.

Economic factors

Given the flood damage to the country, both in terms of agriculture produce and livestock coupled with infrastructure damage, the consensus real GDP growth rate for FY11 is estimated at 2.0 to 3.0%. Overall damage to the economy has been estimated at US\$ 10.1bn (5.8% of GDP) according the Damage and Needs Assessment (DNA) done by the World Bank and ADB back in November 2010.

Slowdown in growth can be expected in all the 3 conventional sectors, i.e. agriculture, industry and services. According to the DNA, agriculture sector is expected to decline by 10% during FY11 against the original growth target of 3.8% stated in the Annual

GDP and Sector Growth



Source: TSL Research

Plan 2010-11 because of major decline expected in both major and minor crops.

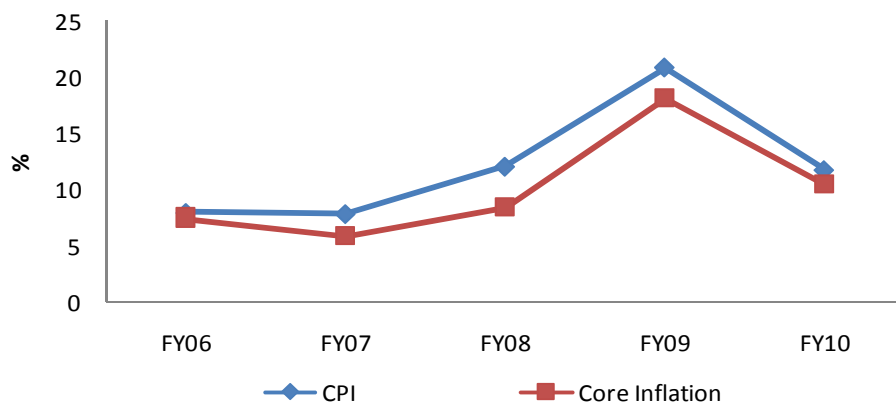
While rural areas have suffered the most from flood devastation, relatively, the industrial sector has not been adversely impacted by floods. Some small industrial units, mostly cotton ginning and rice husking mills, were damaged. Nevertheless, the industrial sector is projected to be quite significantly distressed by loss in cotton, sugarcane and other agricultural crops. The DNA estimates that industrial growth during FY11 will be around 3% as against the original objective of 4.9% as per the Annual Plan.

The DNA states that services sector growth will be reduced on the back of expected decline in agricultural and industrial income leading to weakened demand for services. On the other hand, the sector will benefit by higher construction and public administration activity as rehabilitation efforts get started.

Inflation

Besides the flood impact, inflation was expected to rise further due to higher than expected food prices, 50% raise in government sector salaries and anticipated hike in energy tariffs. The flood impact has reinforced these inflationary expectations as the November 2010 inflation figures depicted a 20.48% YoY increase in the food and beverage

Inflation Trend

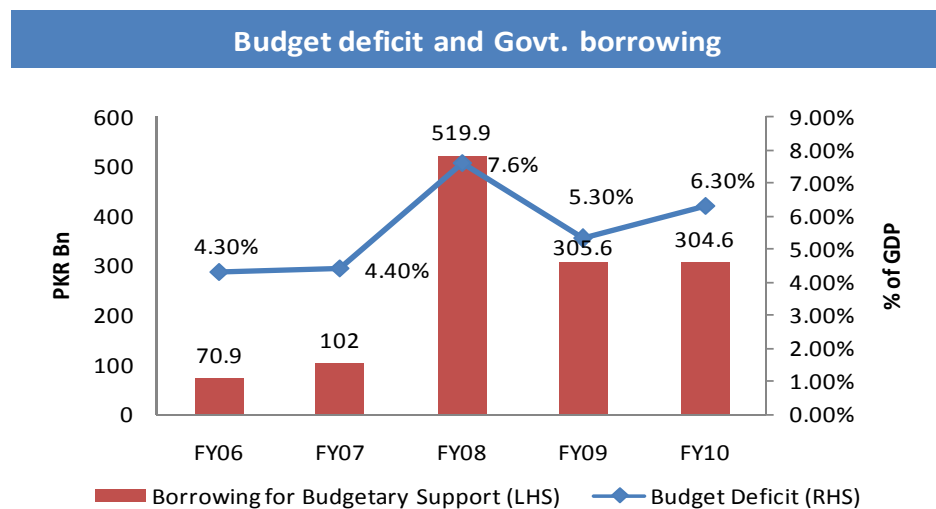


Source: FBS, TSL Research

group. However, central bank assessments imply that the direct impact of the flood-related supply shock is likely to be limited. An indirect, short-term cost-push factor, however, could come from the imposition of flood-related taxes. Likewise, post-flood reconstruction activities might increase prices of building materials, but these would only be gradually revealed in the trends of the House Rent Index (HRI), which has a dominant weight in the CPI. Consequently, revised SBP forecasts show that annual average inflation for FY11 is likely to be in the range of 13.5-14.5% up from both, the 9.5% target and earlier SBP forecast of 11.0 – 12.0% for the year. We believe that the revised SBP estimate of CPI for FY11 may be on the lower side considering that further price hikes in international commodity prices is likely going forward.

Fiscal Situation

As expected, demands on the public finances are projected to climb sharply in FY11 to finance relief and reconstruction activities in the aftermath of the floods. The FY11 government's budget targeted a fiscal deficit of 4% of GDP before the floods; the IMF has allowed some relaxation to the target of 0.7% to 4.7%. The GoP still plans to meet this goal despite the floods; thus, the introduction of RGST and flood surcharge while massively slashing the development budget. The DNA states that the overall reconstruction cost can be spread out over a 3-4 year period but most of the spending would have to be front-loaded in order to re-build key infrastructure.



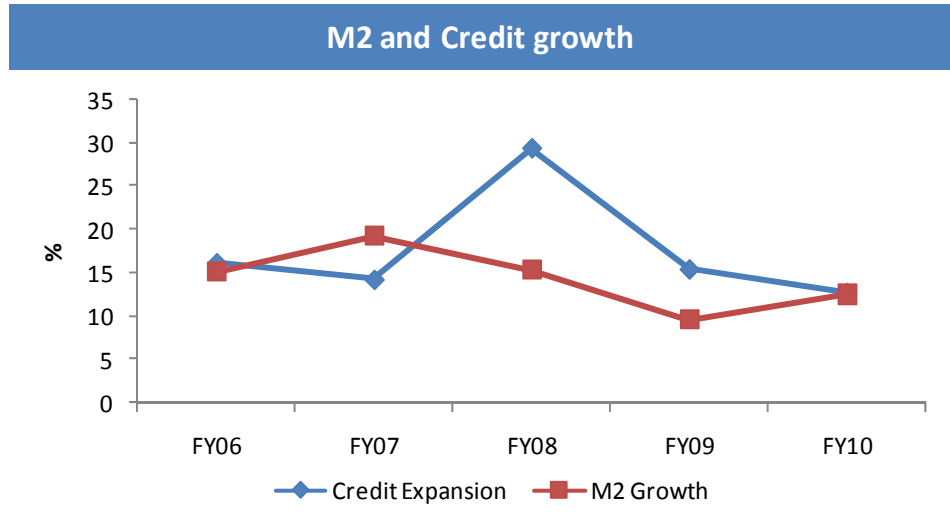
Source: FBS, SBP & TSL Research

Without revenue enhancement and curtailment and re-prioritization of spending, the fiscal target is likely not achievable. We expect that the fiscal deficit would rise above 6% of GDP leading to further borrowing from the SBP which would apply additional pressure on the SBP to maintain the tight money policy. Recently, Ministry of Finance officials have been reported stating that the fiscal deficit could rise to 7.5% of GDP.

Monetary Policy

Monetary policy going into 2011 will continue to attract investor attention, as the key policy rate has witnessed 3 consecutive hikes during 2HCY10. A good probability of high inflation remains for the 1HCY11 due to higher prices likely for major international commodities such as crude oil and further government borrowing from the central bank for budgetary support. In addition, the government will face a difficult task of keeping the fiscal deficit under control without a combination cutting expenditure and enhancing revenue through measures such as RGST and broadening the direct tax base.

The implementation of RGST is still uncertain as the government does not have the requisite votes in the National Assembly to pass the bill, which would place the next tranche of US\$ 1.7bn of the SBA with the IMF at risk despite the 9 month extension. The external account position could worsen without this tranche and lead to devaluation of the Pak Rupee against major world currencies.

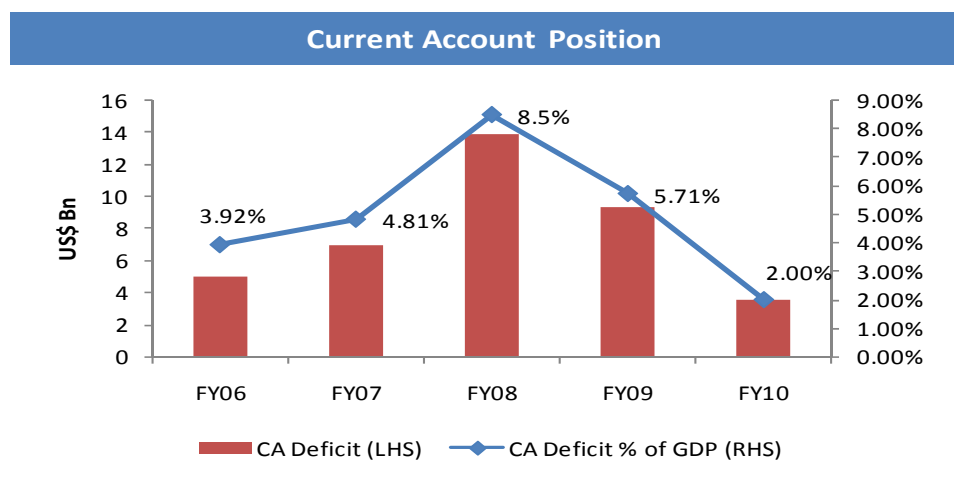


Source: SBP Annual Report 2009-10

We believe that further monetary tightening remains a possibility for the first 6 month of 2011. Depending on the level of inflationary pressure in the economy, we expect a hike in the policy rate ranging from 50 to 100 bps, taking the rate to 14.5 to 15.0% by the end of June 2011.

Balance of Payments Position

Before the floods, the current account deficit was expected to widen from 2.0% of GDP in FY10 to 3.4% during FY11. This outlook has worsened to some extent in the post-floods scenario. A higher than expected trade deficit could materialize on the back of production losses in the agriculture sector (especially cotton), which might be partially offset by projected improvement in current transfers. The SBP estimates the current account deficit to GDP ratio to range between 3 to 4% during FY11.



Source: SBP Annual Report

However, the current account deficit may be higher depending on the level of rehabilitation and reconstruction activities during the current fiscal year as significant hike in imports would be witnessed to support these activities. The financing of a moderate rise in the current account deficit would be tricky in the light of possible non-receipt of future tranches by the IMF under the SBA; thus, applying pressure on Pakistan's foreign exchange reserves and exchange rate.

We expect the Pak Rupee to depreciate by 5% during FY11 and 3% for FY12.

Capital Markets

One of the major drivers for the market in 2011 is the introduction of the margin trading system. This would give a much needed liquidity boost that would improve trading volumes and domestic participation. During 2010, emerging markets experienced massive liquidity and additional liquidity can be expected in the New Year on the back of the recent round of quantitative easing by the U.S. Federal Reserve. According to the Institute for International Finance, equity portfolio flows to emerging markets are expected to reach US\$186bn during 2010 and are forecasted to decline to US\$143bn for 2011. Most fund managers at a Reuters summit singled out emerging markets as a top 2011 wager due to expectations of double-digit returns supported by rising incomes and brisk economic growth. A recent Reuters poll estimates emerging market returns to surpass U.S. and UK equity gains in 2011. However, the risk of excess buoyancy of emerging market returns could lead to an asset bubble situation where a boom-bust cycle could materialize.

PE Comparison

Pakistan's 12-month forward PEx comes to 8.13 as against the regional average of 13.50, while the 12 month forward dividend yield comes to 5.22% as against the regional average of 2.53%. It is possible that the wide discount in PEx may narrow in 2011, as long as liquidity from both local and foreign investors continues to flow into the bourses.

Regional Valuation Comparison

Country	12m F PEx	12m F Div. Yield (%)
China	16.40	1.20
Hong Kong	13.74	2.30
India	13.91	0.98
Indonesia	14.70	1.92
Malaysia	13.77	3.00
Pakistan	8.13	5.22
Philippines	13.14	2.24
Singapore	13.55	2.91
South Korea	9.99	1.18
Taiwan	13.32	3.25
Thailand	12.51	6.31

Source: Thomson One Analytics

Date: December 16, 2010

Investment Strategy for 2011

The first half of 2010 was choppy, but the second half of the year was bullish despite the severe floods that took place during July/August and the poor macroeconomic performance. The positive foreign portfolio inflows especially in selective heavyweight Index stocks such as OGDC led to a remarkable comeback for the market during 2H CY10. It can be argued that the attractive valuations namely PEx which has been trading at a sizeable discount to the regional average has acted as a catalyst for foreign investor activity. However, there are risks emanating from the economic, political and geopolitical fronts that could adversely impact the equity market performance during 2011.

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The precarious macroeconomic situation could receive another shock if Pakistan does not receive the next tranche from the IMF, as the GoP has been granted an extension of up to 9 months in order to meet IMF conditionalities such as implementation of RGST. The continuation of foreign portfolio flows is the main presumption that would drive the equity bourses upwards during 2011, but if the situation worsens on the economic or political front, the foreign portfolio money could exit the country despite the attractive valuations.

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Some of our top picks are ACPL, LUCK, Hubco, Kapco, Attock Petroleum and ICI.

Top Picks for 2011

Stock	Fair Value	Dec 31, 2010 Closing price	Upside Potential	FY/CY11F EPS	FY/CY11F DPS	FY/CY11F PEx	FY/CY11F Div. Yield	FY/CY11F Earnings Yield
Attock Cement	78.10	63.11	23.8%	10.80	5.00	5.84	7.9%	17.1%
Hubco	46.20	37.41	23.5%	4.80	5.30	7.79	14.2%	12.8%
Kapco	48.50	40.68	19.2%	8.60	8.10	4.73	19.9%	21.1%
Attock Petroleum	385.60	334.52	15.3%	53.30	30.00	6.28	9.0%	15.9%
Fauji Cement	5.70	5.02	13.5%	0.40	nil	12.55	nil	8.0%
Lucky Cement	84.60	75.79	11.6%	8.50	4.00	8.92	5.3%	11.2%
ICI Pakistan	160.10	144.24	11.0%	18.80	11.50	7.67	8.0%	13.0%

Source: TSL Research

SECTOR	STANCE	DESCRIPTION
Oil & Gas (E&Ps)	Neutral	Valuations have nearly peaked, especially in the case of OGDC. The international oil prices could continue to rise in the immediate term, but we expect prices to range between US\$75 to 80 a barrel over the next 5 years. However, for the short term, continued rise in oil prices would favor POL and PPL. We still have concerns over the circular debt, if unresolved, it could affect dividend payout and exploration plans of both OGDC and PPL.
Oil & Gas (OMCs)	Neutral	The Fiscal year 2011 marked its presence with positive news of the reduction in Turnover Tax. Despite the expectation of increased demand for Furnace Oil and HSD, we reiterate our stance on the OMC sector to "Neutral" mainly on the back of fixation of margins set by the GoP which would restrict future profitability of the sector amidst rising international oil prices. APL is our top pick for the sector.
Fertilizer	Neutral to Positive	At present the fertilizer sector has been greatly affected by the recent floods, and as a result offtake has been low as compared to FY10. However with Engro's new 1.3m tones fertilizer plant coming online, and FFC in talks over buying of Agritech, should be seen as positive sign for the sector, as there is still a great potential to grow. We expect production to over take domestic demand, hence saving the government precious foreign exchange. Having said this, the recent gas curtailments of 20% and 12% on the Sui and Mari network and further shutting down of plants on the Sui network for 40-45 days is likely to keep prices of Urea high.
Construction & Materials	Positive	The sector is on the road to significant recovery. Rising prices and substantial hope over commencement of reconstruction efforts in 2HFY11 bodes well for cement manufacturers across the country. However, substantial cut in PSDP and possible delay in major projects needs to be taken into consideration. ACPL and LUCK remain our preferred stocks
Automobile & Parts	Neutral	Currently the auto sector is in a slump, being affected by reduced volumes and cost push factors. Further more this, this problem is compounded by reluctance of banks to offer consumer financing. It is important to mention that Pak Rupee has depreciated and currently it's over PKR 1.00. Post flood impact is likely to result in lower volumes by 15% as compared to last year.
Fixed Line Telecom	Neutral	The sector presents a mixed picture, with its cellular area set to fare better in the coming year as opposed to local loop. Broadband will support earnings for the two market leaders: PTCL and Wateen. For cellular mobile operators, we expect earnings level to be maintained due to saturation of the market and stagnant average revenue per subscriber given stiff competition.
Electricity	Positive	Rising power tariffs are projected to enable IPPs to return to higher dividend payouts (which had been their forte historically). Furthermore, significant additions to the national grid expected in FY11 coupled with serious progress in power generation via Thar coal translate into 'Positive' stance for the sector. HUBC and KAPCO remain our top picks.
Commercial Banks	Negative to Neutral	We are downgrading our stance on the banking sector as we believe 2011 to be a tough year for it. Slow growth in the real sector, persistent inflation and high interest rates will result in a new wave of NPLs. Moreover, while we expect net interest income to rise, it will be offset by rising operating expenses.

Source: TSL Research

RATINGS GUIDE

December 31st, 2010

Stock	Fair Value	31-Dec-10		EPS(Rs)			DPS(Rs)			BVPS(Rs)			P/E x	Div Yld(%)	P/BV x	Beta	Sh. Out. (m)	Year end
		Closing price	Rating	FY09A	FY10A/F	FY11F	FY09A	FY10A/F	FY11F	FY09A	FY10F	FY11F						
Allied Bank	60.9	70.15	Sell	9.1	9.8	10.2	3.6	3.4	3.8	38.3	40.5	46.8	7.2	5%	1.7	1.06	782	Dec
Faysal Bank	15.6	15.59	Hold	1.6	3.1	2.7	NIL	1	1	17.5	17.9	18	5.1	6%	0.9	1.15	731	Dec
Bank Alfalah	10.1	11.21	Reduce	0.7	1.2	1.6	0.1	NIL	1	16.4	16.2	17	9	NIL	0.7	1.26	1,349	Dec
Habib Bank	112.5	121.94	Reduce	12.3	15.5	17.7	5.5	4	5.5	70	83.4	100	7.9	3%	1.5	1.1	1,002	Dec
MCB Bank	196.6	228.54	Sell	20.4	22.9	27.3	11	10	11.5	91.7	100.3	117.8	10	4%	2.3	1.2	760	Dec
United Bank	69.9	68.23	Hold	7.5	9.1	10.7	2.3	2.5	2.5	49.8	51.6	62.2	7.5	4%	1.3	1.22	1,224	Dec
Attock Cement *	78.1	63.11	Buy	16.7	11.4	10.8	4	4.8	5	53.3	60.2	68	5.8	8%	0.9	0.9	90	Jun
Cherat Cement *	8.7	10.75	Sell	1.7	-0.1	0.6	NIL	NIL	NIL	23.7	23.5	22.6	16.8	NIL	0.5	0.78	96	Jun
D.G. Khan Cement *	31.7	30.17	Hold	1.4	0.6	0.2	NIL	NIL	NIL	57.3	72.6	104.9	168	NIL	0.3	1.6	365	Dec
Fauji Cement *	5.7	5.02	Accumulate	1.5	0.4	0.4	NIL	NIL	NIL	14	13.9	15	12.2	NIL	0.3	1.5	693	Jun
Lafarge Pakistan Cem	1.9	3.21	Sell	-1	0	-0.3	NIL	NIL	NIL	7.4	8.3	6.8	N/A	NIL	0.4	1.05	1,313	Dec
Lucky Cement *	84.6	75.79	Accumulate	14.2	9.7	8.5	4	4	4	71.9	77.6	82	9	5%	0.9	1.26	323	Dec
M.Leaf Cement *	2.1	2.87	Sell	-1.9	-4.9	-5.6	NIL	NIL	NIL	12.8	9.8	9.7	N/A	NIL	0.3	1.6	526	Dec
Hub Power	46.2	37.41	Buy	3.3	4.8	5.5	3.4	5	5.3	25.5	25.8	26.2	11.4	13%	1.5	0.85	1,157	Jun
KAPCO *	48.5	40.68	Accumulate	6.4	5.8	8.6	6.5	5	8.1	26.2	25.6	71	4.7	20%	0.6	0.68	880	Jun
Attock Petroleum	385.6	334.52	Accumulate	44.6	52	53.3	20.8	25	30	102.5	82.1	106.1	6.4	7%	4.1	1.03	69	Jun
P.S.O	309.7	295.18	Hold	-39.1	52.8	46.1	5	8	10	121.7	188	219	5.6	3%	1.6	1.05	172	Jun
Oil & Gas Dev.	101.1	170.83	Sell	12.9	13.8	14.5	8.3	5.5	5	29.3	36.6	45.9	12.4	3%	4.7	1.13	4,301	Jun
Pakistan Oilfields *	280.7	295.96	Reduce	23.8	31.4	40.5	18	25.5	28	109.6	123.1	135.6	7.3	9%	2.2	1.2	237	Jun
Pakistan Petroleum	207.5	217.15	Reduce	23.2	19.5	26.5	9	7.5	11	52.8	66.9	83.8	11.1	3%	3.2	1.04	1,195	Jun
Indus Motors	272.5	252.47	Hold	17.6	43.8	41.2	10	15	11	131	160.2	186.5	5.8	6%	1.6	1.1	79	Dec
Pak Suzuki	66.4	69.82	Reduce	3.1	5.3	4.7	0.5	NIL	5	174.1	177.6	177.3	13.1	NIL	0.4	0.9	82	Dec
P.I.C.T.	75.8	72.75	Hold	8.6	8.3	11.9	NIL	4	6	27.2	34.1	39.8	8.8	5%	2.1	0.89	109	Dec
P.T.C.L. *	21	19.42	Hold	2.1	2.3	2.2	1.5	1.8	1.7	20.6	21.2	21.7	8.8	9%	0.9	1.11	5,100	Jun
Fauji Fert. Bin	38.2	35.73	Hold	4.1	6.1	6.7	4	5.5	6.2	11.4	12.7	13.6	5.9	15%	2.8	0.97	934	Dec
Fauji Fertilizer	133.1	125.86	Hold	13	14.5	14.8	13.2	14	14.5	19.3	20.7	22.2	8.7	11%	6.1	0.75	679	Dec
ICI Pakistan	160.1	144.24	Accumulate	14.7	17.1	18.8	8	8.5	11.5	97.1	114.7	122	8.4	6%	1.3	1.03	139	Dec
Engro Polymer	12.5	14.27	Sell	-0.5	-1	2	NIL	NIL	0.3	12.2	10.8	12.6	N/A	NIL	1.3	1.09	520	Dec

* Updated for FY10 results

Sectoral Reviews

OIL & GAS (E&P)

NEUTRAL

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Valuation and Stance

	Share Price at 31-Dec-10	Fair Value	Potential Upside/ (Downside)	1QFY11 PAT Growth	FY11F EPS	FY11F P/Ex	Stance
OGDC	170.83	101.10	-41%	39%	14.47	11.81	Sell
PPL	217.15	207.50	-4%	57%	26.46	8.21	Reduce
POL	295.96	280.66	-5%	57%	40.47	7.31	Reduce

Source: Company Reports & TSL Estimates

1QFY11 (Jul-Sep 2010) Review

The TSL E&P universe saw a positive turnaround in fortune during 1QFY11 as compared to the same period last year on the back of higher product prices and minor improvement in production. The overall topline jumped by 34% YoY to PKR 63.06bn leading to a 45% YoY improvement in PAT to PKR 26.73bn. The overall production witnessed a slight increase, however, on a company specific basis; both PPL and POL registered vast improvement in production due to Tal Block fields. The crude oil production of the TSL universe during 1QFY11 registered a 2% YoY increase to 4.37m barrels while natural gas production improved by 3.4% YoY to 176.0 bcf. The average realized crude oil price of the TSL universe companies was US\$ 61.27 a barrel in 1QFY11 as compared to US\$ 56.43 in 1QFY10, an increase of around 9%. The average combined realized price of natural gas during 1QFY11 was PKR 237.84 per mcf as against PKR 162.91 during the same period last year, a jump of 46%.

Out of the 3 TSL E&P Universe companies, Pakistan Oilfields (POL) registered the largest enhancement in net revenues and production, especially natural gas. The improvement in international crude oil prices over the last 12 months along with higher natural gas production especially from Tal Block has had a positive impact on POL, since its revenues are gradually becoming less sensitive to crude oil price movements due to the improving proportion of gas in the revenue mix. The natural gas revenues as a percentage of total net revenues increased from 23% in 1QFY10 to 37% in 1QFY11. Natural gas production has more than doubled from 3.29 bcf in 1QFY10 to 7.67 bcf in 1QFY11.

After POL, PPL posted the second highest improvement in revenues due to both higher production, particularly crude/NGL and prices. PPL's topline surged by 49.5% YoY as crude oil/NGL production jumped by 73.2% YoY to 636k barrels due to mainly enhanced production from Tal Block while natural gas production registered a 6.0% YoY improvement to 81.1 bcf. The average realized crude oil price increased by 8.4% YoY to US\$ 68.52 a barrel while average realized natural gas price jumped by 33.2% YoY to PKR 174.73 per mcf. Other income also supported the bottom line as financial income jumped by 67% YoY due to increase in financial assets.

Despite a decline in production, OGDC still posted a 24% YoY increase in revenues on the back of higher prices. The company recorded a 7.2% YoY drop in crude oil production to 3.32m barrels while natural gas production declined by 3.5% YoY to 87.3 bcf. The average realized gas price during the period under review was PKR 216.50 per mcf as against PKR 160.51 per mcf in 1QFY10. OGDC's net realized crude oil price witnessed a 6.1% YoY improvement to US\$ 61.92 a barrel.

Going Forward

Global Demand and Supply Scenario

According to OPEC in its December 2010 Monthly Oil Report, it expects 2011's oil demand forecast to be mainly affected by expectations for the world economic growth. OPEC estimates world economic growth to be 3.8% for 2011 compared to 4.3% for 2010. One main factor that is suppressing the oil demand forecast is the higher baseline coupled with the pursuit of energy efficiency policies along with the use of biofuel will likely apply more downward pressure on oil consumption worldwide. OPEC estimates that recovering OECD countries will add 0.2m bpd to global demand while non-OECD countries are expected to maintain its growth momentum led by China and the Middle East and add 1.0m bpd to global demand. The total growth in global oil demand during 2011 is estimated at 1.2m bpd resulting in average daily demand of 87.1m bpd.

OPEC estimates Non-OPEC oil supply to be 52.62m bpd during 2011, which is a growth of 50k bpd from 2010. Non-OPEC supply is expected to decline in the second and third quarter of 2011 on maintenance and then rebound in the fourth quarter. The growth is expected to come mainly from Brazil, Ghana, Canada, Azerbaijan, Kazakhstan, and Colombia, while Norway, UK, and Mexico oil supply seen to decline. The risk and uncertainties associated with the supply forecast remains high especially for Russia, US, China, Brazil, Canada, Norway, UK, and Mexico. OPEC oil production is expected to increase by 0.3m bpd during 2011 to 29.24m bpd.

Given the supply and demand scenario, we expect oil prices to remain on the higher side, ranging between US\$ 70 to 90 a barrel. In addition, robust economic recovery in the U.S. and E.U. coupled with continued growth in BRIC (Brazil, Russia, India and China) countries would help sustain higher prices beyond the immediate term.

Tight Gas Policy 2010

The Ministry of Petroleum and Natural Resources have formulated a draft policy in the summer of 2010 with the objective of opening new frontiers for exploring tight gas from the existing gas reservoirs. Pakistan is facing big challenge in meeting its ever growing energy needs due to expanding population and economic growth. Energy demand is projected to grow to 147 MTOE by 2022 reflecting a phenomenal increase of 245% compared to 2008. Gas being largest component of energy supply is also projected to decline from existing 4.2 bcf/d to 1.6 bcf/d in 2022 giving rise to deficit of 7 bcf/d.

Definition of Tight Gas

The Tight Gas Reservoir is defined as a reservoir that:

- the company demonstrates to the satisfaction of the Government that it cannot flow naturally at commercial rate with conventional methods; and
- requires advanced technologies such as high performance perforation, hydraulic fracturing, horizontal wells, multilateral wells &/or infill drilling or combination of these technologies or any new technology acceptable to the Regulator; and
- has estimated value of effective permeability less than 1.0 milli Darcy (mD).

Salient features of the Policy:

- A 40% premium on top of zonal prices computed under 2009 Petroleum Policy. An incentive in the draft is an additional 10% premium on gas prices for those volumes that are brought into production within 2 years of announcement of this policy.
- Royalty shall be payable as per Petroleum Policy 2009 (12.5%).
- No windfall levy will be applicable to the tight gas production.

More incentives may be needed such as lower tax and royalty rates and better pricing for companies to attempt to extract tight gas, but this draft policy is a good starting point. Since most of the tight gas fields are located in Sindh, the largest beneficiaries of the tight gas policy among the publicly listed companies would be OGDC and PPL.

Circular Debt

The circular debt problem still lingers for the sector, in particular for OGDC and PPL. Giving the fiscal challenges of the government, it is difficult to foresee any quick and simple resolution to this issue. The cash flow position of both OGDC and PPL could be adversely impact the longer the circular debt problem remains unresolved. This could lead to lower cash dividend payout to shareholders and trimming of exploration activity, as both companies have aggressive exploration plans going forward and thus, hampering future earnings growth. As per the 1QFY11 accounts, the overdue amount owed to OGDC from various government entities is PKR 64.7bn while similarly for PPL the amount comes to PKR 19.6bn.

Stance

We have a **NEUTRAL** stance on the sector as valuations have nearly reached their upper limits relative to the market. However, if international crude oil prices continue to rise towards US\$ 100 a barrel, then the main beneficiaries in terms of valuations would be POL and PPL.

Impact of changes in oil price				PKR
Crude Price (\$bbl)	Fair Value	EPS FY11F	EPS FY12F	EPS FY13F
Base case Oil Assumption		US \$75	US \$76	US \$77
OGDC				
-20\$	90.50	12.72	13.23	14.44
-10\$	95.80	13.60	14.18	15.47
Base case	101.10	14.47	15.12	16.50
+10\$	106.40	15.35	16.07	17.53
+20\$	111.70	16.22	17.01	18.56
PPL				
-20\$	171.80	21.49	26.93	28.18
-10\$	189.60	23.97	30.13	31.60
Base case	207.50	26.46	33.33	35.03
+10\$	225.30	28.94	36.53	38.45
+20\$	243.10	31.43	39.73	41.88
POL				
-20\$	243.83	33.69	34.06	35.35
-10\$	262.30	37.08	37.46	38.92
Base case	280.66	40.47	40.87	42.48
+10\$	299.04	43.87	44.26	46.03
+20\$	317.45	47.26	47.67	49.60

Source: TSL Research

Pakistan Oilfields (POL)

Valuation Snapshot					PKR
Pakistan Oilfields	FY09	FY10	FY11F	FY12F	FY13F
EPS	23.75	31.44	40.47	40.87	42.48
DPS	18.00	25.50	28.00	29.00	30.00
BVS	109.64	123.13	135.60	147.47	159.95
PE(x)	12.46	9.41	7.31	7.24	6.97
Dividend Yield	6.1%	8.6%	9.5%	9.8%	10.1%
P/B Ratio (x)	2.70	2.40	2.18	2.01	1.85

Source: Company Accounts and TSL estimates

For FY11, POL is the most attractive on the basis of valuation metrics such as PEx, P/Bx and Dividend Yield. However, for the next 2 years, it is the second best stock based on valuation metrics behind PPL. If the international crude oil prices continue to rise, POL should be one of the top picks in the sector further accumulation. It is the largest beneficiary of the production growth expected in the Tal Block over the next few years in terms of EPS and valuation due to its smaller equity base. We project crude oil production for POL to improve by 5.8% per annum over the next 3 years from 1.47m barrels in FY10 to 1.74m barrels in FY13. Natural gas production over the same period is estimated to surge by about 25.0% per annum from 22.64bcf in FY10 to 44.07bcf in FY13. We forecast EPS to grow by a 3-year CAGR of 10.6% to PKR 42.48 in FY13. POL is trading at a PEG ratio (3-year EPG growth) of 1.11.

Pakistan Petroleum (PPL)

Valuation Snapshot					PKR
Pakistan Petroleum Ltd.	FY09	FY10	FY11F	FY12F	FY13F
EPS	23.18	19.52	26.46	33.33	35.03
DPS	9.03	7.50	11.00	13.00	14.00
BVS	52.77	66.87	83.83	98.60	113.79
PE(x)	9.37	11.13	8.21	6.51	6.20
Dividend Yield	4.2%	3.5%	5.1%	6.0%	6.4%
P/B Ratio (x)	4.12	3.25	2.59	2.20	1.91

Source: Company Accounts and TSL estimates

After POL, PPL is the next attractive E&P stock based on PEx, P/Bx and Dividend Yield for FY11. Nevertheless, looking at the valuation metrics overall for the next 3 years, it indicates that PPL is a slightly cheaper stock than POL. Thus, we would rate PPL a better investment for the medium term. It is the largest natural gas producer in Pakistan accounting for around 24% of total production. However, we estimate that gas production will decline by 1.9% per annum over the next 5 years because of the depletion of its largest field, Sui. Conversely, we project crude oil/NGL production to rise by a 5-year CAGR of 11% on the back of oil discovery at Tal Block. We forecast EPS to jump by a 3-year CAGR of 21.5% to PKR 35.03 in FY13. The company plans to embark on an aggressive exploration plan due to depletion of its existing fields that could trim future cash dividend payout and instead declare more bonus shares in the near future.

PPL recently acquired 14 new exploration blocks – the highest by any company last year – taking the total number of concessions to 32. With this, seismic data collection has also considerably increased over the past two years, with potential leads to be explored over the next 2-3 years. However, the circular debt issue can act as a major risk to both exploration plans and dividend payout if it continues to be unresolved and begins to significantly impact cashflows adversely. PPL is trading at a PEG ratio (3-year EPG growth) of 0.34, the lowest among the TSL E&P Universe.

Oil & Gas Development Company (OGDC)

Valuation Snapshot					PKR
OGDC	FY09	FY10	FY11F	FY12F	FY13F
EPS	12.91	13.76	14.47	15.12	16.50
DPS	8.25	5.50	5.00	6.00	6.00
BVS	29.34	36.60	45.87	55.00	65.50
PE(x)	13.23	12.41	11.81	11.30	10.35
Dividend Yield	4.8%	3.2%	2.9%	3.5%	3.5%
P/B Ratio (x)	5.82	4.67	3.72	3.11	2.61

Source: Company Accounts and TSL estimates

As compared to its listed peers, OGDC is slightly expensive on the basis of PEx, P/Bx and Dividend Yield over the next 3 years. However, it has the better potential to add to its production because of its track record of aggressive exploratory activity within the country, and it also has the largest exploration acreage of any single company at 63,581 square kilometers. For FY11, the company has announced a capex plan of US\$800m. This includes US\$380m for drilling 48 wells, US\$230m for development projects and US\$190m for acquisition of new assets. The drilling target is 48 wells which includes 11 exploratory wells in areas that need security clearance.

We estimate crude oil production to increase by 9% per annum over the next 3 years to 17.1m barrels, while natural gas production is projected to grow by only 2.3% per annum to 379 bcf in FY13. We forecast EPS to grow by a 3-year CAGR of 6.2% to PKR 16.50 in FY13. We estimate the dividend per share to vary from PKR 5 to PKR 6 over the next 3 years, which is below OGDC's historical payout due to concerns about circular debt. OGDC is trading at a PEG ratio (3-year EPG growth) of 1.90, the highest among the 3 companies.

OIL & GAS (OMCs)

NEUTRAL

Valuation & Stance

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	Share		Potential	1QFY11			Stance
	Price 31-Dec-10	Fair Value		YoY	FY11E	FY11E	
	PKR	PKR	Upside	PAT Growth	EPS	PEX	
APL	334.52	385.60	15.3%	19.3%	53.27	6.28	ACCUMULATE
PSO	295.18	309.66	4.9%	57.5%	46.08	6.41	HOLD

Source: TSL Research

High & Dry!

The fiscal year 2011 marked its presence with a remarkable downside for the OMC sector as the overall profitability for the sector declined by 70% to stand at PKR 953m in 1QFY11 from PKR 2,959m in the corresponding quarter last year. The results clubbed together, comprise PSO, APL and SHELL. The advancement of dilapidation in the profitability is mainly on the back financial burden being triggered as a result of the never ending phenomenon (at least what it seems now) of circular debt.

Fiddling while Rome burns!

So it is said, we have always been an energy deficit country. Pakistan has the highest EDI (Energy Development Index) of 0.281 ranking in South Asia which is based on four energy development indicators. It is worth mentioning here that the EDI results are strongly correlated with those of Human Development Index (HDI), which is based on data collected on life expectancy, education, per capita GDP and other standard of living indicators at the national level.

The International Energy Agency (IEA) has devised this “EDI” in order to better comprehend the role that energy plays in human development. It tracks the progress in transition to the use of modern fuels in a country or region. It is a scrupulous and analytical basis for policy-making. The four indicators and the respective calculation are given below:

- Per capita commercial energy consumption: which serves as an indicator of the overall indicator of the economic development of the country
- Per capita electricity consumption in the residential sector: which serves as an indicator of the reliability of, and consumer’s ability to pay for electricity services.
- Share of modern fuels in total energy sector energy use: which serves as an indicator of the level of access to clean cooking facilities.
- Share of population with access to electricity.

A separate index is created for each indicator, using the actual maximum and minimum values for the developing countries covered. Performance in each indicator is expressed as a value between 0 and 1, calculated using the formula below, and the EDI is then calculated as the arithmetic mean of the four values for each country.

$$\text{Indicator} = \frac{\text{Actual value} - \text{Minimum value}}{\text{Maximum value} - \text{Minimum Value}}$$

Oil Prices - Take the rough with the smooth!

Oil prices for the fiscal year 2010 registered a relatively stable price movement, which was maintained at \$ 73.44/bbl as compared to a spiky ebb and flow in international oil prices for FY09.

However, as per the World Economic Outlook, the recovery is manifested as “uneven” in terms of regions and countries and thus, is brittle. Domestic price level was further dented with the hike in global commodity prices, chiefly relating to food and energy. It is expected that future energy demand in the country will continue to grow owing to expected natural gas constraints specifically for power generation sector.

Circular debt - Unmitigated Disaster!

The Ministry of Finance on Dec 23, 2010 endeavored to provide a cushion to ease circular debt by releasing PKR 35bn to cash-strapped Pakistan State Oil, which is at the brink of default owing to the failure of the power sector to make any payments to them.

Receivables of PSO against its major clients stood as follows; Hubco PKR 62.6bn, WAPDA PKR 51.2bn, KAPCO PKR 27.24bn, Price differential claims on HSD and PMG PKR 6.18bn, KESC PKR 1.99bn, PIA PKR 1.38bn (including financial charges from PIA PKR 960m) and OGDC, 411m.

Amounts due by PSO stand at PKR 128bn to local as well as international fuel suppliers, which are as follows; PKR 37.12bn to PARCO, PKR 29.23bn to ARL, PKR 11.5bn to PRL, PKR 9.3bn to NRL, , PKR 4.69bn to Byco and PKR 31.6bn on L/Cs payments to international fuel suppliers.

Margin Fixation – Like it or lump it!

OGRA has changed the ex-refinery and max ex-depot sale price, on the account of rising international oil prices. The notification on 1st December 2010 by OGRA, government (ECC in its 15th October meeting) decided to absorb the rising international Oil prices by fixing the Dealer and OMC’s margins. Incidentals previously allowed for on C&F have been abolished for the calculation of ex-refinery price of de-regulated notified petroleum products. These changes are in line with the ECC’s decision of deregulating the petroleum prices and energy market. Therefore the prices remained unchanged for the month of December 2010.

	Old Margin November	Fixed Margin December	% Chg
Motor Gasoline	1.92	1.50	-22%
H.O.B.C.	2.20	1.72	-22%
Kerosene	2.10	1.58	-25%
L.D.O.	2.07	1.61	-22%

Source: TSL Research

Product	Unit	Effective 01	Effective 01	Diff inc/(dec)	%age
		December 2010 Old frame work	December 2010 New framework +PL Adjust		
Petrol	Rs/Liter	74.18	72.96	(1.22)	-2%
HOBC	Rs/Liter	88.08	86.67	(1.41)	-2%
LDO	Rs/Liter	70.31	66.61	(3.70)	-5%
Kero	Rs/Liter	74.72	70.95	(3.77)	-5%

Source: TSL Research

Suggested Measures

FoDP's task force recently presented 'Integrated Energy Sector Recovery Report & Plan' document, providing a roadmap to the resolution of country's energy deficit in next 3 years.

It directs at free energy market, deregulated prices, elimination of subsidies to refineries, removal of protectionist measures and establishment of a 'watch dog' to support fair competition.

To achieve these objectives, the report provides the following short term to medium term plans.

Short term:

- Deemed HSD duty of 7.5% should form part of retail price and government should ensure its recovery/payment to refineries. Any subsidies paid to refineries should be linked to international benchmark for profitability of refineries.
- Regulated product prices should be linked closely to international prices.
- Deregulated product prices should be notified, till energy market matures.

For deregulation to work certain pre-requisites need to be met:

- A cap should be announced for dealer margins.
- Nominal duties should be added to all imported products to support local refineries.

Medium term:

- To improve efficiency and up-gradation of capacity, subsidiaries to refineries be removed.
- Protectionist measures should be removed, to support imports by improving logistics infrastructure.
- Cap on dividends of refinery of 50% of capital should be removed to enhance investor confidence.
- Shift in dependence on local fuel oil, to encourage up grading of fuel oil to white product.

Going Forward

- Increase in discount rate will increase the financial risk hence reduce the value of the company.

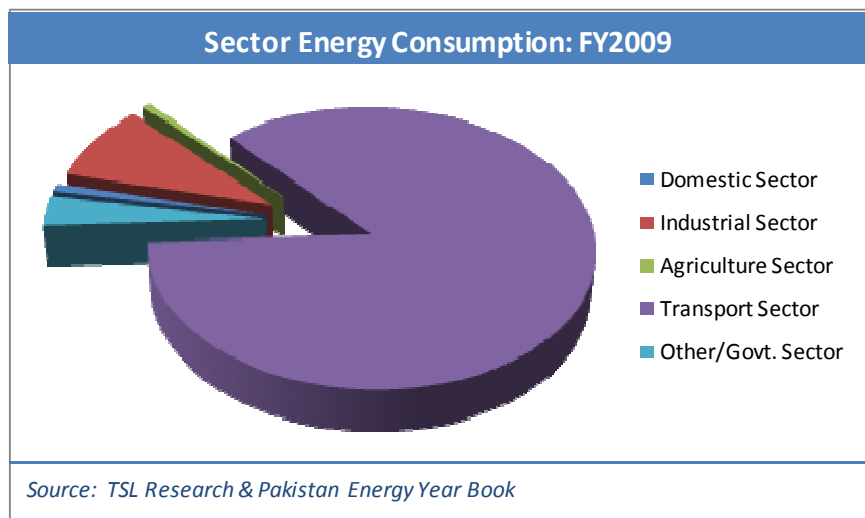
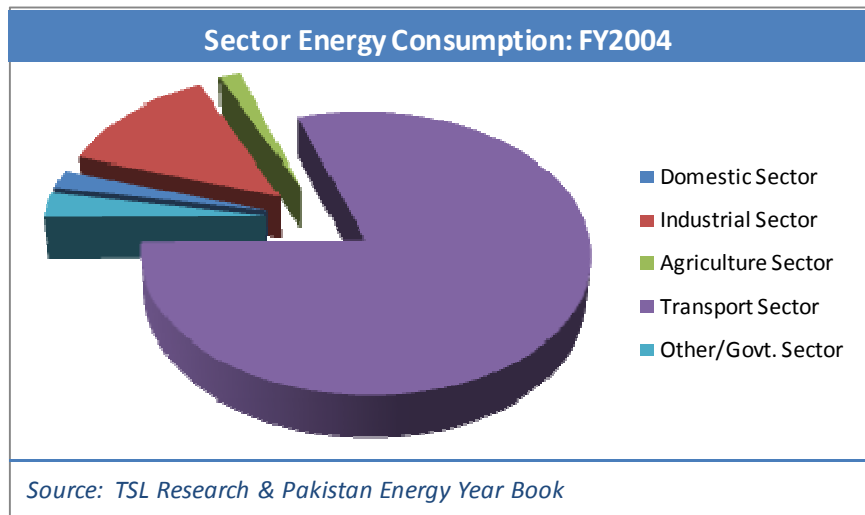
- Given our crude oil price assumption, we expect the average oil prices to hover around \$75-80 bbl for the five year period from fiscal year 2011 to fiscal year 2015.
- In future, we expect the Government will not freeze pump prices and prices will be more reflective of international crude oil price variance. It is expected that in the current scenario, government will further revise pump prices upwards in order to reflect the international price.

Stance on the Sector

We have revised our fair value for the OMC sector and based on DCF method of valuation, our respective fair values for the OMC scrips are as follows:

- **PSO - PKR 309.66 - HOLD**
- **APL - PKR 385.60 - ACCUMULATE**

Following is the sector wise energy consumption comparison between 2004 and 2009, which reflects how composition of the sectors' consumption has changed over time:



Pakistan State Oil - Working out the kinks!

Valuation Snapshot					PKR
PSO	FY09A	FY10A	FY11E	FY12F	FY13F
EPS	(39.05)	52.76	46.13	55.62	58.68
DPS	5.00	8.00	10.00	15.00	21.50
BVS	136.42	187.57	219.34	265.40	307.40
PE(x)	Nil	5.59	6.40	5.31	5.03
DIVIDEND YIELD	1.69%	2.71%	3.39%	5.08%	7.28%
PB Ratio (x)	2.16	1.57	1.35	1.11	0.96

Source: TSL Research

The acclaimed largest balance sheet company of Pakistan jumped back on the band wagon of companies in the green zone by posting a PAT of PKR 9.05bn (EPS: PKR 52.76) in FY10 against the comparable year's LAT of PKR 6.7bn (LPS: PKR 39.05). The zeal continued when the company preserved the stance of staying in the green zone by posting a PAT of PKR 809.86m for the opening quarter of fiscal year 2011.

The company depicted a show of strength by posting a PBT of PKR 17.96 billion in FY10 against a loss of PKR 11.35 billion due to absorption of increase in international prices in oil by OMCs. Financing costs increased to PKR 10 billion due to financing of working capital requirements. As at 30 June 2010, major power generating companies together with GoP owed PKR 111 billion and creditors stood at PKR 81 billion. Sales revenue increased 22% due to increase in local POL prices. Market share achieved in supply of Liquid Fuels and CNG of 71% and 22% in volume respectively is due to large distribution network. It also imports 90% of the total oil imported, increase in FOREX exposure.

Any hike in interest rate will adversely affect the fair value of the company. Sensitivity of fair value to discount rate is PKR 15. If interest rate is increased by 1% it will decrease our fair value by almost PKR 15.

We expect the net sales of PSO to grow at 4 year CAGR of 6.77% resulting in an increase in bottom line from **PKR 7.9bn (EPS: PKR 46.13) in FY11E to PKR 10.4bn (EPS: PKR 60.51) in FY15.**

The finance ministry has decided to soften the burden of PSO's debts by releasing PKR 35bn. Receivables of PSO against its major clients as of late December stood as follows; Hubco PKR 62.6bn, WAPDA PKR 51.2bn, KAPCO PKR 27.24bn, Price differential claims on HSD and PMG PKR 6.18bn, KESC PKR 1.99bn, PIA PKR 1.38bn (including financial charges from PIA PKR 960m) and OGDC, 411m. A schematic diagram of the circular debt for PSO is given at the end of the OMC report.

Amounts due by PSO stand at PKR 128bn to local as well as international fuel suppliers which are as follows; PKR 37.12bn to PARCO, PKR 29.23bn to ARL, PKR 11.5bn to PRL, PKR 9.3bn to NRL, , PKR 4.69bn to Byco and PKR 31.6bn on L/Cs payments to international fuel suppliers.

PSO plans to acquire Pakistan Refinery Limited for uninterrupted supply of white oil and decrease dependence on imports. Deregulation of IFEM will change the market dynamics in favour of PSO with 90% of local supplies. PSO is carrying out a study of connecting Keamari Port to Qasim port through pipeline for white oil. Efficient inventory management and loading facilities at Shikarpur Terminal and Keamari Terminal 'B', improved the PSO's throughput time by 20% of Fuel Oil.

Going forward, we reiterate our DCF based fair value of PSO at PKR 309.66. At the closing price on Dec 31st 2010 of PKR 295.18, the scrip has a potential upside of 5% to its fair value, hence, we recommend a “**HOLD**” stance. Based on our FY11E EPS of PKR 46.08, the stock is trading at a PEx of 6.4x.

Attock Petroleum Limited – Working out the corporate ladder!

Valuation Snapshot					PKR
Attock Petroleum Limited	FY09A	FY10A	FY11E	FY12F	FY13F
EPS	45.01	52.00	53.27	57.42	59.13
DPS	25.00	30.00	35.00	40.00	40.00
BVS	51.81	82.05	106.10	137.81	157.97
PE(x)	7.43	6.43	6.28	5.83	5.66
Dividend Yield	7.47%	8.97%	10.46%	11.96%	11.96%
PB Ratio (x)	6.46	4.08	3.15	2.43	2.12

Source: TSL Research

Amidst a year of persistent global recession, fiscal slump and oscillating price movements of international crude oil, the company was assiduous in its standpoint to make profits, which for FY10 grew by 17% YoY. The company generated cash from operating and investing activities amounting to PKR 3.359bn and PKR 318m respectively.

Net sales revenue reached to PKR 83 billion against PKR 62 billion for FY10 and FY09 respectively, due to high international oil prices. EPS increased to PKR 52.00 (fully diluted) in FY10 from PKR 45.01 (fully diluted) for FY09. Financing costs increased to PKR 300 million due to circular debt situation.

APL’s gross profit margin composed of 40% Black Oil products and 56% White Oil products. It is worth mentioning that Diesel and Petrol sales volume increased 70% and 90% against the industry’s decline for diesel and petrol by 3.9% and 27% respectively. Consequently, market share for diesel increased from 3.5% to 6.2% in FY10 and for petrol from 3.3% to 4.9%.

POL prices are key drivers of OMC’s performance, linked to global prices but regulated by GOP.

Going forward

- Based on our **DCF valuation we have a fair value of PKR 385.60**. As of the price on Dec 31st 2010 of PKR 334.52, the scrip has an upside of 15.26% to its fair value, therefore, we recommend an “**Accumulate**” stance on the stock. Based on our FY11E EPS of PKR 53.27, the stock is trading at a PEx of 6.28x.
- Sensitivity of fair value to discount rate is PKR 12.80. Any hike in interest rate will adversely affect the fair value of the company. If interest rate is increased by 1%, it will decrease our fair value by almost PKR 12.80.
- We expect the sales volume of APL to grow at 4 year CAGR of 8.36% resulting in an increase in bottom line from PKR 3.68bn in FY11E to PKR 4.65bn in FY15F. The bottom line would witness a CAGR growth of 6% for the same time period.

Nothing ventured, nothing gained

APL commenced operations of White oil Pipeline and Mehmood Kot-Faisalabad-Machike Pipeline. These pipelines give APL a strategic position in the OMC indus-

try. APL has plans for enhancement of its storage capabilities at both Rawalpindi Bulk Oil Terminal and Machike Bulk Oil Terminal.

Similarly, the company has an urge to grow and respond to the changing business environment and has boded well with its vision by enhancing its operational capacity, commencement of operations and entering into a joint venture with Askari CNG to convert 20 of its existing CNG outlets into multi-fuel facility outlets. FY13F. The bottom line would witness a CAGR growth of 6% for the same time period.

Alternative Valuation

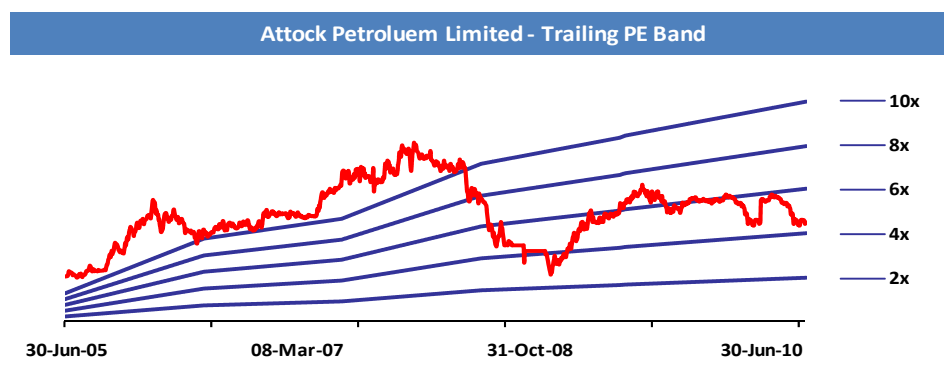
The scrip of APL is currently trading at an earnings multiple (adjusted price taken) of 4.64x as of June 30th, 2010. An analysis of average price multiple for FY10A reveals that the highest PE witnessed for the year was recorded at 7.23x, whereas, the average PE for the same period was 5.83x and the lowest PE being 4.37x. On the basis of Alternate Valuation, our average PE ratio based value arrives at PKR 330.22, lower than our fair value of PKR 385.60 using DCF methodology.

PER Valuation : Trailing Multiples

	P/E Multiple	Fwd 3Y Avg EPS	PKR / Share
Highest PER (52 wks)	7.23	56.61	409.21
Lowest PER (52 wks)	4.37	56.61	247.64
Average PER (52 wks)	5.83	56.61	330.22

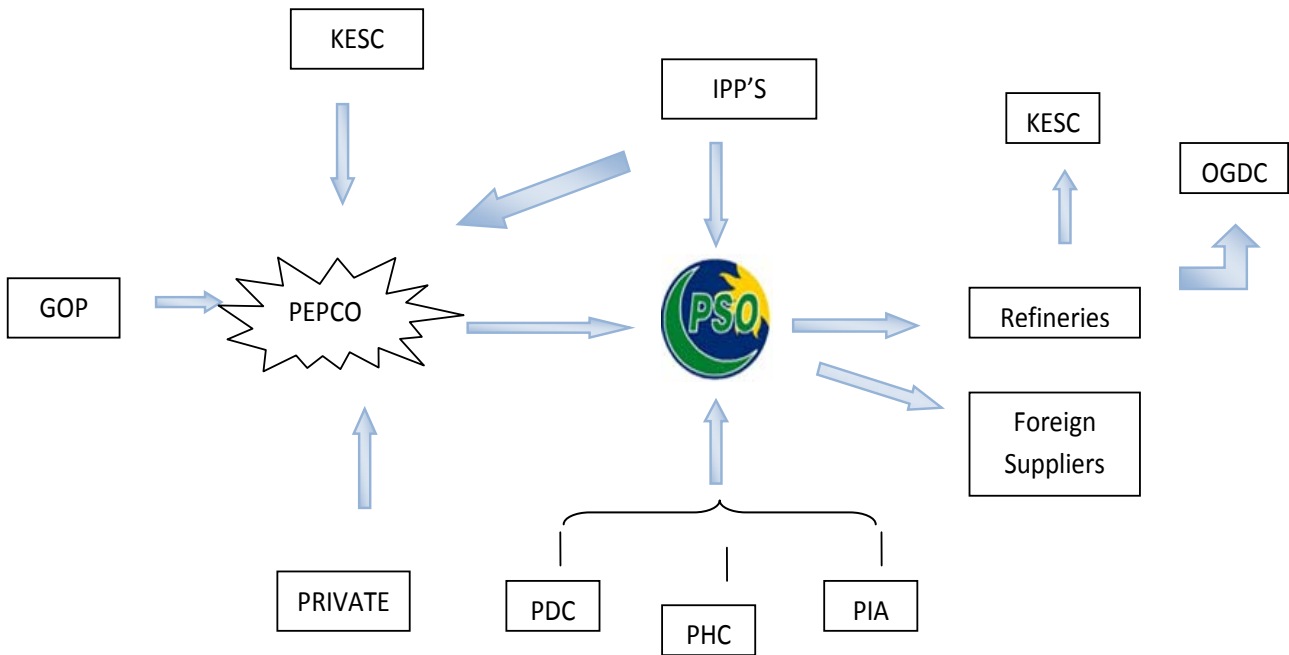
Source: TSL Research

Apropos of the above, another way of approaching the value for the scrip is using the PE multiple of the market, which is 8.13x and multiplying it with the FY11E EPS of 53.27, which would reflect a value of PKR 433.08 per share. This is in conjunction to the fact that the current PE of 6.28x (as of Dec 31, 2010 price) is trading at a discount of 29% to the market PE of 8.13x, which may suggest that the price would go up in the future.



Source: TSL Research

Below is the schematic diagram of circular debt with reference to the OMC's, whereby PSO is the major victim.



Key Abbreviations:

- PDC-Price Differential Claims
- PHC-Power Holding Company
- PIA - Pakistan International Airlines
- GOP- Government of Pakistan
- PEPCO -Pakistan Electric Power Company Limited
- KESC- Karachi Electric Supply Corporation
- IPP- Independent Power Producers
- OGDC- Oil & Gas Development Company Limited

FERTILIZER**NEUTRAL****Valuation Snapshot****PKR**

Analyst:
MohammadAli Ghanghro
 m.ali@taurus.com.pk

	Share Price 31- Dec-10 PKR	Fair Value PKR	Potential Upside	9MCY10 YoY PAT Growth	CY11E EPS	CY11E PE _x	Stance
FFC	125.86	133.07	5.7%	6%	14.78	8.52	HOLD
FFBL	35.73	38.22	7.0%	62%	6.74	5.30	HOLD

Source: TSL Research

Fertilizer Sector-Rising on

We remain upbeat on Pakistan's fertilizer sector, with agriculture contributing 22% to GDP. Currently our universe consists of 2 companies FFC and FFBL. As Pakistan has one of the lowest yields per acre in the world, hence it's likely that high use of fertilizer will continue. According to our estimates, historically agricultural output has grown at 4% p.a. Furthermore, Pakistani economy is further supported by agro based industries in particular textile industry; hence cotton crop will play an active role in the fertilizer market. Another important reason could be that Pakistan's 60-65% population is based in the rural area and farm economics is likely to play a key role for the fertilizer sector. Government policies remain a key factor. At present, government support in the form of continued high support prices for crops such as wheat and subsidizing natural gas on fertilizers are likely to keep prices lower than the international market. Fertilizer industry in Pakistan with its current low cost structure has ensured healthy margins for the companies.

Higher Prices to Change Rural income

Pricing of fertilizer in Pakistan remain insulated from international prices. Recently, rising grain prices in the international markets over the past 3-4 months has ensured demand for fertilizer. Crops Yields in Pakistan are one of the lowest, resulting in high usage of fertilizers. With producers already under pressure due to gas curtailments, higher farm incomes could help ensure recovery of their margins.

Capacity Expansion-Consequences

Engro's new Urea plant of 1.3m tones is to come online. This will push the total capacity to 2.3m tonnes. As per our estimates, we project sector earnings will increase at a three year CAGR of 15% during CY11-CY13. Engro stands out as it's likely to benefit from all its subsidiaries except EPCL. More importantly both ENGRO and FFC have made investments in power plants which will likely add to the value and which would be evident going forward. The dynamics of the fertilizer sector will also change as ENGRO will become the largest Urea producer surpassing FFC.

Agricultural Sector –Farmers Friend

Agriculture having greatly contributed to the GDP historically is likely to remain a key concern for the government. With its direct implication on the rural population, its likely government economic policy makers will develop a consistent plan to tackle inflation and ensuring adequate food supply. At present, fertilizer prices (Urea) have increased to PKR 950 as compared to PKR 530 per bag in 2008. This is also evident from the fact that the government has ensured continued subsidy on local urea with total subsidy amounting to PKR 400 as of CY06. Presently, the gov-

ernment is holding talks to increase wheat support price as an incentive to increase crop cultivation. This is evident from the increased demand for fertilizer with urea and DAP off take rising by 18% and 118% in CY09.

Floods in Pakistan

Pakistan's worst floods have severely impacted the fertile lands of the country. We witnessed massive damage to agricultural output and infrastructure. Important crops like cotton rice and sugarcane have been causing shortage and price escalation. Fertilizer sales had to bear the brunt of this and demand fell by 44% during July and August CY10. Wheat being sown in the winter season was spared from the floods. Since the beginning of the season, wheat prices raised 35-40% since July. This year we are expecting a bumper wheat crop. We believe this will bode well for the fertilizer sector during the summer season.

Subsidy a Driving Force

Currently, gas for fertilizer production is subsidized. At present, the feed stock price of PKR 102/mmbtu of is significantly lower than the international gas price of US\$ 8.6mmbtu. The government has taken a strong action by encouraging investment in this segment; newer capacities are provided feed stock at an even fixed rate of US\$ 0.7/mmbtu over a period of ten years. Engro's new Urea plant which has just come online is expected to be the main beneficiary of this policy. This enables producers to sell Urea 30-40% lower than the international price.

Gas Curtailments-A Key Concern

Fertilizer companies have enjoyed gas subsidies; however recent gas curtailments conducted in order to provide gas to the power companies initially planned for 3 months during the peak summer months; however, later on it was extended. The latest development is that, curtailments by the government has increased gas load shedding, starting from January to increase curtailments to 20% as well as 45 days shut down of plants on the Sui network and subsequently increasing gas load shedding on Mari network to 12%. Urea producers have raised prices by PKR 190 per bag, to compensate for the loss of production during this period. The biggest beneficiary of this would be FFC as its supplied from the Mari field. We expect FFC to gain the most with an estimated 35% higher margin. It is pertinent to mention here that after the spike in the gas curtailments, local urea prices translate to US\$ 237/ton as compared to international prices of US\$377.

2011-The big picture

We believe Urea to remain high in CY11 as the government provides fertilizer manufactures with subsidized gas, the benefit of which is directly passed on to the consumers. The local prices have historically been at a discount of 40% to the international prices. During CY10, prices increased by 27%, mainly due to the flood impact and gas curtailments. With demand recovering in the winter season we have seen a higher DAP off take. However, with improved farmer income, we remain upbeat on the fertilizer sector and forecast higher Urea and DAP off take during the summer crop.

FFC- Stable and Strong

Valuation Snapshot					PKR
Fauji Fertilizer	CY08A	CY09A	CY10E	CY11F	CY12F
EPS	9.62	13.00	14.50	14.78	15.13
DPS	13.75	12.70	13.10	13.30	13.60
BVS	18.11	19.28	20.69	22.16	23.69
PE(x)	13.08	9.68	8.68	8.52	8.32
Dividend Yield	10.9%	10.1%	10.4%	10.6%	10.8%
P/B Ratio(x)	6.95	6.53	6.08	5.68	5.31

Source: Company Reports & TSL Research

We resume our coverage of FFC with a revised **target price of PKR 133.07**. Our Valuation is premised on its strong fundamentals back at stable returns and appealing price which at present is trading at a discount of 5.7% to our target price.

FFC is one of the pioneers of the fertilizer industry in Pakistan, and while Engro is set to become the largest producer of Urea once its new plant comes online, FFC looks the most stable company in terms of cash flows and a decent dividend yield. We like FFC as a defensive scrip, with our target price of PKR 133.07 implying a potential upside of 5.7%. Moreover, the scrip offers CY11E dividend Yield of 10.6%. It remains the market leader for both Urea (market share of 45%) and DAP (market share 48%) business together with its subsidiary FFBL which is the sole DAP producer in Pakistan. FFC has a majority stake of 50.88% stake in FFBL and dividend payouts are likely to benefit FFC. Besides this it also holds 12.5% equity stake in Pakistan Maroc Phosphore SA (PMP) in Morocco which meets the entire raw material of FFBL's DAP Production.

Demand for Urea in Pakistan witnessed a drop in the after math of the floods. However, as of September 2010, we believe demand has recovered indicating a sharp revival in Urea and DAP volumes. The company having consolidated its position through both acquisition and organic growth and has consistently being making stable earnings is worthy of praise.

FFC has maintained a historically high payout ratio, and being a cash cow in the Fauji Foundation which relies on its dividend payments. FFC has one of the highest dividend yields on KSE -100. One of the strongest points about FFC is its low level of debt. This could change as FFC has expressed interest in acquiring 79% of Agritech Ltd. We estimate that should this acquisition take place dividends could be lower in 2011E by 15%. Regardless of this, considering the nature of fertilizer and keeping in mind that Pakistan has an agro-based economy, the resultant acquisition could lead to higher payout.

With no planned capacity enhancements projects, FFC top line is all set to increase by an annual growth rate of 8% over the next 4 years. FFC has proposed a US \$24m wind power project for the development of wind power project at Jimpher. This is likely to add value however the details are still not clear. FFC had informed the exchange of its intention to acquire a majority stake in Agritech, this potential acquisition could add value and drive some earnings momentum as Agritech had planned debottlenecking of its urea plant to increase its capacity by 125K tonnes and SSP (Single Super Phosphate) capacity by 70K tonnes. The most important factor over the said acquisition would be at what price FFC acquires Agritech. Cash strapped Azgard Nine Limited is undergoing debt restructuring and its likely FFC

would bag a bargain. We are expecting the offer range to be from PKR 25-30 per share materializing at to PKR 7.8-9.4bn. In addition to the acquisition, FFC would also have to make a tender offer for 50% of the remaining holding at the transaction price stipulated by Pakistan's takeover laws.

We upgrade our 4Q10E earnings to PKR 5.29 and dividend to PKR 5, on the basis of increased 4Q10 urea demand in the country. Due to FFC's present low cost base, the company enjoys one of the highest EBITDA and gross margins of 70% and 43%, respectively. We expect earnings to grow at a steady rate having an average growth rate of 8%, at par with the industry and agricultural growth. We are expecting FFC ROE to increase to 65% by 2012. Recent announcements by the government resulting in the gas curtailments of domestic and industrial units, has resulted in the gas curtailments of 20% of plants based on the Sui network and 12% for plants based on Marri gas field. In response, its likely fertilizer producers will raise prices of the product. This will result in a net benefit for Urea producers, and with FFC with the lowest gas supply cut amongst its peers FFC has the most to gain in the these circumstances. At present, prices in Pakistan translate to US\$ 237/tonne compared to the global prices of US\$ 377/ tonne still at discount to the international prices.

FFBL– The Lynchpin

Valuation Snapshot					PKR
Fauji Fertilizer Bin Qasim	CY08A	CY09A	CY10E	CY11F	CY12F
EPS	3.10	4.05	6.05	6.74	6.25
DPS	2.85	4.00	5.50	6.20	6.00
BVS	11.23	11.41	12.71	13.60	13.75
PE(x)	11.51	8.82	5.91	5.30	5.72
Dividend Yield	8.0%	11.2%	15.4%	17.4%	16.8%
P/B Ratio(x)	3.18	3.13	2.81	2.63	2.60

Source: Company Reports & TSL Research

FFBL has the unique advantage of being the sole producer of DAP in the country. FFBL having come this far is quite a stable company. In CY09, the company achieved few significant milestones as highest amount of DAP was produced totaling to 540,096 tonnes, having achieved the highest ever earnings after tax totaling to PKR 3.8bn and highest ever dividend declared amount to PKR 3.7bn (DPS PKR 4.00).

However, gas curtailments has recently resulted in price increases of DAP. We believe this to bode well for the company as majority of the DAP off take occurs in the winter season. With domestic DAP prices soaring higher in line with international prices, DAP price has risen to PKR 2,870 per 50 Kg bag. China, one of the largest consumers of fertilizer and a major exporter in the region, is likely to place restriction on the export of fertilizer in order to cater to local demand.

Of late FFBL has been a key performer at the KSE. We believe it is currently trading slightly below its **target price of PKR 38.22**.

Inventory Position

High DAP off take resulted in high core margins locked into the high inventory buildup by FFBL. At the end of May CY10, DAP inventory stood at 22Ktons and increased to 223K tons by August 2010. Furthermore, DAP core margins during the year stood at a comfortable US\$ 215 per tone during Jan- Nov 10. It's likely in the

face of current inflationary circumstances dealers might start stocking. DAP inventory having almost depleted in November with closing inventory of just 8K tons. If imports are not made on a timely basis a shortage could result further resulting in price escalation, clearly benefitting FFBL.

DAP prices to stay stable

Albeit DAP Price is soaring during the winter crop (Rabi), but we expect them to come down in CY11 as issues of new international plants at Mosaic and Ma'aden come online. Higher prices of DAP in the international market were pushed higher with US gulf prices rising by US\$ 87 per tonne since August and mid Cornbelt prices have moved higher with a US\$ 90 per tonne increase. Domestic DAP prices are linked with international prices due to heavy dependence on imports, local DAP prices followed suit increasing by US\$47 per tonne to reach US\$641 per tonne. Dealers, started to stock DAP as prices followed to move upwards. Furthermore, DAP prices are strongly correlated to phosphoric acid and it is possible the phosphoric acid might over take earlier projections.

Earnings Outlook

The company is expected to produce a topline of PKR 42,644m, PKR 45,294m and PKR 46,739m for CY10E CY11F and CY12 respectively. FFBL bottom line is also expected to grow from a PAT of PKR 5.65bn (EPS: PKR 6.05) in CY10 to PKR 6.29bn (EPS: PKR 6.74) in CY11, a growth of 11.51%. The CAGR is relatively higher and mainly on the back of lower base-case value for CY10 amidst recent floods hitting the nation. We expect the operating profitability to surge from PKR 10.01bn in CY10 to PKR 10.25bn in CY13 growing at a CAGR of 13% during CY10-13.

During the 9MCY10, the company's financial results have shown a marked improvement during the nine months of CY10 as compared to the corresponding period with Gross profit of PKR 6.7bn at 30, September 2010. Further owing to better liquidity position, the company has resorted to less utilization of working capital lines bringing 39% decline in company finance cost during the period by PKR 468m to PKR 720m during 3QCY10 as compared to PKR 1,188m in the same period during last year.

CONSTRUCTION & MATERIALS

POSITIVE

Valuation & Stance

Analyst:

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	Share price at 31-Dec-10	Fair Value	Potential Upside/ (Downside)	1QFY11 PAT Growth YoY	FY11F EPS(PKR)	FY11F P/Ex	Stance
LUCK	75.79	84.60	12%	-34%	8.45	8.97	ACCUMULATE
DGKC	30.17	31.66	5%	-92%	0.18	167.61	HOLD
ACPL	63.11	78.07	24%	-60%	10.82	5.83	BUY
FCCL	5.02	5.73	14%	-29%	0.41	12.24	ACCUMULATE
CHCC	10.75	8.68	-19%	164%	0.64	16.80	SELL
MLCF	2.87	2.12	-26%	-353%	(5.62)	n.m.	SELL
LPCL	3.21	1.93	-40%	-155%	(2.00)	n.m.	SELL

Source: TSL Research

The construction sector over the past few years has grown substantially and contributed significantly to the national exchequer with valuable foreign exchange. However, FY10 can be termed as one of the most forgettable years in the sector's history. Disintegration of the price cartel in November last year led to cement prices falling to abysmal levels, the likes of which could not be resolved by demand recovery in 2HFY10.

Domestic cement prices and off-take - some respite in sight

Cement prices have begun to witness an upward trend from June onwards this year. This bodes well for the sector since numerous manufacturers which have been running into losses could return to profit making and improve their financial health. However, during the ongoing winter season, cement prices are expected to remain flat owing to slower construction activity.

On the other hand, local off-take deteriorated post FY11 on the back of floods. However, going into 2HFY11 demand is expected to improve substantially on the back of construction work being expedited on Diامر-Bhasha and Munda Dam along with much awaited commencement of reconstruction efforts. As per a preliminary assessment by the World Bank, reconstruction costs (pertaining to housing, transport and sanitation sector) have been estimated to be PKR 257 billion, therefore unlike 2HFY10, the cement sector is expected to witness both price and demand led recovery in 2HFY11 and beyond.

Sector	RECONSTRUCTION COSTS	
	Costs	
	PKR million	USD million
Housing	135,014	1,588
Transport	112,911	1,328
Water Supply & Sanitation	9,306	109
Total	257,231	3,025

Source: World Bank, TSL Research

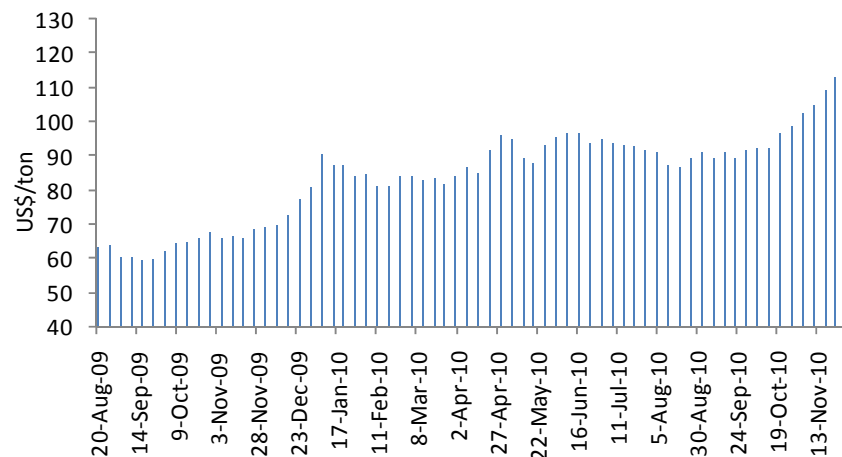
Rising coal prices and their potential impact

International coal prices remained around US\$ 90 per ton for the 1QFY11. However, mid-October onwards coal prices began to increase gradually. This gradual upside in coal prices transformed into abnormal growth in late November on the back of supply concerns which rose due to floods in Australia. The worsening flood situation in Australia led to coal prices peaking at US\$ 117/ton on 1st Dec, 2010.

The rising trend in coal prices also led domestic manufacturers to raise cement prices due to increase in production costs. Going into 2HFY11, the upward trend in coal prices coupled with 3.5% raise in furnace oil prices by local refineries will further increase production costs particularly for manufacturers in the North whose plants are furnace oil based such as; MLCF, Bestway, DGKC (partially).

Furthermore, rising production costs could force uncompetitive and small manufacturers to shutdown their operations leaving the competition open for larger and cost efficient cement producers for instance; Lucky, ACPL, DGKC etc.

International Coal price trend



Source: Globalcoal.com, TSL Research

PSDP- Falling way behind on promises

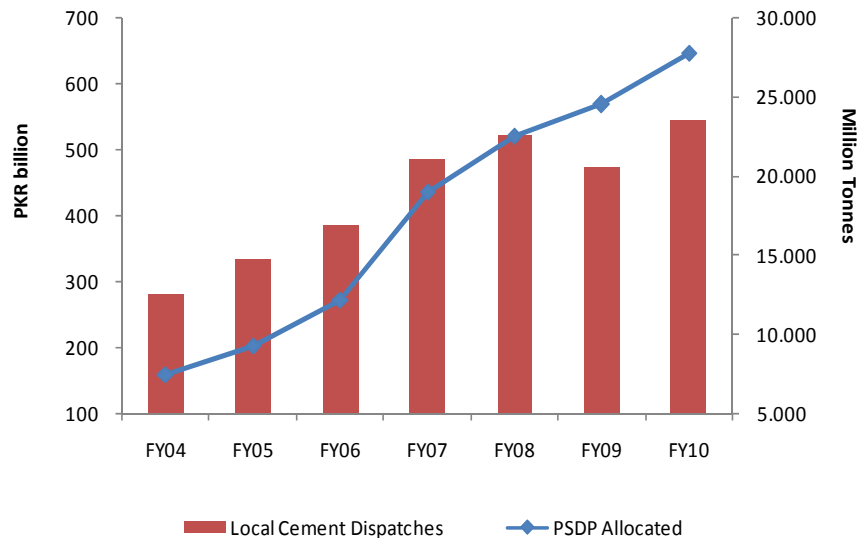
Allocation of the PSDP is considered as a major demand determinant for the cement sector. PSDP has a positive correlation of +0.95 with the local cement demand (annual basis). The GoP has consistently and significantly increased the PSDP allocation over the last five years for instance; PSDP allocation for FY11 stands at a massive PKR 663 billion (approx. 3% increase YoY). However, actual amount disbursed each year under the PSDP leaves a lot to be desired.

Owing to increasing IMF pressure and growing financial constraints, PSDP for FY11 has already been cut by 50% (federal component) by reducing portfolio of development projects worth PKR 500 bn. Moreover, provinces have been directed by the GoP to reduce their respective share by PKR 143 billion as well. Such massive cuts to the PSDP do not bode well for the cement sector since many of the projects expected to commence in

FY11 could get stalled indefinitely.

Although delaying of major infrastructure projects would suppress the gradually improving domestic demand but commencement of reconstruction efforts going into 2HFY11 would provide some respite to local off-take.

Correlation between PSDP and Cement Dispatches



Source: Planning Commission, APCMA, TSL Research

Exports – witnessing demand instability

Export dispatches have shown a fluctuating trend for the year 2010 characterized by new cement manufacturers becoming operational both in the Middle East and East Africa. Cement exporters from Pakistan (i.e. Lucky, ACPL, DGKC) to the Middle East have witnessed stiff competition from KSA, China and Turkey.

Although KSA's proximity and cost advantages have led to dip in exports from Pakistan (34% YoY decline for 5m FY11) but the ban imposed by the KSA government (which has still been partially lifted) on its cement manufacturers disallows them to export cement unless local demand is aptly fulfilled. This leaves a significant demand supply gap which can be capitalized by cement exporters from other regions (including Pakistan).

On the other hand, Afghanistan due to lack of limestone reserves has attracted significant demand in the past years and continues to do so. Although dispatches to the region fell by 18% YoY for 5m post FY11, but this decline in off-take to the region was characterized by floods which both submerged and damaged road and rail links. Hence, making transport to the region considerably difficult despite proximity.

Going forward, Afghanistan is forecasted to remain the top cement importer of Pakistan owing to cost advantage due to proximity whereas, exports to both Middle East and Africa will continue to witness from demand instability going into 2HFY11. However, exports to East Africa are projected to remain subdued only in the short term because the adverse impacts of 10% raise in Common Export Tariff (CET) from 25% to 35% will be short lived. Furthermore, cement exporters in the country are diversifying by entering newer markets for instance; Sri Lanka, Egypt and Bangladesh.

FY11 Projections for TSL Universe Cement Stocks

	LUCK	ACPL	DGKC	FCCL	CHCC	MLCF
Total Dispatches (MTonnes)	7,136,154	1,922,658	5,154,410	1,129,271	1,040,915	3,492,396
Sales (PKR m)	26,720	8,057	16,967	4,419	3,747	14,191
PAT	2,732	937	66	282	61.2	(2,954)
EPS	8.45	10.82	0.18	0.41	0.64	(5.62)
DPS	4.00	4.00	Nil	Nil	Nil	Nil
BVPS	82	69.13	72.82	15.42	22.64	9.74
D/E Ratio	0.60	0.34	0.76	1.54	0.83	3.16
Gross Margin	27%	24%	14%	16%	9%	19%
Net Margin	5%	12%	0.4%	6.4%	2%	n.m.

Source: TSL Research

Attock Cement Pakistan Limited (ACPL) – Falcon to reach newer heights!

Valuation Snapshot					PKR
Attock Cement Pakistan Ltd.	FY09A	FY10A	FY11E	FY12F	FY13F
EPS	17.24	11.74	10.82	11.61	13.67
DPS	5.00	5.00	4.00	4.00	4.00
BVPS	53.72	60.85	67.67	75.28	84.95
PE-x	3.17	5.58	6.05	5.64	4.79
Div. Yield	8%	8%	6%	6%	6%
PB-x	1.22	1.08	0.97	0.87	0.77

Source: TSL Research

Attock Cement is among the best performing cement companies in the country. Functioning under the umbrella of The Pharaoh Group, ACPL is associated with manufacturing top quality cement under its flagship brand FALCON® both within and outside the country.

Although profit after tax (PAT) dropped considerably for both FY10 and 1QFY11 but going forward both off-take and PAT are projected to increase at a 5-yr CAGR of 5.18% and 13.42% respectively on the back of improved local demand and discovery of newer venues (for exports). Furthermore, completion and subsequent functioning of the Waste Heat Recovery Plant (WHRP) next year will substantially bring down fuel and power costs.

With a WACC of 19.19% and Terminal growth rate of 2%, our DCF-based fair value for the scrip stands at PKR 78.07. Based on 31st Dec, 2010 closing price of PKR 63.11, the scrip offers an upside of 24%, hence we recommend a 'BUY' stance on the scrip.

D.G.Khan Cement (DGKC)

Valuation Snapshot					PKR
D.G.Khan Cement	FY09A	FY10A	FY11E	FY12F	FY13F
EPS	1.73	0.64	0.18	0.26	0.92
DPS	Nil	Nil	Nil	Nil	Nil
BVPS	82.51	104.59	104.86	105.23	105.12
PE-x	17.86	48.43	169.72	119.23	33.45
Div. Yield	Nil	Nil	Nil	Nil	Nil
PB-x	0.37	0.29	0.29	0.29	0.29

Source: TSL Research

D.G.Khan Cement is among the largest cement producers in the country. DGKC has been marginally profitable for both FY10 and 1QFY11 and that too on the back of dividends from related parties i.e. MCB, NML and Adamjee Insurance.

Going into FY11, DGKC will benefit from forecasted uptick in both local off-take and exports to Afghanistan. However, increase in furnace oil prices coupled with high gearing could pull down margins from witnessing any significant improvement.

With a WACC of 16.18% and Terminal growth rate of 2%, our SOTP based fair value arrives at PKR 31.66. Based on 31st Dec, 2010 closing price of 30.17, the scrip offers an upside of 5%, hence we maintain a 'HOLD' stance on the scrip.

Lucky Cement Limited (LCL)

Valuation Snapshot					PKR
Lucky Cement Ltd.	FY09A	FY10A	FY11E	FY12F	FY13F
EPS	14.21	9.70	8.45	10.50	14.06
DPS	4.00	4.00	4.00	4.00	4.00
BVPS	72.13	77.85	82.31	88.83	98.92
PE-x	4.44	6.40	7.36	5.92	4.42
Div. Yield	7%	6%	6%	6%	6%
PB-x	0.88	0.80	0.75	0.70	0.63

Source: TSL Research

Lucky Cement continues to be the front-runner of the domestic cement sector. The company holds onto its position as the biggest cement exporter in the country. Although profitability and dispatches (exports in particular) took considerable hit for both FY10 and 1QFY11 but, Lucky still managed to perform much better than the industry.

Going forward, both dispatches and bottomline are projected to grow at a 5- year CAGR of 6.78% and 21.75% respectively. Improving local demand and prices are expected to increase Lucky's local market share over the next year which coupled with an already impressive export portfolio bodes well for the company.

With a WACC of 18.7% and a terminal growth rate of 3%, our DCF based value for Lucky is PKR 84.6. Based on 31st Dec, 2010 closing price of 75.79, the scrip offers an upside of 12%, hence we recommend investors to 'ACCUMULATE'.

Fauji Cement Company Ltd. (FCCL)

Valuation Snapshot					PKR
Fauji Cement Company Ltd.	FY09A	FY10A	FY11E	FY12F	FY13F
EPS	1.36	0.34	0.41	0.21	0.10
DPS	Nil	Nil	Nil	Nil	Nil
BVPS	13.98	13.86	15.42	15.63	15.73
PE-x	4.53	13.28	12.35	23.92	47.83
Div. Yield	Nil	Nil	Nil	Nil	Nil
PB-x	0.47	0.33	0.33	0.32	0.32

Source: TSL Research

Under the auspices of the Fauji Foundation and with a production capacity of 1.165 million tonnes per annum, FCCL is among the most resilient cement manufacturers in the North. Despite a tough FY10 which sent many cement manufacturers into losses, Fauji Cement was successful in keeping its head above the water with marginal profitability.

Going forward, FCCL is actively pursuing to increase its production capacity to an estimated 2.27 mtpa. Furthermore, both local off-take and exports are expected to grow at a 5-year CAGR of 4.77% and 7.92% respectively since it will be among the major beneficiaries of exports to Afghanistan.

With a WACC of 16.81% and a Terminal growth rate of 2%, our DCF-based value is PKR 5.73 which in comparison with December 31st, 2010 closing price of PKR 5.02, offers an upside of 14%. Hence we recommend investors to **'ACCUMULATE'**.

AUTOMOBILE & PARTS**HOLD****Valuation & Stance****PKR**

Analyst:
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	Share Price 31- Dec-10 PKR	Fair Value PKR	Potential Upside / (Downside)	1QFY11/ 9MAY10 YoY PAT Growth	CY11E EPS	FY11E PEX	Stance
INDU	252.47	272.54	7.9%	-24%	41.2	6.13	HOLD
PSMC	69.82	66.42	-4.9%	83%	4.7	14.86	REDUCE

Source: TSL Research

The auto industry in Pakistan, designs, develops, markets and sells motor vehicles. It is an important sector of the economy and growth in the auto industry is important in terms of cheaper transport for the rising middle class income segment of the society. Furthermore, it's a vital source of revenue for the government in terms of taxation. It is interesting to note the growth of the auto industry. The industry has witnessed a boom a few years ago primarily due to financing by the banks and lower exchange rates. To date 2007 was the best year for the auto industry. Auto industry contribution to GDP is around 2.8% but its share in the manufacturing sector is around 16%.

Its is pertinent to note that despite the devastating floods and security issues, sales of cars and LCV clocked in at 33,496 units during the 1QFY11. This is testament to the strong demand and steady foundation of the auto industry. It would not be incorrect to say that the auto industry is currently undergoing a slump. The industry is being "crushed" by rising input cost and a weak Rupee. The most important component is the CKD kits which are imported. With Yen crossing to over 1 Pak Rupee and the Yen at a 15 year high as compared the greenback, adding to the cost of manufacturing. Furthermore, other factors like rising steel prices and higher electricity prices plus increased gas rates have greatly affected the industry. In such turbulent times the industry will have to enhance its localization programs and push the government to not allow the import of used cars.

Auto Financing: Catalyst to growth

A phenomenal growth was witnessed in consumer financing from FY01-FY07 when most commercial banks were involved in consumer lending through several financing modes. This was beneficial for both banks and end consumers in term of availability of goods and banks benefited as their spreads remained high. Pakistan at present has one of the highest interest rate spread in the world. Currently, interest rate spread has increased to 8% and the interest rate increasing to over 13%. With not many options to invest in, it's likely that bank deposits are likely to remain high and thus, banks would not be lending money for car purchases. Consumer financing has been a key component in improving the quality of life of the people who have the capacity of servicing loans. Car financing has the second largest share in the consumer financing pie. As per reports issued by SBP, 30% of consumer financing comprised of auto industry related loans. However as of June 2010, outstanding loans on car purchasing decreased to PKR 64bn, as compared to PKR 78bn during FY09 and PKR 105bn in FY08. The decreasing loans in car purchasing resulted in lower demand. Let's not forget that auto industry in Pakistan is dominated by Indus Motor and Pak Suzuki with Honda Atlas coming in at a distant third. Due to the monopolistic nature of the industry car sales are increasingly tak-

ing place on cash basis. Presently banks are offering car leasing and car financing. Car financing is the type of loan in which the car registration is done under the name of person obtaining the loan and is mortgaged by the bank, with the consumer paying the monthly installments. Presently around 70% of total sales are through finance lease.

Auto industry Evolution

The auto industry in Pakistan has come a long way. For the auto industry to survive in Pakistan, its likely to invest in additional localization of parts. Newer trends along the lines of changing models, improving fuel efficiency, cutting costs and enhancing users comfort without compromising quality are some of the vital challenges of the auto industry. With a variety of auto parts being manufactured across the world, the world lead outsourcing being done in China. It is important that Auto industry in Pakistan should move towards increased localization of parts. A higher localization would also result in increased employment domestically. Indus Motors has imported 2 press machines from USA and have announced price reduction on their cars as result on localization. As cost structure is vital in pricing of cars localization of parts can help in improving profitability and keeping prices low to attain a higher volume. Pak Suzuki has already taken the initiative and its product Mehran is highly localized.

Mean while production of new vehicles in FY09 was down 33% as compared to FY08. Total units produced were 247,036. During the 1HCY11 a total of 67,673 motor vehicles were produced as compared to our forecast number of 115,147.

Import of Used Cars- Please not again

The government with a confused mindset allowed the import of used cars of up to 5 years only to subsequently revert to the old policy of import of 3 year old cars. On December 10, 2010 the government allowed the import of used cars up to 5 years. It was argued 5 year cars would be cheaper than the 3 year old which were to be imported under transfer of residence and personal baggage scheme of expatriate having a stay of more than 6 months abroad and gifts schemes entitled to blood relatives in case of stay of more than 2 years. These schemes were meant for overseas Pakistanis the commercial importers would cash on this by import cars on bulk basis while using passports details of overseas Pakistanis. This decision would have generated revenue for the government as well as help in curb smuggling in Balochistan and Khyber Pakhtunkhwa. A particular lobby is interested in the imports of used cars, and the reasons given are local prices are too high, and out of the reach of the local consumers. If truth be told with import of used cars, would result in the country being a junkyard of used cars. The government did not realize, or rather failed to look in to the fact that from 2007 to date Yen has appreciated by 113%. Realizing its "mistake" the government reverted to the old policy of allowing import of 3 year old cars.

Plan to invite New Entrants in to Auto Sector

The latest developments in the auto sector were announced by the government of its plans of a newer policy with China and other key international players in the auto industry would be invited to to invest in the country through joint ventures or other options of car manufacturing. This proposal called for including imports of buses, wagons trucks tractors and other five year old models. The latest developments on this were that this proposal was sent to ECC, for approval. If this policy is implemented it would allow the import of 100% CKD kits.

High Price and import duties-Nasty Surprise

Local Cars being produced by the Indus Motor, Pak Suzuki and Honda Atlas Cars are in the range of 800cc-1,800cc. In the 800cc segment, Pak Suzuki is the major producer and has the biggest market share while also leading in the 1,000cc segment. As per data provided by APMDA Honda Atlas, Pak Suzuki and Indus Motors have increased prices by 4,5 and 5 times, respectively in 2010. Similarly in 2009, Indus Motor however was the first to reduce its price by was PKR 15,000-40,000, after it imported press machines in order to increase localization of parts.

Indus and Pak Suzuki

Two auto giants being Pak Suzuki and Indus Motor are likely to be affected with volumes reduction and the brunt of this impact is likely to be borne by the low end segment, in particular the 800-1000cc category cars, as their demand is price elastic. A number of reasons are the cause of this, the recent floods together with unfavorable political environment, and rising interest rates. However, we remain upbeat on motor cars, in the mid- upper end segments of 1.3-18L segment. The 1.3L share would comprise of Honda City, Corolla and Liana. Around 80% of this market is dominated by Corolla and Indus Motor are the key beneficiary.

Indus Motor-The Path Finder

Valuation Snapshot					PKR
Indus Motor Company	FY09	FY10	FY11	FY12	FY13
EPS	17.62	43.81	41.20	42.45	47.83
DPS	10.00	11.00	13.00	13.00	14.00
BVS	131.00	160.15	186.52	213.69	244.29
PE(x)	14.33	5.76	6.13	5.95	5.28
Dividend Yield	4.0%	4.4%	5.1%	5.1%	5.5%
P/B Ratio(x)	1.93	1.58	1.35	1.18	1.03

Source: Company Reports & TSL Research

Indus Motor is engaged in the principle business of manufacturing and distribution of Japanese motor vehicles. With its wide dealership through the country. Indus Motor's plant is the only manufacturing site in the world where both Toyota and Daihatsu are being manufactured. Indus Motors currently line of products include Toyota Corolla Hilux and Daihatsu Cuore. Total sales to date have been

Toyota Motor Corporation and Toyota Tsusho Corporation both have 25% stake in the company's equity. The majority shareholder is the Habib Group. At present, the company's shares are quoted on the stock exchanges of Pakistan. Currently, it has an annual production of 50,000 units based on double shifts.

IMC vision is to be the most respected and successful enterprise, delighting customer with a wide range of products and solutions in the automobile industry with the best people and best technology. The company's production facilities are located at Port Bin Qasim Industrial Zone near Karachi. Initially it started with an investment of PKR 1.2bn, with total shareholders' equity of the company in excess of PKR 8.5bn. The company is ISO-14001 and 9001 certified.

Indus Motor's star product, the Corolla is the favorite car, as more Corollas have been sold during FY10 as compared to Pak Suzuki's cheapest car, the Mehran. This proves that as demand for cars with a better brand image has sold and that people

in the low end segment haven't been able to afford cars.

During the 1QFY11 total sales by the company were 12% higher as compared to 1QFY10. Total sales during the 1QFY11 were 12,114 units. Indus Motor's total market share increased to 34%. It is also pertinent to mention here that the company's revenue from the CKD CBU and parts sales increased by over 20%, to PKR 14.3bn as compared to PKR 11.9bn. However, PAT was down 24% in the said period and clocked in at PKR 577m as compared to PKR 759m during the same period last year. We believe this occurred due to the flood impact and high base effect in FY10. Cost pressures on CKD kits and local parts also resulted in reduced profits during 1QFY11.

Total sales of Indus Motor from July to November 2010, totaled 20,375 units. Sales of Corolla registered at 17,149 units. Total share of Corolla in the pie was 84.17%. Total sales of passenger cars and LCV during the 1QFY11 came to 12,186 units higher by 14% as compared to 10,631 units sold during the same period of last year. During FY10, inflation amounted to 11.7%, however over the past few months, inflation has edged close to 15% and the recent announcement of increase in fuel prices will further increase inflation adding to costs. We expect this to affect demand due to the cross elasticity of demand for fuel with cars.

As per our discussions with the management, we have learnt that IMC has procured d3 press shops. In the first phase, the company invested PKR 82bn to set up a press shop 3 years ago, to help in the localization of parts. Importing of components other than CKD kits will be costly, as there is import duty on those products. Clearly this time around, the industry is focusing on localization of parts. A close look at the break up of the cost will indicate that one third of the cost goes in to imports while another third goes in to government taxes. Indus Motor has maintained healthy margins of 8-9% over the last 3 years. We project that with 3 press machines, Indus Motor will maintain its margins of 8% going forward.

IMC revenue driver is the Corolla and the total market of automobiles in Pakistan was around 220,000 in FY07 which dropped to 185,000 units in FY08 and further declined in FY09 to 105,000 units.

We remain positive on IMC and have a target price of **PKR 272.54** and at presently we maintain a **HOLD** stance.

FIXED LINE TELECOM

NEUTRAL

Analyst:

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Valuation and Stance

PKR

Company	Share Price Dec 31'10	Fair Value	Upside/(Downside) Potential	EPS (PKR) FY11F	P/BVS (x) FY11F	Stance
PTC	19.42	21.03	8.29%	2.21	0.89	Hold

Source: TSL Research

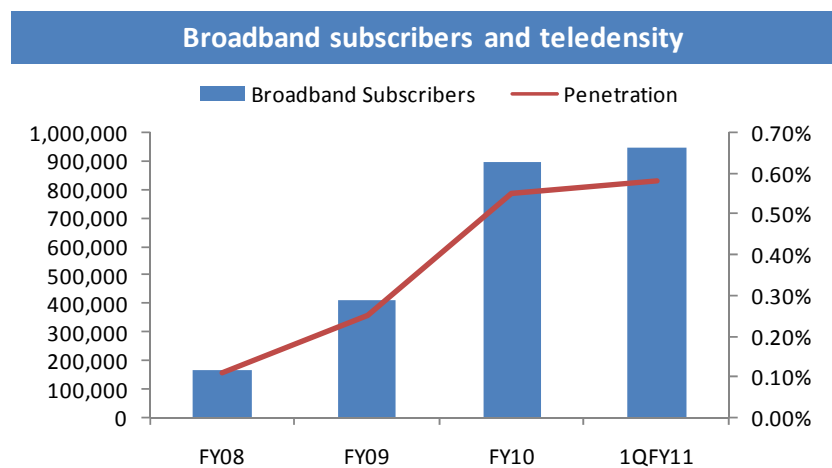
2010 was a mixed year for the telecom sector; though teledensity increased, FDI declined substantially. Revenue increased overall for the sector by around 6.5%, however this was mostly in the cellular mobile sector. Revenues from local loop (fixed) and long distance international actually declined in FY10 by 1.76% and 1.88% respectively. Subscribers for fixed local loop continued to decline, while cellular rose albeit at a lower rate compared to previous years due to saturation of the market.

Cellular mobile operators have been benefiting from continued rise in cellular users, which has reached 100.7 million subscribers by October 2010. Moreover, the declining trend of average revenue per subscriber (ARPU) has reversed since September 2009, and ARPU per month for June 2010 actually stood at USD 2.46, a two-year high.

Going into 2011, we expect majority of growth to come in Broadband (in EvDO and WiMax technologies). Cellular mobile operators' revenues will remain somewhat stagnant due to high competition not letting tariffs be raised and also because cellular penetration has slowed down. Cellular teledensity increased by 218bps in FY10 to stand at 60.4%, as opposed to 352bps in FY09 and 1380bps in FY08. It is important to note here that out of the three technologies, cellular, fixed local loop and wireless local loop, cellular is the only one which continues to increase its penetration.

Broadband offers opportunities

Broadband has blossomed recently, with 150% growth in the last three years. Increased competition (amongst 13 companies providing broadband services) has brought down tariff rates to one of the lowest in the SAARC region, thus increasing affordability for subscribers and subsequently penetration. Broadband teledensity has reached 0.58% by September 2010, and so there's still a lot of room for growth.



Source: PTA, TSL Research

PTCL continues to enjoy the largest market share here, and though its fixed lines will be of limited use in this area in the future (DSL market share is declining) we expect its EvDO (which goes with the brand name of EVO) to make up for the market it will lose due to DSL. By technology EvDo and WiMax are leading the way in broadband having gained market share by 690bps and 720bps respectively in 2010. Wateen follows PTC in broadband, and given the prospects in this area, stands to gain from its edge here. In FY2010 Broadband was the only business segment of WTCL which saw a rise in revenues despite the fact that ARPU had declined (by 32% to stand at PKR 1075) given intense competition. The reason was the surge in broadband subscribers.

PTCL

Valuation Snapshot					PKR
PTCL (consolidated)	FY09A	FY10A	FY11E	FY12F	FY13F
EPS	2.14	2.30	2.21	2.55	2.63
DPS	1.50	1.75	1.70	1.90	2.00
BVS	20.64	21.19	21.74	22.38	23.04
PE(x)	9.07	8.44	8.79	7.62	7.38
Dividend Yield	7.72%	9.01%	8.75%	9.78%	10.30%
PB Ratio (x)	0.94	0.92	0.89	0.87	0.84

Source: TSL Research

PTCL continued to be the market leader in fixed local loop and wireless local loop. In cellular, its subsidiary PTML (Ufone) lost its market share, which dropped from 21.2% to 19.7% in 2010 (Mobilink and Telenor gained market share). Despite that, Ufone's revenues surged by 25% in FY10, with ARPU going up by 20%.

Ufone's contribution to PTCL's revenues has gone up from year to year, with FY10 contribution up to 42.2% from 36.1% in FY09. We expect PTCL's bottom line to be buoyed by Ufone as well as its broadband services going forward. As for long distance international (LDI), we expect grey traffic, which has previously eaten away a large part of the international communication market, to continue being a big threat.

ELECTRICITY

POSITIVE

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Valuation & Stance

Company	Share price at 31-Dec-10	Fair Value	Potential Upside/ (Downside)	1QFY11 PAT Growth YoY	FY11F EPS(PKR)	FY11F P/Ex	Stance
HUBC	37.41	46.2	23%	15%	5.49	6.81	BUY
KAPCO	40.68	48.5	19%	52%	8.63	4.71	ACCUMULATE

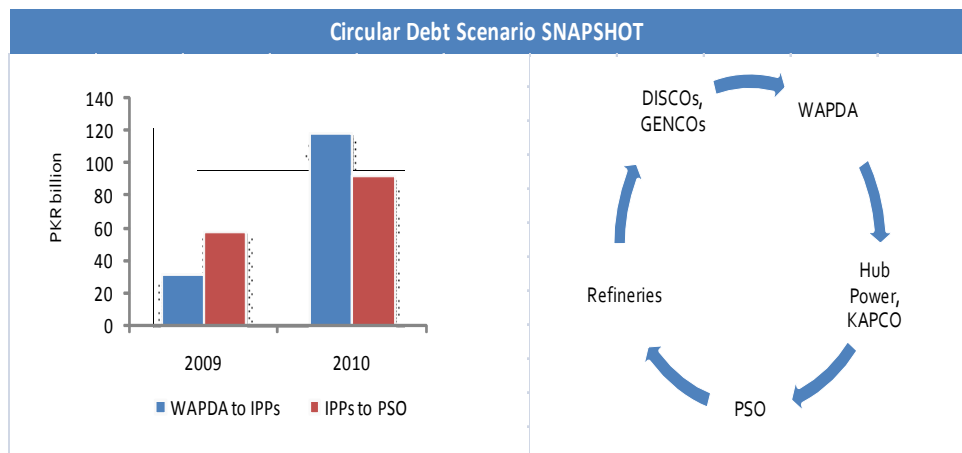
Source: TSL Research

The electricity sector of the country continues to witness increased turbulence with each passing year. Growing domestic demand and inability of the local infrastructure to fulfill it has widened the demand-supply gap more than ever. Resultantly, the power sector is unable to become a frontrunner of the country’s economy despite the country having abundant key resources at hand.

Circular debt - the woeful tale continues!

Circular (or inter-corporate) debt has had a substantial negative impact on the local energy sector ever since it started surfacing (materially) in FY07-08. The GoP has taken various measures over the years to curb this crisis i.e. through floating of PKR 160bn TFC (via SPV Pvt. Ltd.) and raising electricity tariffs. However, any positive effects from these efforts were short-lived and remained unsuccessful in bringing an end to the crisis.

WAPDA’s inability to timely pay-off its obligations is perhaps the key reason behind amassing of the circular debt, which has led the IPPs to default on their payments as well. To date, WAPDA owes an estimated PKR 118.32bn to the IPPs (HUBC and KAPCO) which are more than a threefold increase over last year (PKR 31.8bn in 2009). This has had a spill-over effect on the IPPs whose payables to PSO have surged by biblical proportions (currently standing at PKR 92bn). However in late December 2010, the Finance Ministry paid PKR 26.9bn to PSO against an earlier promise made of PKR 35bn hence only marginally resolving the circular debt issue.



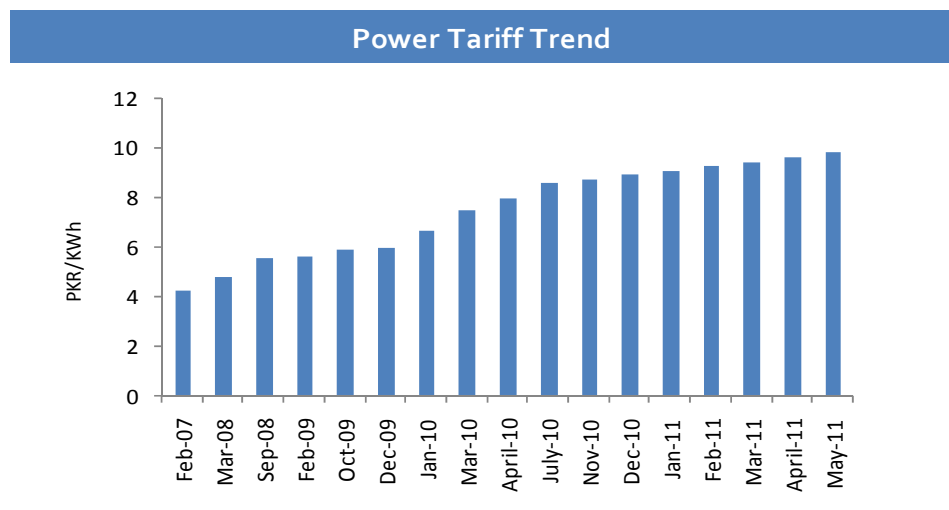
Source: Company Accounts, TSL Research

Power tariffs on the move!

Growing IMF pressure has forced the GoP to show sincerity in its efforts to resolve the worsening energy crisis in the country and resultantly a 2% increase in electricity tariffs would be made every month until tariffs completely cover power generation costs (power tariffs cover 76% of generation costs to date). Rising power tariffs will also translate into a much improved cash flow profile of the energy sector gradually leading to improved payout ratios to (around 50-80%).

However, generation costs could witness another surge in the wake of rental power projects (RPPs) coming online, largely because they are crude oil based and oil prices have been on the rise ever since. Likewise, various electricity distributors in the country (DISCOs) continue to witness from line losses largely due to poor infrastructure, electricity theft and occasional maintenance. WAPDA suffers an estimated PKR 125bn from T&D losses each year.

Despite the aforementioned facts which leave the GoP no option but resort to monthly tariff increases (as a short term move), it is quite possible that tariffs might be reduced in the wake of mounting political pressure. Witnessing such incidents time and again under the ruling coalition, materializing of a future upward trend in tariffs seems doubtful.

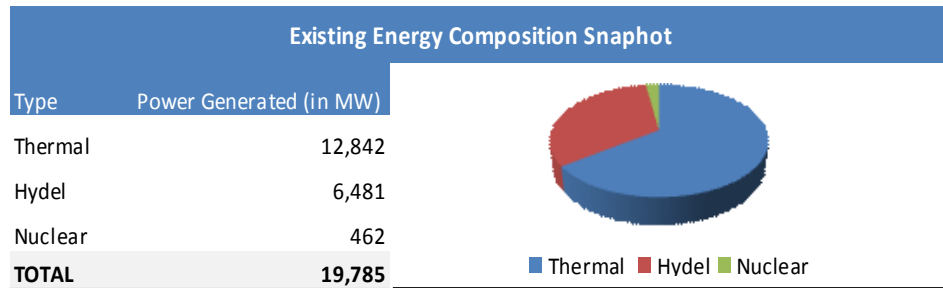


Source: Nepra, TSL Research

Thermal based power generation rules the roost!

Raising power tariffs to resolve the circular debt issue is a partial solution to the country's growing energy needs. It is the need of the hour that the GoP resorts to efficient fuel alternatives. The current power generation in the country stands at 19,785 MW which is thermal intensive followed by hydel and nuclear based generation.

Oil based power generation is perhaps the most expensive costing an estimated PKR 10/KWh followed by gas based generation which costs an estimated PKR 5/KWh. Considering the lower generation costs of gas based generation, the GoP seeks to increase power generation through the country's gas reserves by an estimated 51% until 2030 as part of the 'Vision 2030' strategy. However, the ongoing gas load-shedding in the country and no newer discoveries of gas reserves raises significant questions over the increased emphasis on gas based generation.



Source: Pakistan Energy Yearbook 2009

Coal-fired power plants – More than meets the eye!

Coal constitutes a significant 38% of power generation across the world whereas in Pakistan it stands at an embarrassing 0.1% despite having massive coal reserves in the Thar district. In 1992 as per a study conducted by the Geological Survey of Pakistan, the Thar district comprises an estimated 185 billion tonnes of lignite which are sufficient to produce electricity for 200 years. More recently, a MoU was reached between the Sindh government and Engro Power Gen (Pvt.) Ltd. to form a joint venture under the title of Engro Coal Mining Company which would be responsible for setting up a 1,200 MW coal fired plant.

Growing global concerns over usage of coal as a fuel resource with many countries labelling it as the 'dirty fuel' has led the GoP to revisit its strategy with respect to coal mining in the Thar area (for power generation purposes) and hence has opted for Underground Coal Gasification (UCG). Considering the fact that Pakistan unlike US, China or India is not a major polluter of the global environment, therefore it could still go ahead with setting of coal fired plants since the UCG option would be very costly. However, a major bottleneck in this regard is the difficulty in obtaining funds since both IMF and World Bank are under considerable pressure to avoid funding such projects.

Going into 2HFY11, a major positive development is the successful test burn of coal in the Thar CoalField. The success of this test has set aside many discouraging projections made previously and paves the way for power generation through coal reserves more sooner than later.

Hub Power Company Ltd.

Valuation Snapshot	PKR				
Hub Power Company Ltd.	FY09A	FY10A	FY11E	FY12F	FY13F
EPS	3.27	4.80	5.49	6.88	7.69
DPS	3.35	5.00	5.00	6.50	7.50
BVPS	25.52	25.82	26.17	27.05	27.64
PE-x	11.45	7.79	6.81	5.43	4.86
Div. Yield	9%	13%	14%	18%	20%
Payout ratio	1.03	1.04	0.96	0.97	0.98

Source: TSL Research

Hub Power Company continues to build on its position as the most efficient IPP in the country. It currently operates a 1,292 MW RFO fired plant located at Pipri with an estimated remaining life of 20 years. Considering the fast growing energy needs of the masses, HUBC has initiated work on two mega projects. One of them is the 214 MW oil fired plant located at Narawal.

Although this plant was scheduled to commence operations during 2010, but due to technical issues at the end of the construction, contractor MAN Diesel of Germany the project is now rescheduled to achieve COD by February 2011. Upon commencement the Narowal project would increase power generation capacity (gross) to 1,506 MW.

HUBC is also constructing its first hydel based power project with a gross capacity of 84 MW near Mangla, AJUK under its subsidiary Laraib Energy limited at an estimated cost of USD 215 million. Improving tariffs and commissioning of the Narowal Project in 2HFY11 will improve cash flow profile of the company translating into significant improvement in payout ratios.

Our revised Dividend Discount Model (DDM) based target price of HUBC stands at **PKR 46.20** incorporating future value addition from commencement of the Narowal Project in 2HFY11. Hence it provides an upside potential of 23% from December 31st, 2010 of closing price of PKR 37.41/share and we recommend investors to **'BUY'**.

Kot Addu Power Company Ltd.

Valuation Snapshot					PKR
Kot Addu Power Company Ltd.	FY09A	FY10A	FY11E	FY12F	FY13F
EPS	6.44	5.78	8.63	8.68	9.00
DPS	6.45	5.00	8.00	8.50	8.50
BVPS	68.12	88.16	70.50	57.40	61.50
PE-x	6.31	7.04	4.71	4.69	4.52
Div. Yield	16%	12%	20%	20%	22%
Payout ratio	1.00	0.86	0.94	0.96	0.98

Source: TSL Research

KAPCO is perhaps the oldest IPP in the country and operates a combined cycled multi-fueled power plant with a gross capacity of 1,466 MW. KAPCO was one of the major sufferers of the worsening circular debt crisis during FY10 as it witnessed fuel stoppage from PSO more than once (due to non-payment of dues). Furthermore, power plant of KAPCO also witnessed idle time post floods when flood water entered into its vicinity.

Going forward, KAPCO has no plans for expansion and owing to gradual rise in tariffs it will be able to maintain its payout ratio of 100%. Based on Dividend yield, KAPCO is an attractive scrip in the short term.

Our revised DDM based target price for KAPCO arrives at **PKR 48.47**. Based on 31-Dec-10 closing price of PKR 40.68/share, the scrip offers an upside of 19%. Hence we recommend investors to **'ACCUMULATE'**.

COMMERCIAL BANKS

NEGATIVE-NEUTRAL

Analyst:

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Valuation and Stance

PKR

Bank	Dec 31'10 Closing Price	Dec 31 '11 Target Price	Upside/(Downside) Potential	EPS (PKR) CY11F	P/BVS (x) CY11F	Stance
UBL	68.23	69.85	2.37%	10.74	1.10	Hold
FABL	15.59	15.61	0.13%	2.42	0.82	Hold
HBL	121.94	112.49	-7.75%	17.74	1.22	Reduce
BAFL	11.21	10.11	-9.81%	1.64	0.66	Reduce
ABL	70.15	60.94	-13.13%	10.2	1.50	Sell
MCB	228.54	196.58	-13.98%	27.32	1.94	Sell

Source: TSL Research

CY2010 saw some strengthening in the performance of banks, due to improved net interest income and lower provisioning charges, despite the fact that NPLs actually increased during the year.

The year saw quite a bit of M&A activity too. Arif Habib Bank was renamed Summit Bank and Emirates Global Islamic Bank and Al-Baraka Islamic Banks merged. As of December 31, 2010 RBS and Atlas Bank stand amalgamated into Faysal Bank and Summit Bank respectively. MyBank will merge into Summit Bank too; and we expect more M&A activity in 2011.

Going into CY11 we expect:

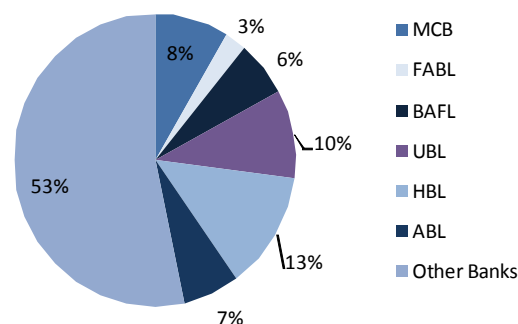
Limited profitability: In CY2011 we expect the issue of NPLs to get much worse due to slow growth in the real sector and high interest rates, which will keep the earnings depressed.

Also operating expenses will remain high due to the persistent inflation, and will offset the benefits from an expected higher net interest income.

Continued crowding out of private sector by government: We expect the declining share of advances in total assets to continue going into 2011. Reason being that fresh wave of NPLs will maintain Bank's risk averseness and private sector's appetite for credit will remain suppressed. Also, government demand will remain high given that the remaining IMF tranche is not expected to be received before Jun 2011, and RGST will not be implemented before then as well.

Banking Spreads to remain at high levels: Going forward, we expect both lending and deposit rates to rise further as we are expecting a policy rate hike of another 50 -100 bps in the remainder of the fiscal year.

Market share in terms of deposits as of Sep '10



Source: SBP, Company Reports, TSL Research

Profitability to remain limited in CY11

Earnings during CY10 were much improved compared to CY09 for the banking sector. Before tax ROE for 9MCY10 was 17.23% compared to 14.17% in the same period last year. This was due mostly to lesser provisioning charges as well as improved net interest income.

For CY11, we expect earnings to remain restricted due to an expected new surge in NPLs. A saving grace will be net interest income which we expect to be somewhat higher than in 2010.

NPLs to be the biggest limiter to bottom line growth

For CY11, we expect NPLs to rise given a higher interest rate environment (policy rate has been raised by 150bps this year, and we expect a further 50-100 bps hike in the first half of CY11) which will negatively impact the debt servicing capabilities of borrowers; as well as tough economic conditions for different industries (high production costs given inflation and high power tariffs as well as slowdown in demand).

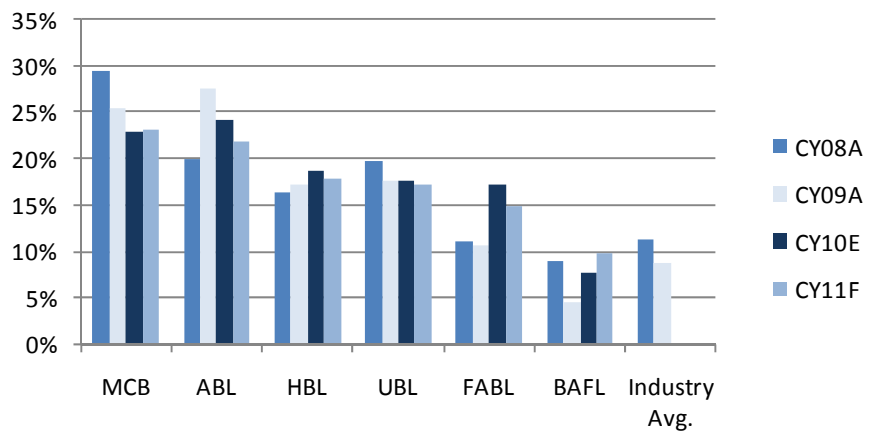
As the loan books of banks age, provisioning too will increase, limiting the profitability of banks in CY11.

Admin Expenses to further suppress the bottom line

Furthermore, we expect administrative expenses to remain on the higher side in CY11 given persistent inflation. We expect inflation to remain around 15% in CY11 because government borrowing from SBP will remain high due to the fact that IMF’s SBA has been extended by nine months (to September 2011), and so we do not expect increased revenue (through RGST) and IMF’s tranche to allow the Government to borrow less from the SBP before the last quarter of 2011 and 2012.

Out of all our coverage banks, we expect BAFL and FABL to face the largest surge in administrative expenses. BAFL’s admin expenses will rise due to its aggressive expansion of branch network in 2010, and FABL’s admin expenses will rise due to its plans to add more branches post merger with RBS.

Returns on Equity to remain low in CY11 for TSL covered banks



Source: SBP, Company Reports, TSL Research

Net interest income to offer some support

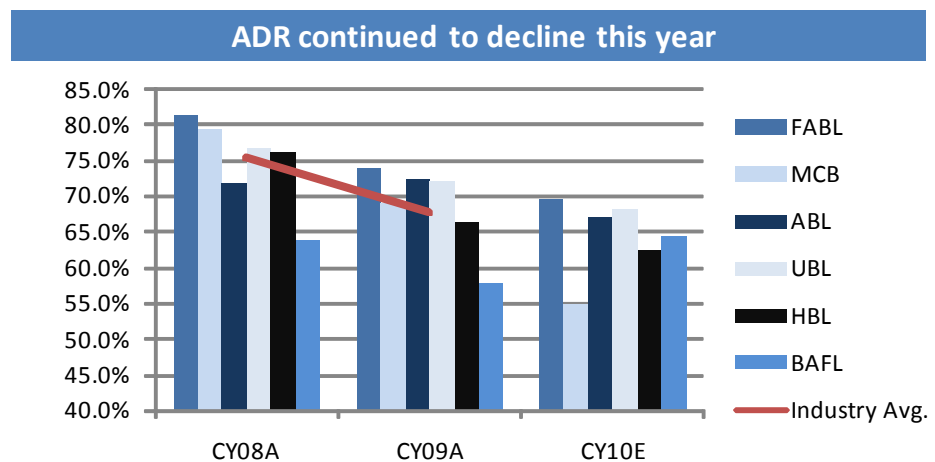
Due to limited curtailment of government borrowing from SBP, we expect money supply to remain high in CY11. This would result in continuation of cheap funds availability for banks, keeping the cost of funds low like in CY10. Weighted average deposit rates for 11 months in CY10 were down 61bps to 5.93% (average of 6.54% in 11MCY09).

Interest income from both advances and investments in government securities will remain high due to raised interest rates. Also, given an expansion in deposits, interest earning assets will rise as well.

Asset composition of Banks: declining trend for advances to continue

CY2010 saw a continuation in the trend of decreasing advances to deposits ratio. Though deposits increased considerably (by around 5% from PKR 4787bn to PKR 5021bn) advances did not increase by as much due to bank's reluctance to lend and decreased appetite of private sector. Moreover, Government borrowing remained high which crowded out loans to the private sector. The yield on government securities was attractive too, especially in the latter half of the year, which gave banks a reason other than risk averseness to focus on this avenue.

For CY11 we expect credit off take to remain slow due to the fact that a high interest rate environment will worsen debt servicing capabilities of borrowers. As a result banks will prefer to invest in government securities. Therefore, investments (the government securities' part) will crowd out advances.

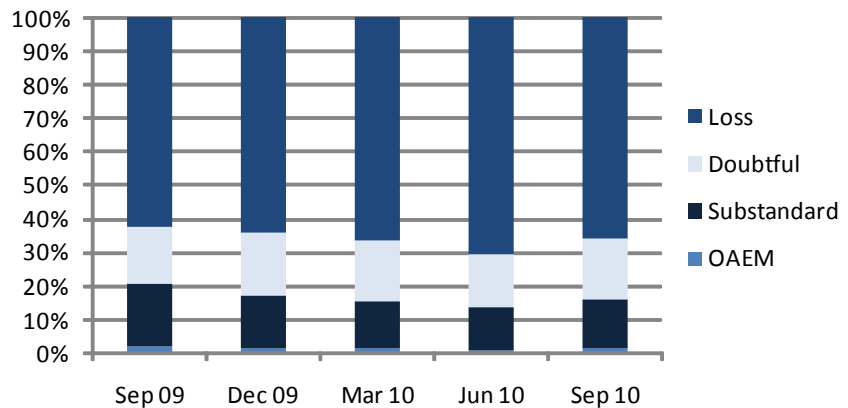


Source: SBP, Company Reports, TSL Research

Tougher times ahead in terms of NPLs

The worsening of asset quality for banks continued into 2010, with the industry average for NPLs to total loans increasing from 12.6% in Dec CY09 to 14.0% in Sep CY10 (end CY08: 10.5% and end CY07: 7.6%). There was some let down in fresh accretion of NPLs in the second quarter, when the increment was less than that recorded for the previous two quarters. However, this trend was reversed after the floods and so we saw a surge in NPLs of 7.4% QoQ in 3QCY10. Along with floods, higher costs of production (due to inflation, rupee depreciation, high interest rates and power issues) and other strains in the business environment adversely affected the repayment capacity of borrowers in the real sector.

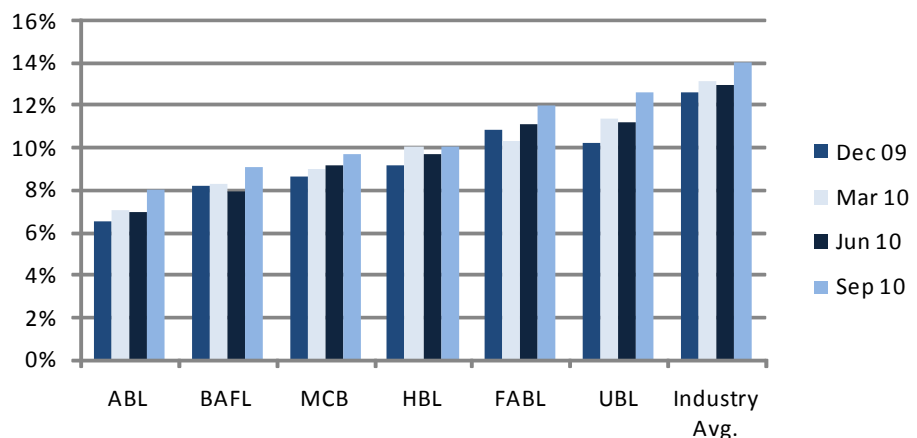
Bad loans of our covered banks aged till 1HCY10; fresh NPL accretion in 3QCY10



Source: SBP, Company Reports, TSL Research

For 2011 we expect NPLs to increase even further due to a high interest rate environment. We expect a policy rate hike of 50bps in the first half of CY11, and the policy rate to not go below 14.5% in the latter half of the year, which will make it harder for borrowers from all sectors to repay. Moreover, 2010 was a slow year for the real sector, and SBP actually expects growth rate in FY11 to remain low at 2.5%. This tapering off of productivity (and subsequently profitability) of the real sector will result in bad loans for the banking sector in CY2011.

Infection ratio rose in the third quarter CY10



Source: SBP, Company Reports, TSL Research

Banking Spreads

Banking spreads declined by 5bps YoY in first eleven months of CY11 to average 7.44%. This was brought about by lending rates declining more than rates on deposits (65bps and 60bps respectively). The reason for this decline was the cut in discount rate in the second half of 2009 (from 14% to 12.5%) and then maintaining of the rate till July, which brought both lending and deposit rates down. On monthly basis, the deposit rates touched their trough in September when they were at 5.77%, a two year low. Lending rates reached a 26-months low in October when they reached 13.32%.

Going forward, we expect both lending and deposit rates to rise further as we are expecting a policy rate hike of another 50-100 bps in the remainder of the fiscal year (depending on inflation). Moreover, deposit rates will also rise due to little

room to move downwards. We believe that deposit rates reached their trough in September and will not move down further. This upward movement will be limited somewhat by a greater availability of funds for banks given surge in M2. Net foreign assets are up by 12.7% (PKR 69bn) and net domestic assets by 7.40% (PKR 387bn) in the fiscal year so far (till December 24, 2010).

United Bank Limited

Valuation Snapshot					PKR
United Bank Ltd	CY09A	CY10E	CY11F	CY12F	CY13F
EPS	7.51	9.05	10.74	13.15	16.82
DPS	2.50	2.50	2.50	2.50	2.50
BVS	42.70	51.55	62.15	74.19	92.91
PE(x)	9.09	7.54	6.35	5.19	4.06
Dividend Yield	3.66%	3.66%	3.66%	3.66%	3.66%
PB Ratio (x)	1.60	1.32	1.10	0.92	0.73

Source: TSL Research

Going into CY11 we expect NPLs to continue being a big threat to UBL's profitability, which was already a big source of concern in the previous years with UBL's infection ratio higher than its closest peers (HBL, ABL and MCB).

On a positive note, we expect the divestment of UBL's shares by ADG (20% shares) to result in a clearer strategic focus for the Bank as Bestway Group will now hold around 51% stake and will have greater control over it.

Also, UBL gave a strong performance in 9MCY10, due to healthy growth in net interest income and we expect this trend to continue in CY11. The bottom line was also helped by a decline in provisions charge, which we believe will be hard for the Bank to maintain due to surge in NPLs in the second half of CY10.

Faysal Bank Limited

Valuation Snapshot					PKR
Faysal Bank Ltd	CY09A	CY10E	CY11F	CY12F	CY13F
EPS	1.64	3.07	2.67	3.43	3.60
DPS	Nil	1.00	1.00	2.50	2.50
BVS	15.51	17.94	17.97	19.10	20.74
PE(x)	9.51	5.08	5.84	4.55	4.33
Dividend Yield	N.M	6.41%	6.41%	16.04%	16.04%
PB Ratio (x)	1.01	0.87	0.87	0.82	0.75

Source: TSL Research

Faysal Bank had a couple of tough years (CY09 and CY08) but its performance has improved much since then and we expect better earnings in CY11 too. We expect RBS's merger into FABL to result in cost synergies and greater income due to the expanded asset size. FABL also stands to benefit from new customers, human potential and a greater deposit base.

Like all other players in the sector, NPLs will remain a big issue for FABL going into CY11. FABL will see some reversals in provisions coming through RBS's loan

book; however, we expect this to be offset by the recent accretion in NPLs which will need to be provisioned for in CY11.

NOTES

KSE 100- KEY INDICATORS

Sector	Company	Mkt. Cap (mln)	Equity (mln)	Sh. O/S (mln)	PAT (mln)	EPS (Rs)	P/E (x)	Price 31-Dec	Div. Yield (%)	Weightage (%)
Oil And Gas	Attock Petroleum Ltd	23,122	7,082.3	69.1	3,082.4	44.6	7.5	334.52	7.47	0.75%
	Attock Refinery	10,634	12,070.5	85.3	1,016.8	11.9	10.5	124.68	0.00	0.34%
	Mari Gas	9,185	8,232.7	73.5	2,151.9	29.3	4.3	124.97	2.57	0.30%
	National Refinery	21,894	19,638.0	80.0	3,284.8	41.1	6.7	273.79	4.57	0.71%
	O G D C	734,728	157,392	4,300.9	59,177.1	13.8	12.4	170.83	4.83	23.77%
	Pakistan Oilfields	70,008	25,934.4	236.5	5,618.3	23.8	12.5	295.96	6.08	2.26%
	Pakistan Petroleum Ltd	259,489	79,906.2	1,195.0	23,320.5	19.5	11.1	217.15	5.99	8.39%
	Pakistan Refinery	3,770	2,179.3	35.0	(4,571.7)	(130.6)	N.M	107.72	1.33	0.12%
	Pakistan State Oil	50,629	29,336.1	171.5	9,049.6	52.8	5.6	295.18	1.69	1.64%
	Byco Petroleum	4,419	(4,208.1)	392.1	(1,616.4)	(4.1)	N.M	11.27	0.00	0.14%
Sec. P/E: 9.1	Shell Pakistan	14,261	8,270.6	68.5	2,562.9	37.4	5.6	208.22	15.85	0.46%
Chemicals	Clariant Pakistan	4,995	2,236.9	27.3	585.8	21.5	8.5	183.00	6.83	0.16%
	Dawood Hercules	23,867	19,882.7	120.3	(1,138.3)	(9.5)	N.M	198.36	2.02	0.77%
	Engro Corporation	63,519	26,888.2	327.7	3,957.3	12.1	16.1	193.81	3.10	2.05%
	Engro Polymer & Chem.	9,468	6,359.7	663.5	(231.8)	(0.3)	N.M	14.27	0.00	0.31%
	Fauji Fertiliser Bin Qasim	33,376	10,659.9	934.1	3,784.4	4.1	8.8	35.73	11.20	1.08%
	Fauji Fertilizer	85,399	13,082.4	678.5	8,823.1	13.0	9.7	125.86	10.45	2.76%
Sec. P/E: 9.43	ICI Pakistan	20,021	14,414.0	138.8	2,044.7	14.7	9.8	144.24	5.55	0.65%
	Lotte Pakistan	20,745	7,450.4	1,514.2	3,383.3	2.2	6.1	13.70	3.65	0.67%
Forestry And Paper	Security Papers	1,846	2,969.9	41.2	332.2	8.1	5.6	44.86	11.15	0.06%
Industrial Metals And Mining	International Industries	7,176	4,038.9	119.9	374.8	3.1	19.1	59.85	3.76	0.23%
Construction And Materials	Attock Cement	5,465	5,395.4	86.6	1,003.6	11.6	5.4	63.11	5.15	0.18%
	Bestway Cement	6,873	8,215.6	325.7	974.0	3.0	7.1	21.10	9.48	0.22%
	D.G. Khan Cement	11,015	20,918.4	365.1	525.6	1.4	21.0	30.17	0.00	0.36%
	Fauji Cement	3,480	9,610.7	693.3	250.2	0.4	13.9	5.02	0.00	0.11%
	Javedan Cement	3,486	731.3	58.1	(428.0)	(7.4)	N.M	59.97	0.00	0.11%
	Lafarge Cement	4,214	9,763.9	1,312.6	(1,279.0)	(1.0)	N.M	3.21	0.00	0.14%
Sec. P/E: 6.22	Lucky Cement	24,509	25,095.9	323.4	3,137.5	9.7	7.8	75.79	5.28	0.79%
General Industries	Ghani Glass	5,259	3,460.9	106.7	712.8	6.7	7.4	49.30	6.09	0.17%
	Packages Limited	10,852	23,416.9	84.4	4,063.9	48.2	2.7	128.61	2.53	0.35%
	Siemens Engineering	10,338	6,911.2	8.2	1,365.2	165.5	7.6	1253.51	7.18	0.33%
Sec. P/E: 4.28	Thal Limited	3,998	4,387.6	30.7	654.1	21.3	6.1	130.25	0.77	0.13%
Electronics & Electrical Equip	Pakistan Cables Limited	1,177	718.8	21.5	45.5	2.1	25.9	54.82	4.10	0.04%
Industrial Engineering	Al-Ghazi Tractors	4,873	5,419.9	21.5	1,743.5	81.2	2.8	227.00	17.62	0.16%
Sec. P/E: 8.34	Millat Tractors	18,295	3,370.8	36.6	1,215.1	33.2	15.1	499.78	9.00	0.59%
Industrial Transportation	P.I.C.T	1,310	3,718.0	18.0	907.8	50.4	1.4	72.75	4.12	0.04%
Sec. P/E: 4.36	P.N.S.C.	5,012	6,461.2	132.1	711.5	5.4	7.0	37.95	7.91	0.16%
Support Services	TRG Pakistan Limited	1,376	1,015.7	385.4	(1,616.8)	(4.2)	N.M	3.57	0.28	0.04%
Automobile And Parts	Atlas Honda	7,824	3,321.3	62.6	224.5	3.6	34.8	124.98	2.60	0.25%
	Indus Motors	19,844	12,587.6	78.6	3,443.4	43.8	5.8	252.47	3.96	0.64%
Sec. P/E: 14.84	Pak Suzuki Motors	5,746	14,325.6	82.3	255.2	3.1	22.5	69.82	0.72	0.19%
Beverages	Muree Brewery Company	1,627	1,438.8	17.3	315.3	18.2	5.2	93.94	5.32	0.05%
Food Producers	Nestle Pakistan	107,699	4,427.0	45.3	3,005.1	66.3	35.8	2374.86	2.53	3.48%
	Rafhan Maize	19,488	4,007.7	9.2	1,297.1	140.4	15.0	2109.87	4.27	0.63%
	Unilever Pakistan Ltd.	289,951	3,291.1	66.5	3,055.7	46.0	94.9	4360.17	5.25	9.38%
Sec. P/E: 20.37	Unilever Foods Ltd	6,804	268.7	6.2	176.8	28.7	38.5	1105.00	3.08	0.22%
Household Goods	Pak Electron Limited	1,649	6,795.7	117.4	260.5	2.2	6.3	14.04	0.00	0.05%
Leisure Goods	Grays of Cambridge Pak	367	223.2	7.3	(3.2)	(0.4)	N.M	49.99	5.00	0.01%
Personal Goods	Azgard Nine Limited	4,341	18,469.7	449.3	60.5	0.1	71.7	9.66	0.00	0.14%
	Bata Pakistan Ltd.	5,210	1,960.7	7.6	585.5	77.4	8.9	689.15	1.16	0.17%

Sector	Company	Mkt. Cap (mIn)	Equity (mIn)	Sh. O/S (mIn)	PAT (mIn)	EPS (Rs)	P/E (x)	Price 31-Dec	Div. Yield (%)	Weightage (%)
	Colgate Palmolive	29,158	2700.2	31.6	750.0	23.7	38.9	923	1.25	0.94%
	Ibrahim Fibers	13,085	11870.8	310.5	1625.4	5.2	8.1	42.14	3.56	0.42%
Sec. P/E: 12.28	Nishat Mills	22,562	19330.8	351.6	1268.0	3.6	17.8	64.17	3.12	0.73%
Tobacco	Lakson Tobacco Comp.	17,853	6819.9	61.6	958.4	15.6	18.6	289.92	3.10	0.58%
Sec. P/E: 10.14	Pakistan Tobacco	28,163	4260.2	255.5	3022.4	11.8	9.3	110.23	10.89	0.91%
Health Care Equip & Services	Shifa International Hospitals	1,513	1507.9	50.5	127.7	2.5	11.9	29.95	8.01	0.05%
Pharma And Bio Tech	Abbot Laboratories	10,744	3238.5	97.9	825.7	8.4	13.0	109.74	10.93	0.35%
Sec. P/E: 14.66	GlaxoSmith-Kline Pak Ltd.	15,052	8104.1	170.7	933.9	5.5	16.1	88.19	5.67	0.49%
Travel And Leisure	Dreamworld Ltd	19,520	345.2	32.0	5.0	0.2	3943.0	610	0.16	0.63%
	P.I.A.C. (A)	5,260	-2077.3	2327.3	-5822.4	-2.5	N.M	2.26	0.00	0.17%
Sec. P/E: 18.62	Pak Services	5,472	10981.2	32.5	-229.8	-7.1	N.M	168.25	0.89	0.18%
Fixed Line Telecom	PTCL	73,291	99389.6	3774.0	9151.2	2.4	8.0	19.42	7.72	2.37%
Sec. P/E: 4.91	WorldCall Telecom	2,496	11379.1	860.6	-490.8	-0.6	N.M	2.9	0.00	0.08%
Electricity	Hub Power Company	43,289	29881.3	1157.2	5556.1	4.8	7.8	37.41	8.95	1.40%
	K.E.S.C.	19,424	-8737.5	6912.5	-15484.9	-2.2	N.M	2.81	0.00	0.63%
	Kohinoor Energy	3,691	6703.3	169.5	905.1	5.3	4.1	21.78	20.66	0.12%
Sec. P/E: 3.66	Kot Addu Power Co. Ltd	35,809	23083.2	880.3	5672.4	6.4	6.3	40.68	15.86	1.16%
Gas Water And Multiutilities	Sui Northern Gas Ltd	14,683	18702.1	549.1	2554.6	4.7	5.7	26.74	0.00	0.48%
Sec. P/E: 45.9	Sui Southern Gas	17,971	9683.5	839.0	257.5	0.3	69.8	21.42	0.00	0.58%
Banks	Allied Bank Limited	54,864	29960.0	782.1	7122.2	9.1	7.7	70.15	5.70	1.77%
	Askari Bank Limited	11,370	14949.1	642.7	1107.8	1.7	10.3	17.69	0.00	0.37%
	Bank Al-Habib	26,548	14105.0	732.2	2856.3	3.9	9.3	36.26	5.52	0.86%
	Bank Al-Falah	15,124	22133.4	1349.2	897.0	0.7	16.9	11.21	7.14	0.49%
	Bank Of Punjab	5,188	3743.1	528.8	-10059.5	-19.0	N.M	9.81	0.00	0.17%
	Faysal Bank	11,395	12782.7	730.9	1200.2	1.6	9.5	15.59	0.00	0.37%
	Habib Bank	122,169	79095.6	1001.9	12298.6	12.3	9.9	121.94	4.51	3.95%
	Habib Metropolitan Bank	25,314	18740.5	873.2	2739.5	3.1	9.2	28.99	3.45	0.82%
	KASB Bank	2,387	4958.9	950.9	-4227.7	-4.4	N.M	2.51	0.00	0.08%
	MCB Bank Ltd.	173,740	69740.0	760.2	15495.3	20.4	11.2	228.54	4.81	5.62%
	Meezan Bank	11,801	9184.5	698.3	1025.4	1.5	11.5	16.9	0.00	0.38%
	National Bank	103,358	119556.4	1345.5	18211.8	13.5	5.7	16.9	9.76	3.34%
	NIB Bank	11,929	41528.2	4043.7	691.0	0.2	17.3	76.82	0.00	0.39%
	Royal Bank	7,353	8804.8	1718.0	-1338.1	-0.8	N.M	2.95	0.00	0.24%
	Soneri Bank	5,005	7803.2	602.3	145.4	0.2	34.4	4.28	0.00	0.16%
	Standard Chartered Bank	33,296	47745.9	3871.6	669.4	0.2	49.7	8.31	0.00	1.08%
Sec. P/E: 5.74	United Bank Limited	83,526	60936.7	1224.2	9192.7	7.5	9.1	8.6	3.66	2.70%
Non Life Insurance	Adamjee Insurance	10,824	10781.2	123.7	2434.5	19.7	4.4	68.23	3.43	0.35%
	East West Insurance Co.Ltd.	7,439	329.7	22.9	-537.1	-23.5	N.M	87.5	0.00	0.24%
	E.F.U. General Insurance	5,505	10464.5	125.0	732.3	5.9	7.5	325.5	9.08	0.18%
	IGI Insurance	6,961	10960.8	71.8	264.0	3.7	26.4	44.04	3.61	0.23%
	New Jubilee Insurance	4,693	2621.0	79.1	656.5	8.3	7.1	96.89	5.06	0.15%
Sec. P/E: 8.93	Pakistan Reinsurance	4,875	6785.7	300.0	269.9	0.9	18.1	59.33	18.46	0.16%
Life Insurance	E.F.U. Life Assurance	6,412	1628.5	85.0	711.7	8.4	9.0	16.25	7.29	0.21%
Real Estate Investment And Service	Pace Pakistan Limited	761	5194.4	278.9	436.8	1.6	1.7	75.44	0.00	0.02%
	Jahangir Siddiqui & Co	8,320	19279.0	763.3	-14413.4	-18.9	N.M	#REF!	0.00	0.27%
Equity Investment Instruments	PICIC Growth Fund	3,756	6522.9	283.5	-2343.0	-8.3	N.M	10.9	0.00	0.12%
Software And Computer Services	Netsol Technologies Limited	1,490	2378.9	77.9	294.1	3.8	5.1	13.25	0.00	0.05%
Technology Hardware And Equipm	Pakistan Telephone Cables Ltd	49	155.6	21.0	-107.4	-5.1	N.M	19.13	0.00	0.00%
Media	Media Times Ltd.	7,136	1438.7	134.1	-2.6	0.0	N.M	2.35	0.00	0.23%

N.A = Not Available, N.M = Not Meaningful

(**) Companies have equity, dividend yield and PAT of 2009

KSE-100 INDEX	12,022
Market Cap. (Rs m)	3,091,008
P/E (x)	11.22
Dividend Yield (%)	4.90
ROE (%)	18.72

KSE-100 STATISTICS

December 31, 2010

20 Lowest P/E x Stocks		20 Lowest P/BV x Stocks		Top 20 EPS Stocks (Rs)	
P.I.C.T	1.4	Pace Pakistan Limited	0.1	Siemens Engineering	165.5
Pace Pakistan Limited	1.7	WorldCall Telecom	0.2	Rafhan Maize	140.4
Packages Limited	2.7	Azgard Nine Limited	0.2	Al-Ghazi Tractors	81.2
Al-Ghazi Tractors	2.8	Pak Electron Limited	0.2	Bata Pakistan Ltd.	77.4
Kohinoor Energy	4.1	NIB Bank	0.3	Nestle Pakistan	66.3
Mari Gas Company Limited	4.3	Pakistan Telephone Cables	0.3	Pakistan State Oil	52.8
Adamjee Insurance	4.4	P.I.C.T	0.4	P.I.C.T	50.4
Netsol Technologies Limited	5.1	Fauji Cement*	0.4	Packages Limited	48.2
Muree Brewery Co Ltd	5.2	Pak Suzuki Motors	0.4	Unilever Pakistan Ltd.	46.0
Attock Cement	5.4	Lafarge Pakistan Cement	0.4	Attock Petroleum Ltd	44.6
Security Papers	5.6	Jahangir Siddiqui & Co	0.4	Indus Motors	43.8
Shell Pakistan	5.6	Packages Limited	0.5	National Refinery	41.1
Pakistan State Oil	5.6	KASB Bank	0.5	Shell Pakistan	37.4
National Bank	5.7	Pak Services	0.5	Millat Tractors	33.2
Sui Northern Gas Ltd	5.7	E.F.U. General Insurance	0.5	Mari Gas Company Limited	29.3
Indus Motors	5.8	D.G. Khan Cement	0.5	Unilever Foods Ltd	28.7
Thal Limited	6.1	Kohinoor Energy	0.6	Pakistan Oilfields	23.8
Lotte Pakistan PTA Ltd.	6.1	PIIC Growth Fund	0.6	Colgate Palmolive	23.7
Kot Addu Power Co. Ltd	6.3	Arif Habib Corporation	0.6	Clariant Pakistan	21.5
Pak Electron Limited	6.3	Security Papers	0.6	Thal Limited	21.3

Top 20 ROE Stocks (%)		Top 20 Market Cap Stocks (Rsm)		Top 20 Div. Yld Stocks (%)	
Unilever Pakistan Ltd.	92.85	O G D C	734,728	Kohinoor Energy	20.66
Pakistan Tobacco Comp.	70.94	Unilever Pakistan Ltd.	289,951	Pakistan Reinsurance	18.46
Nestle Pakistan	67.88	Pakistan Petroleum Ltd	259,489	Al-Ghazi Tractors	17.62
Fauji Fertilizer	67.44	MCB Bank Ltd.	173,740	Kot Addu Power Co. Ltd	15.86
Unilever Foods Ltd	65.81	Habib Bank	122,169	Shell Pakistan	15.85
Lotte Pakistan PTA Ltd.	45.41	Nestle Pakistan	107,699	Fauji Fertiliser Bin Qasim	11.20
E.F.U. Life Assurance	43.70	National Bank	103,358	Security Papers	11.15
Attock Petroleum Ltd	43.52	Fauji Fertilizer	85,399	Abbot Laboratories	10.93
O G D C	37.60	United Bank Limited	83,526	Pakistan Tobacco Company	10.89
Millat Tractors	36.05	PTCL	73,291	Fauji Fertilizer	10.45
Fauji Fertiliser Bin Qasi	35.50	Pakistan Oilfields	70,008	National Bank	9.76
Rafhan Maize	32.36	Engro Corporation	63,519	Bestway Cement	9.48
Al-Ghazi Tractors	32.17	Allied Bank Limited	54,864	E.F.U. General Insurance	9.08
Shell Pakistan	30.99	Pakistan State Oil	50,629	Millat Tractors	9.00
Pakistan State Oil	30.85	Hub Power Company	43,289	Hub Power Company	8.95
Bata Pakistan Ltd.	29.86	Kot Addu Power Co. Ltd	35,809	Shifa International Hospitals	8.01
Pakistan Petroleum Ltd	29.18	Fauji Fertiliser Bin Qasim	33,376	P.N.S.C.	7.91
Colgate Palmolive	27.77	Standard Chartered Bank	33,296	PTCL	7.72
Indus Motors	27.36	Colgate Palmolive	29,158	Attock Petroleum Ltd	7.47
Clariant Pakistan	26.19	Pakistan Tobacco Compan	28,163	E.F.U. Life Assurance	7.29

KSE-100 Sector Statistics

	P/Ex	ROE(%)		P/Ex	ROE(%)
Oil And Gas	10.93	31.21	Tobacco	11.56	35.93
Chemicals	10.10	19.28	Health Care Equipment And Services	11.90	8.47
Forestry And Paper	5.60	11.18	Pharma And Bio Tech	14.66	15.51
Industrial Metals And Mining	19.10	9.28	Media	N.M	N.M
Construction And Materials	8.72	7.39	Travel And Leisure	3943.00	0.04
General Industries	4.48	17.80	Fixed Line Telecommunication	8.01	8.26
Electronics And Electrical Equipments	25.90	6.33	Electricity	6.82	20.34
Industrial Engineering	7.83	33.66	Gas Water And Multiutilities	11.61	9.91
Industrial Transportation	3.90	15.91	Banks	9.36	13.02
Support Services	N.M	N.M	Non Life Insurance	7.54	10.39
Automobile And Parts	8.52	12.98	Life Insurance	9.00	43.70
Beverages	5.20	21.92	Real Estate Investment And Services	1.70	8.41
Food Producers	56.26	62.82	Financial Services	N.M	N.M
Household Goods	6.30	3.83	Equity Investment Instruments	N.M	N.M
Leisure Goods	N.M	N.M	Software And Computer Services	5.10	12.36
Personal Goods	17.33	7.89	Technology Hardware And Equipment	N.M	N.M
			KSE-100 Index	11.22	18.72

Top 20 Liquid Shares (m)		20 Lowest PEG Stocks ^a		10 Highest/Lowest Rel. Perf.	
Lotte Pakistan PTA Ltd.	9.01	Allied Bank Limited	0.04	Colgate Palmolive	203.3%
Fauji Fertiliser Bin Qasim	6.48	Pakistan Telephone Cable	0.05	Nestle Pakistan	97.1%
National Bank	5.92	Unilever Foods Ltd	0.10	Thal Limited	90.7%
Bank Al-Falah	5.02	Attock Petroleum Ltd*	0.12	Unilever Pakistan Ltd.	87.5%
Arif Habib Corporation	3.21	Attock Cement	0.13	Shifa International Hospit	86.4%
United Bank Limited	3.08	Bank Al-Habib	0.15	Lotte Pakistan PTA Ltd.	71.3%
Azgard Nine Limited	2.96	Millat Tractors*	0.16	TRG Pakistan Limited	67.6%
Jahangir Siddiqui & Co	2.90	New Jubilee Insurance	0.17	Millat Tractors	62.5%
D.G. Khan Cement	2.82	MCB Bank Ltd.	0.21	National Refinery	54.7%
Fauji Fertilizer	2.57	Pak Services	0.23	O G D C	52.7%
Engro Corporation	2.46	Packages Limited	0.23	Royal Bank	-74.8%
Nishat Mills	2.44	Netsol Technologies Limited	0.25	Jahangir Siddiqui & Co	-63.5%
NIB Bank	2.35	Fauji Cement*	0.27	KASB Bank	-60.7%
Pakistan Oilfields	2.04	International Industries*	0.27	Pace Pakistan Limited	-53.6%
PTCL	1.87	Meezan Bank	0.28	Azgard Nine Limited	-52.1%
Attock Refinery	1.87	Bank Of Punjab	0.29	Bank Of Punjab	-52.1%
K.E.S.C.	1.50	Mari Gas*	0.29	E.F.U. General Insurance	-50.8%
Bank Of Punjab	1.23	Habib Bank	0.30	Arif Habib Corporation	-50.0%
TRG Pakistan Limited	1.23	Thal Limited	0.33	NIB Bank	-38.4%
Hub Power Company	1.12	Colgate Palmolive*	0.35	Grays of Cambridge Pak	-37.7%

^a growth taken over last 5 years

Rel. Performance taken over MoM

ECONOMIC INDICATORS

	FY04	FY05	FY06	FY07	FY08	FY09	FY10A/P
Nominal GDP (Rs billions)	5533	6548	7195	8235	9922	12082	13844
Real GDP Growth (%)	6.4	8.4	5.8	6.8	3.7	1.2	4.1
Large Scale Manufacturing Growth(%)	18.2	15.4	8.3	8.7	4.0	(8.2)	4.4
Agriculture Growth (%)	2.2	7.5	6.3	4.1	1.0	4.0	2.0
Major Crops: Wheat (m tons)	19.5	21.6	21.6	23.3	21.0	24.0	23.9
Cotton (m bales)	10.0	14.3	14.3	12.9	11.7	11.8	12.9
Sugarcane (m tons)	53.4	47.2	47.2	54.7	63.9	50.0	49.4
Rice (m tons)	4.8	5.0	5.0	5.4	5.6	7.0	6.9
Services Sector Growth (%)	6.0	7.9	6.5	7.0	6.0	1.6	4.6
Exports (US\$ millions)	12313	14391	16451	16976	19052	17688	19346
Growth (%)	10.3	16.9	14.3	3.2	12.2	(7.2)	9.4
Imports (US\$ millions)	15592	20598	28581	30540	39966	34822	34710
Growth (%)	27.6	32.1	38.8	6.9	30.9	(12.9)	(0.3)
Trade Balance (US\$ millions)	(3279)	(6207)	(12130)	(13564)	(20914)	(17134)	(15364)
Current Account Balance (US\$ millions)	280	(1070)	(4990)	(6878)	(13874)	(9261)	(3495)
SBP Foreign Exchange Reserves (US\$ millions)	10326	9578	10836	14333	8745	9527	13112
Exchange Rate (Rs per US\$)	57.6	59.4	59.9	60.6	62.5	78.5	83.8
% change	(1.6)	3.1	0.8	1.3	3.2	25.5	6.8
Total External Liabilities (US\$ billions)	35.3	35.8	36.4	39.5	44.9	51.1	54.5
Domestic Debt (Rs billions)	1979	2129	2337	2610	3275	3861	4653
of which:							
Permanent (Rs billions)	537	501	500	553	608	678	794
Floating (Rs billions)	543	778	941	1108	1637	1904	2399
Unfunded (Rs billions)	899	850	882	940	1020	1271	1456
Tax Revenue (Rs billions)	510	590	704	840	1010	1252	1483
Budgetary Expenditures (Rs billions)	899	1001	1196	1365	1921	2101	2577
Budgetary Deficit (% of GDP)	2.3	3.3	4.3	4.4	7.6	5.3	6.3
Borrowing for Budgetary Support (Rs billions)	63.7	60.2	70.9	102.0	519.9	305.6	304.6
Credit Expansion (%)	23.7	22.2	16.1	14.2	29.3	15.4	12.7
M2 Growth (%)	19.6	19.1	15.1	19.3	15.4	9.6	12.5
Consumer Price Index (FY91=100)	4.6	9.3	7.9	7.8	12.0	20.8	11.7
Sensitive Price Index (FY91=100)	6.0	11.1	7.8	9.4	14.2	22.7	13.2

Source : SBP Annual Reports

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We, Salman Rasheed, Saad Najaf Ali Sayed, MohammadAli Ghanghro, Nabil Saleh and Shumaila Badar, the authors of this report, hereby certify that all of the views expressed in this research report accurately reflect our personal views about any and all of the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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