

Revised Duty for Refineries

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PREAMBLE

Reportedly, in the Economic Coordination Committee (ECC) meeting held in the evening today it was decided that the deemed duty on High Speed Diesel (HSD) would be slashed by 250bps to 7.5%. The effect of this is going to be highly detrimental on refineries as the sector earnings for FY09 are expected to drop by 40% to PKR4.7bn compared to our initial expectations of PKR7.8bn. While there was another ruling vis-à-vis capping of OMC margins at US\$100/bbl, it still remains unclear as to how this mechanism would actually work.

COMPANY-WISE IMPACT

As mentioned above, the reduction in deemed duty by 250bps will have an adverse effect on the sector. However, due to a different production mix and refining dynamics, the individual impact would vary from refinery to refinery. According to our estimates, NRL will be the least affected as it would face a profitability reduction of 25%. This would be followed by ATRL and PRL with a bottom line deterioration of 29% and 58% respectively. The major brunt of the move would be felt by BPL as it is expected to incur losses. The primary reason behind this is the reduced margins on diesel, its only profit making product, which comprises 35% of its total production mix.

Impact on FY09 Earnings				
	(PRs m)	No Change	Reduction to 7.5%	% Ch.
ATRL	Gross Prof.	2,871	1,775	-38.2%
	Net PAT	2,237	1,598	-28.6%
	EPS (PRs)	31.47	22.48	-28.6%
NRL	Gross Prof.	7,329	5,552	-24.2%
	PAT	4,192	3,163	-24.6%
	EPS (PRs)	52.42	39.55	-24.6%
PRL	Gross Prof.	1,988	728	-63.4%
	PAT	1,171	489	-58.2%
	EPS (PRs)	33.45	13.98	-58.2%
BPL	Gross Prof.	2,891	1,878	-35.0%
	PAT	246	-509	N/M
	EPS (PRs)	0.63	-1.30	N/M
Sector	Gross Prof.	15,079	9,934	-34.1%
	PAT	7,845	4,741	-39.6%

RECOMMENDATIONS

In view of the aforementioned change, the effect that it will have on the fair values of refineries is shown in the table below which indicates that despite this change, there remains reasonable upside on NRL and PRL, while ATRL's revised fair value is expected to slide below its current price by 10%. Therefore we recommend a **SELL** stance on the scrip.

Scrip	Fair Value			Current Price	Potential	Stance
	Old	New	Change			
NRL	376.4	309.8	-17.7%	251.7	23.1%	BUY
ATRL	235.5	189.2	-19.6%	209.5	-9.7%	SELL
PRL	225.5	141.4	-37.3%	123.9	14.1%	BUY

OTHER REPERCUSSIONS

We believe that the reduction in deemed duty would have no major effect on OMCs as it would be offset by a lower PDC hence leaving the OMC margins unchanged. However, this would improve their working capital position and therefore give some relief in terms of financial charges.