

Transcript of BMA Investor Call

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BMA Economic and Market Outlook for 2008, by Maheen Rahman, Head of Research, BMA Capital

GDP, in real terms, has grown 7.0% on average over the last five years. In nominal terms the size of the total economy is estimated at USD146bn and will grow to USD165bn by June 2008. Per capita income is set to cross USD1000 by the end of this fiscal year and 2000 by 2014 as indicated by the IMF; Pakistan will then join what is classified as middle income countries. A rising middle class, abundant labor force, improvements in regulatory reform along with stability in governance have contributed significantly to this turnaround story. In the long run, the real sustainability of Pakistan's economic growth story comes from the organic and sustained push on the aggregate demand function coming from a rising middle class and growing population. As the sixth most populous nation in the world with a young demographic, the country is set to add 3.4mn people to the labor force annually; if properly harnessed the growth potential is substantial. And it is this endogenous growth story which will serve us well though 2008 and beyond.

We are now more than halfway through FY08 and the good news is that the economy has weathered several global and domestic challenges. On the domestic front, economic activity has by and large survived domestic politics. Investment and consumption spending has remained resilient (albeit at a slower pace given the tight monetary policy environment). Private sector credit offtake growth has been approximately 10% over 1HFY08 - lower than previous years; but corporate spending has been sustained through alternative forms of debt financing, in particular Sukuks, TFC's and other bonds in which USD164mn have been raised in 1HFY08 alone.

Remittances, which have historically acted as a significant booster to future consumption spend registered a 23.5% increase over the same period last year. Other consumption indicators with regard to consumer goods registered an average growth of 23.8% over Jul - Oct 07. And despite positive real interest rates, auto financing actually rebounded by 56.2% YoY and housing finance by 131.8% over 1QFY08. As for investor confidence consider that the HBL and Arif Habib IPO's both came in 1.5x and 5.8x oversubscribed, an encouraging development given that latter IPO came just days after the Bhutto assassination.

In the global context, a downturn in the global business cycle seems imminent with a high probability of a US recession materializing over the first half of this year - this has led to initial indications of some softening in Asian growth. Exports from India, China and other exporting countries are beginning to show some weakness albeit marginally although domestic demand momentum continues unabated. Pakistan remains relatively hedged in this regard given that export contributes only 12.5% to total GDP and Pakistan's exports have to date registered improved growth.

So where does this leave us in terms of economic growth for FY08 - we believe growth should clock in at 6.3 - 6.6% for the year due to both below target agri performance and a tightened monetary policy.

Our key concerns on the economic front are related to high oil prices which have yet to filter through into the real economy. International oil prices have come off triple digit highs but will probably remain over \$85 /barrel for the first

half of the year. So far, public subsidies have shielded much of the consumers in Pakistan from the full brunt of costly energy but these subsidies are fast becoming unsustainable. High oil subsidies have contributed to a worsening fiscal deficit and we believe the decision to pass on the subsidy in the form of higher retail prices is a decision to be made sooner rather than later. At the same time, the government's curtailment of PSDP spend due to excessive pressure on the deficit from subsidies, will negatively impact GDP growth on that front.

Oil imports have also contributed to a worsening of the trade deficit and pushed the BOP into negative territory highlighting the economy's reliance on foreign inflows. As such while FDI flows have not slowed considerably, inward portfolio flows has suffered due to political uncertainty and we do not expect that trend to reverse until post elections.

As with the rest of the region, inflationary pressures driven by high commodity and agri prices have contributed to consistent upward pressure on headline CPI. The CB continues to maintain a tight stance on this front and last week raised the discount rate by an additional 50 bps to 10.5%. We believe the SBP is responding to supply side shocks coming from higher international food prices and increased budgetary borrowing in the face of higher subsidies and reduced privatization and GDR inflows and expect the SBP to continue its hawkish stance over the next six months.

Politics remains the key risk for 2008; with elections scheduled for 18th Feb, the ushering in of a strong central government bodes well for the future. Economic policies will stay the same – differing opinions on foreign policy and unrest in tribal regions. – Indications that PPP stands to gain a significant majority and PML-Q will lose their previous strong position in the NA.

Future economic managers of the country must deal expeditiously with key issues of a widening fiscal and trade deficit and must effectively re-start the privatization and GDR process to improve these imbalances.

All said and done, a 6.3 – 6.6% growth rate is reasonable in the regional context where international brokers estimate a 5.5%– 6.0% growth over 2008. This would make Pakistan the third fastest growing economy over the year just behind China and India. Underlying growth factors remain intact and a conclusion to politics is required to adeptly handle short term concerns.

Where does all this place us in terms of equity markets. Well, the markets have proved their resilience several times over in 2007, closing the year up 40% just behind Indonesia and China. 2008YTD we are the best performing market in Asia down only 0.42% compared to the region which is down on average 10%.

With global growth worries persisting over 2008, downward surprises on emerging market earnings growth is a possibility which implies that emerging market valuations are looking increasingly overstretched. High value and high growth markets driven largely by domestic demand and better insulation from a US recession will attract considerable interest over the year. In that sense, Pakistan with a growing economy and robust equity market performance is well positioned to benefit.

For those who are not yet invested in Pakistan, the market still presents extremely attractive valuations. The KSE100 Index remains sorely undervalued trading at a mere 11.4x FY08E PER or at an estimated 25.0% discount to the

region. Our themes for the year are a play on domestic demand, relative insulation from a US recession, insensitivity to domestic politics / tight monetary policy and high oil and commodity prices. We project a KSE100 Index target of 17,000 for CY08 driven by earnings growth in FY08E of 12.2% and FY09 of 18.0%. In fact, FY08E would have been stronger except for a one-time impact of higher provisioning in the banking sector due to a change in SBP regulations. We believe FY08E earnings will be led largely by the OMC sector (up 71.5%) due to inventory gains resulting from high international oil prices. Fertiliser and E&P too should register strong rebounds. Telecom is likely to have another disappointing year due primarily to a large one off expense from a retirement scheme currently being pursued by PTC. The auto sector too, will suffer from high interest rates for auto financing and rising costs of production.

FY09E earnings performance looks brighter largely due to a completion of various one off events in FY08 (bank provisioning, telecom writeoffs). Bank earnings by Jun 09 should rebound by about 56.5% while PTC earnings should see a strong upswing. Strong demand should keep the fertilizer and cement sectors buoyant. We may see a dip in OMC earnings resulting from weaker inventory gains over FY09E, but E&P growth remains robust at 11.7%. We advise focus on E&P, OMC, Banks and Fertilizer companies which should register strong earnings for FY08 on the back of high oil and commodity prices. Our top picks are PSO, OGDC, NBP, BOP and ENGRO.

Pakistan in a Regional Perspective, by Marios Maratheftis, Regional Head of MEPNA Research Standard Chartered Bank Plc.

Yes I'm here, thank you very much. I'd like to address thank everybody for inviting me on this call thank everyone for attending this call its a great pleasure to be taking part in this and giving our view on Pakistan and how it feeds in the regional story and how it feeds in the global story and there is one message I'd like to start with and it's the message for the need to be balanced in a view both on the way up and also on the way down people tend to be very optimistic when things are blooming but they reverse very quick and become very pessimistic when things turn around. We believe that we are entering more challenging times globally in 2008 we find a very important period of strong growth, extraordinarily strong growth globally the strongest growth in the global economy for more than 30 years. Now this is changing as with the economic conditions are deteriorating but that does not mean there are no opportunities and in fact we are very optimistic and positive on Pakistan going forward. We acknowledge the risk but now that things are turning we think it's very important to acknowledge the structural benefits and positives that Pakistan has against the cyclical challenges because the cyclical challenges will be solved across the world. I would like to address the issue of decoupling, it's a very popular word that gets a lot of attention globally, I always get asked about decoupling and no matter where I am or who I'm speaking to so I might as well address it here from the beginning and when we talk about decoupling and Pakistan we can mention economic decoupling, the Pakistan economy and Pakistani markets have been booming and performing fantastically well at a time when the global economy of the west in particular was facing some challenges. The US economy has been growing below trend for almost all of 2007 and yet countries in the east, countries in Asia, countries here in the Middle East have been outperforming and growing at very fast levels, their equity markets have been performing very well, there was no feed through of the slowdown in the US of the challenges the US economy was facing and the UK economy was facing to markets and economies in Asia and the Middle East and in Pakistan

so there was an economic decoupling we've experienced it we've seen it and it's something that impressed the markets especially in the west, its not something that has surprised us, we were always bullish on Asia, bullish on Pakistan because we were acknowledging the structural reforms and the structural improvements those economies were undertaking. The second part of the decoupling story with regards to Pakistan is in relation to politics. Its been a challenging few months to say the least when it came to the political situation in Pakistan. I think we should be aware of the risk of misunderstanding the decoupling with immunity because I don't think there is complete immunity. The US is still the largest economy in the world and the US consumer makes 70% of economic activity in the United States. So even if there is no direct exposure to the US per se I think that if the US economy does fall into recession and there is a risk for that, I think it would be natural to expect a slowdown and a deceleration in the rest of the world. Having said that, we do expect things to slow down, we do expect more moderate growth in Asia, more moderate growth in china and slightly slower growth in Pakistan as well in 2008 so there is no immunity to what is happening in the US but we're in a much better position to deal with a slowdown in the US, now Pakistan with the importance of private consumption is in a better position to deal with it and its always worth bearing in mind that if sentiments deteriorate, if people become too negative, if there is a slowdown in the Pakistan economy from a US recession, that's when people should be looking for the opportunities because the when sentiments run high I think that's where the opportunities can be found but the long term story, the medium term story of Pakistan is positive. Cyclical challenges, its going to be a difficult year across the year and I think Pakistan will be affected but within these difficulties we should always remember the long term positives, there is 160mn consumers in Pakistan, the middle class is growing and its going to be the next big story in the next few years. Policy and the policy environment is very credible and the central bank is one of the most credible central banks globally both because of the way its been tackling inflation and its old fashioned way of looking at monetary aggregates which has proved to be correct across the world. Having said that we do not think there will be hike in interest rates any further this year because of the weakening global economic environment but also because of the way this has been the currency situation, the reason why we haven't had violent moves in the Pakistani rupee following the political events is to a great extent a credit to the way the central bank has handled the situation so there are lots of long term positives, policy environment is definitely one of them, the growing middle class is another one and the 160mn consumers, you mentioned earlier on you think agriculture could be a very good sector for 2008, I couldn't agree more with you on that there is a global phenomenon of food price inflation which is rising further, even though there are some concerns about some moderate cooling off in oil and hard commodities in 2008 as the global economy softens we think the pressure on food and on softer commodities is likely to remain if not increase so that's again a great opportunity for Pakistan for 2008 and 2009. Just to sum up, it always pays off to be balanced, both on the way up but more importantly on the way down. We are entering more challenging times globally and even though there's been decoupling in economic activity between the west and the east, even though there was decoupling in Pakistan between politics and the economy, we think there is no immunity and because of the global environment deteriorating, we believe that political events will be having an impact later on in the year if global conditions are tougher and we think if things deteriorate if sentiment does deteriorate it always pays to keep in mind the long term and the structural improvements and positives of the Pakistan economy because that's the only way one can take

advantage of the opportunities and the positives are the growing middle class, the number of consumers and also the very strong credible policy environment and with that I'd like to close my very brief briefing and take questions and answers later on.

Maheen

All right Marios could you just stay on the line for some Q&A.

Question 1

What do you think are the preferred sectors for Pakistan?

Marios

Ok I wouldn't like to go very deep into different sectors but I think that because of what is happening globally, the big thing we're seeing across the world of food price inflation, if there was one sector we would think is looking very strong for the coming months if not coming years even in the longer term is agriculture. Despite the challenges that the sector is facing, there is huge pressure globally. Based here in the Middle East I visit Pakistan regularly and a clear sign of this food price pressure across the world. You look at china, you look at the Middle East, you look at Pakistan itself, the pressures are there and anything they could increase even further, so now we're speaking, even I was about to choose just one sector, I would be choosing that sector. Our outlook for oil as standard chartered research team is conservative. We do not expect oil prices to fall significantly. We expect oil prices to trade in a range between 80 to 100 dollars per barrel, so we're not anticipating a huge increase in oil prices this year, mainly because of the slowdown of the global economy, but having said that we do not expect a collapse of oil prices. It's a challenging year but because of the strength in countries like China in Pakistan and generally in the East, yes they will be affected but we think they will maintain their growth momentum and that's why we do not expect commodity prices in general to collapse but if it was just one sector that we would pick it would be the agriculture side.

Question 1 (cont'd.)

So if I understand correctly, your view is that oil prices wont go beyond a 100 dollars this year.

Marios

I mean even if they do break 100, we don't think they will be sustained above it for this year. We think it could only stay there for a short time. There is just another factor that is affecting oil prices is the performance of the US dollar and we've been bearish on the dollar for the past five years. It was one of the favorite trades of ours to go short the US dollar against more or less... but in 2007 there are some signs in global FX markets, very recent signs that suggest to us that maybe in 2008 we could be seeing the dollar rebounding slightly. Not very aggressive rebound but nevertheless, an end to this one way trend we've seen in the dollar before it resumes towards the end of the year and part of the weakness, sorry part of the rise and the increases in oil prices is directly related to the weakness in the dollar. Now why do I think that this weakness is going to be too much, if you look at the events of the US economy of the past one month, there were extraordinary events. The Federal Reserve cut by 125 basis points in a week. That doesn't happen very often. We had unemployment jumping from 4.7% to 5%, a 0.3% jump from one month to the other. That's only the fourth time this has happened in history. The first time it was in 1991 when there was a US recession. The second time and third time they were in

2001 and again there was a US recession so these are very alarming signs from the US economy and yesterday's number, the non manufacturing ISM was even below the levels of post 9/11. So these signs from the US economy are quite strong and very concerning. The housing market in the US is not just falling its collapsing at the moment and the question and the concern I have is if in this environment that the US is showing this significant signs of weakness, if the Fed is cutting interest rates aggressively and the Euro dollar exchange rate fails to break 149.70 what do we need to see in order to break this. I think this level will have been holding up very well and the fact that it has held to me it signals that the market is already massively short the dollar and I think because of the market positioning, because of the failure to break these key levels at a time when everything was going against the US economy I think there is a reaction it could be some disappointment in the markets with a very moderate rebound in the dollar and I think this moderate rebound in the dollar should keep oil prices under control. We don't think they will be falling very significantly, we think they would be in a range but we do not expect this one way trend in oil prices to continue for much of 2008.

Question 1 (cont'd)

So when you talk about the US dollar prices vis-a-vis the oil prices and all the changes that you've talked about with the US economy, interest rates 125 points lower, dollar stronger against the Euro than where it was lets say about a month ago, in reality it may have actually strengthened quite a bit already given that the interest rates have moved negatively for the US dollar.

Marios

I cannot hear you very well but if I got the question right it's about the extent of the strength of the US dollar. I think the next big level we should be looking at when it comes to the dollar especially against the Euro is at 143.10. It's a huge level, for the moment we're in a range when it comes to the dollar against the Euro, now I think you're talking about broader dollar trends its best to look at the dollar against the Euro. We think it will break 43.10 later on in the year, we think we could go as low as 138, 137, that's why I think there will be maybe some more reaction in the FX market may be some more strength, moderate strength of the dollar but around 137, 138 I think the dollar would start coming under pressure once again but its also a seasonal pattern. The dollar usually comes under pressure in the last three months of the year particularly in December. I think this is going to happen again in 2008 but until we reach the last couple of months of the year, I think we're mainly going to be in a range bound market and if there is a bias its for the dollar to rebound slightly higher but its not the end of the multi-year dollar weakness trend but I believe for the next six to nine months because of the extent of the market positioning we will be seeing some rebound in the dollar.

Question (2)

Marios whats your view on the Pakistan rupee?

Marios

For the Pakistan rupee we think that a lot of the weakness we have seen is because of sentiment rather than a reflection of the view on the markets on the Pakistani economy. Given our view of no immunity of the rest of the world to developments in the US, we believe that Asian currencies in general with the exception of the Chinese Yuan will be weakening, so we expect some very moderate and gradual weakness in the Pakistani rupee. I think the central bank has controlled the extent and the pace of depreciation in the rupee very

effectively, its been very orderly and gradual, nothing to worry about. I think the same will continue, I think there will be some gradual weakness in the Pakistani rupee in 2008 and that would be in line with gradual weakness in Asian currencies in general with the exception of the Chinese Yuan and we expect the Chinese Yuan to be appreciating by 9% in 2008, as a tool, used as a tool by the Chinese authorities to deal with the overheating economy and the inflationary pressures that they are still facing, so, but overall our view on Asian FX is one of moderate depreciation and especially between the second quarter and the third quarter of the year and maybe then rebounding slightly and moderately towards the end of the year in line with some broader dollar pressure towards the end of the year.

Question 3

Marios if I can come back to commodities for a second, you earlier mentioned that you don't think that they're going to go too far beyond where they have already gone in 2007. Gold peaked out at about 930 dollars an ounce. What do you think is going to happen from here on?

Marios

Gold is slightly different. We're not so negative on gold. We think maybe given a return of a deterioration in sentiment, risk aversion mainly because of the inflationary pressures India and china and the Middle East are facing, we think they could remain more supported in 2008 so from a relative value story we would favor gold over oil but above everything we would favor the soft commodities in front of everything. We think soft commodities are our first pick. Second we would be positive on gold in general but and then certainly we would choose oil but again we do not expect any collapse in any of the prices but we think that some cooling off some deceleration in oil is likely for 2008 given our forecast for softening of the global economy we think there is a business cycle in place, we've been on the way up for such a long time and we've had impressive rates of growth globally for the past 3 years. We believe that Asia, we believe that Pakistan are structurally different economies than they used to be and we're hence positive on them in the medium term and the longer term but that does not mean there are no cyclical challenges and because of these cyclical challenges I think we could be seeing some sort of deceleration in 2008 which could be reflected in some of the commodity prices but positive on gold, less optimistic on oil and other commodities.

Question 4 (addressed to BMA)

My question is that since as you quoted the stock exchange will touch 17,000 going from here, my question is that if in the economic outlook is not that much robust at the moment its because of the fact that the central bank discount rate is tightening with the monetary policy stance increase over there and our growing deficit is also pushing us other increase our exports which is at the decreasing side for textiles at the weakening side. I'm talking about the global scenario a recession in US economy seems to be looming on their heads so how can you be able to touch 17,000 with the index despite of the fact that our exports are on the decline side and a much heavy weighted index in scrips such as oil, your fertilizer sector where will they perform in this scenario

Maheen

Ok there are two questions in there. First of all the impact of a US recession and I think the second one related to further monetary Tightening. In terms of a US recession, yes a large chunk of our exports do go to the US and related economies in Europe and the UK but then again exports are only about 12.5%

of our GDP and the bulk of our economic growth is derived from domestic demand. Keeping that in consideration there are other economies in the region for example that derive almost 60% of their GDP growth from exports not just to the US but obviously to other markets as well. So in that sense Pakistan is still relatively hedged from a US recession because we derive most of our GDP growth from the domestic side. Now in terms of which companies will benefit from the domestic side and the reason we're recommending fertilizer and oil and gas and E&P is largely because these sectors are relatively insensitive to a slowdown in exports and two monetary tightening as well. If you look for example at the E&P sector, its driven largely by production growth. We still import about 70% of our crude oil requirements so hence the room for there for domestic companies to grow and increase production is very strong. At the same time, fertilizer off take, we tend to import about 60-70% of our fertilizer needs as well so in that regard any slowdown on the import front is matched by increasing production on the local front. And with high commodity and high sort of fertilizer prices coming through that will only boost margins in the future for fertilizer companies. So essentially the stocks that we want to focus on over 2008 relate to these two areas which is essentially a play on the fact that oil prices will remain high, commodity prices will remain high and agricultural prices will remain high. So in that regard when we calculate an index target of 17,000 we do it on the basis of earnings growth for 2008 and 2009. If you look at our 2009 numbers we're calculating about 17, 18% earnings growth which does take our index target to 17,000 assuming that you revert the PE multiple for 09 which is currently at about 9.6x moves into 11.4 territory which is on average where the stock exchange has traded over the last two years. So in that regard I think 17,000 by the end of this year is fairly achievable.

Farrukh Khan

I'm very happy the finance minister Dr. Salman Shah is in our offices and he is now going to give his view.

Pakistan Outlook, by Dr Salman Shah, Minister of Finance, Government of Pakistan

I think generally speaking on the fiscal side we have the oil price pressure on the subsidy side but that's something that we foresee that in the next 6 months we will be pushing the oil prices to the consumer and this should ease up some of the burden we are hoping that our fiscal deficit will be very close to our target which was 4%. This is the increase is going to also be offset further by some other fiscal measures as well so the deficit remains under control. On the growth side I think the economy is fairly moving along on good strides, we still expect growth to be in the range of 6.5 and 7.5% the agriculture sector has done well with the exception of cotton which had some bug infection but other than that we've had a good agriculture sector and we hope that the wheat production will be good and we expect to get good prices for that. On the manufacturing and services side the economy is moving fine. The political campaign for reelections will be over in another 2 weeks and we're moving into elections. The elections will then lead to new government which will be formed after the elections whether it's a coalition or one party government we're not certain about that at this point in time. So I think the picture will become clear once the elections are held and the results are compiled. The dynamics of the economy, I think it will continue to sustain a good growth of 7-8%. We have very outstanding demographics which means the market will continue to grow, both the product markets and the services markets and also the financial sector should do very well. On the energy side we are facing some shortages

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because of the unprecedented growth in demand and new energy projects, lot of financial closes have been done and we hope by next fiscal year some of these projects will be coming online and I think in the longer term energy is going to be a big opportunity in Pakistan so overall I think the elections if they are held in a good peaceful fashion would be a big plus for the environment and that should help in moving the economy forward.

Question 1

I just want to know about the agricultural sector driving the GDP growth in the coming years. Now one of the things with respect to agricultural sector is fertilizer input. We see volatility in fertilizer prices and that decreases the affordability of the farmer to buy fertilizer. Do we see increase in subsidy?

Dr. Salman Shah

Well I think the biggest change which is happening in the agricultural side is the prices of agriculture commodities and we have seen substantial increases in the price of wheat, corn, sugar cane, even in the livestock area. So I think affordability will not be a major issue going forward because farm incomes are probably going to be doubled in the next 12 months or so, so I think the issue is more about where the farmer is able to get the prices and I think under the current situation there is very little chance that they will not be able to get these global prices. So I think the issue in the agriculture side is going to be the prices and incomes in the rural sector are, if they do grow by what we expect them to grow by, would unleash a rural kind of consumer demand which would be matched by increased production domestically, so I think the silver lining in commodity prices whereas on the one side it is contributing to our CPI with a 40% weight, on the other side I think the rural incomes present a great opportunity and that will drive the economy as we look into the near future.

Question 2

Regarding PSDP. There has been a 70bn cut in the PSDP. Is this directly related to the oil subsidy and fuel price subsidy alone or is there another reason for it?

Dr. Salman Shah

I think this is a result of a mid year review and of course when we take the review we take everything into account and this cut is basically not a cut in the traditional sense but what it says is that those projects which are nearing completion we would put additional funding into it to make sure they're completed within the fiscal year and those projects which have been slow or haven't started yet they will be pushed over into the next fiscal year so I think in that sense this represents fine tuning of the economy and these will be good savings if we can achieve them and of course part of them would be because of the higher subsidies for oil and maybe for food so this is part of a review we're taking and the end result is we want the fiscal deficit to be as close as possible to the 4% target which we hope to achieve.

Question 2 (cont'd)

Sir, two points from this. Cut in PSDP is not exactly a saving right? And two, to the oil subsidy which we call the traditional oil subsidy is more than made up for with the taxes that are levied on oil prices as they stand right now

Dr. Salman Shah

No I think the oil subsidy is what we're paying to the oil companies and that's the difference between what they get and what they buy the oil at and this is

not a cut this is something which because if you look at our budgeting system, now we're moving to what is called the medium term budgetary framework where you are looking at things in a three year perspective so I don't think it really has any impact on the economy per se because without this it would still have these numbers would still be there available for us in balancing the budget.

Question 3

I guess one key concern that we do have is the given the uncertain political situation, the election year, what challenges does Pakistan face in plugging its current account deficit and to what extent will it have a negative impact on the country's foreign exchange reserves.

Dr. Salman Shah

Look I think at this point in time our major contributor to the current account deficit is the oil prices and the petroleum imports into Pakistan and I think it will depend upon what we can do to increase energy efficiency in terms of consumption and reduce some of the requirements because the pices have gone up substantially but the volumes are also going up so we need to control those volumes and I think if we can achieve a ten to fifteen percent reduction in volumes, that should compensate us for this additional burden on the balance of payments and I think in the medium term the current account deficit we are looking at 3.5-4% and this will be done on the basis of greater efficiency in the consumption of energy and higher exports as we believe that our PE is very competitively priced now in comparison to competitor countries. We should expect to see a bounce in our exports and a reduction in other imports other than oil as well so I think that in the medium term 3.5-4% of GDP is the target. In the short run I think the balance of payments may be affected to a small degree based on the financial flows. We are planning to have some GDRs in the last qtr of the fiscal year and if they are successful I think we will be able to finance the current account deficit without any problems.

Question 3 (cont'd)

What is the exact portion of the GDR supposing they don't go ahead as planned then will that mean we will be running down our reserves?

Well this would be something that we're doing on the National Bank and Habib Bank along with KAPCO and these transactions are on track and we don't expect any major issues over here. Other than that the remittances are coming I very strongly they're much higher than last year and I think the foreign investment also, the numbers that we have seen so far are not all that bad so overall we think that we should be able to sustain this deficit for the next year.

Thank you.

Question 4

Discount rate hike last week and PIB rates have gone up by abut 60 basis points... What do you think this impact will be... and do you approve of the govt doing these things?

Dr. Salman Shah

Over here to the 50bp increase in the discount rate I think not all of it will be passed to the industry. The banks need to look at the spreads and there is room for greater competitiveness over there so we'll have to wait and see what this impact is. In terms of inflation I don't see there will be a major impact because most of the inflation at this point in time is being run by food prices

and international commodity prices and these are both outside the control of the monetary policy. So lets wait and see how it pans out in the next quarter.

Question 4 (cont'd)

The governor is of the clear opinion that inflation needs to be controlled and that's why the discount rate is being hiked.

Dr. Salman Shah

Yes inflation has to be controlled but 70% or 75% of it is food inflation and commodity prices of things like steel and cement and wages and salaries of the construction workers and the remaining 25% is something which will have I mean the monetary policy will have some impact so I think the major impact would come if global oil prices come down but it would really help.

Question 4 (cont'd)

So does that mean that you're of the opinion that the discount rate hike will not impact inflation considerably? And the PIB rates that were taken up, they wont impact the lending rates either?

Dr. Salman Shah

Well I hope that there will be adjustment in between. I don't think it will be full 50bps adjustment. There will be something in between and lets hope that global prices for prices weaken somewhat and if the US economy shows signs of recession then the oil prices might come down significantly and that will have a major impact.

Question 4 (cont'd)

What about the PIB rates?

Dr. Salman Shah

I think the last auction they did increase by 50-60bps and the idea over there is to develop the yield curve in Pakistan and therefore I expect that we will continue to do the PIBs on a continuous basis and yields will more or less remain stable where we have them right now.

Question 4 (cont'd)

The previous auction held about a month ago was scrapped at lower rates and these auctions higher rates were accepted. Is there a strategy somewhere in there?

Well the reason was that there was the monetary policy statement was going to come in any case therefore we decided to accept these rates and going forward I think that we should see a much greater demand for PIBs and the rates I don't foresee any major increase in the rates.

Question 5

If I could ask actually 2 questions. One, today REITs regulations were introduced. I think that is a significant development because that's an asset class that was not really available to both the retail investors as well as the foreign investors because of the various regulatory issues. We see quite a lot of demand in that. Do you expect much FDI to flow in that sector. And secondly, coupled with the earlier point that you were making if there is slippage on the fiscal deficit side etc., how does it get handled because there is a fiscal responsibility at..how will that be impacted or what happens in that situation.

Dr. Salman Shah

On the REITs I think this is a product which had been, people had been waiting for this for a long time and there are lots of people in the pipeline who would like to do REITs. The min size is 5 billion so at least I would expect that in the initial round 2-3 REITs will be floated and then once they will be more comfortable with this product then we will have more issues of this and of course foreign investment is something which we are looking for in REITs and it depends on the partnerships that will be formed by our own developers and REIT management companies with their global partners, so I think this will give us a good opportunity of bringing investors not only domestic investors but also international investors into the real estate business and in Pakistan and so this is something which we look forward to. In terms of the slippage of the deficit, its well within the fiscal responsibility law and that's what the whole objective is, to stay within the law and that's what we're planning to do.

Question 6

In today's environment that Pakistan is facing, would you characterize the job of the finance minister as being a very tough job and what do you see as your key challenges over the next 12 months?

Dr. Salman Shah

Well I don't think it's a tough job I mean you guys do all the work I just watch and see what's going on but I think the basic challenges which any economy would face which is a non oil producing economy is to cope with the higher energy cost and the adjustment which will take place in relative prices of other products and I think some of these are going to be very beneficial for us for example on the agriculture products if the prices move up it helps our economy because two thirds of our people are in the rural areas and it can also generate better exports and agriculture can develop as an industry in Pakistan. The second challenge is I think that our demographics are so amazing that we have to invest in our people to really take a demographic dividend where almost 100mn under the age of 25, these are the people who are going to drive Pakistan's economy for the next 50 years and if we can leverage them with skills and they are able to compete in the global markets then I think the economy can grow at 8-10% for the next 50 years, I would say that would be a challenge in terms of reallocating resources in human development and putting resources into infrastructure so that our economy becomes more competitive on a global scale.

Question 7

With regards to both from a FDI and a capital markets perspective what would you say are the key investment themes of the market over the next year or two?

Dr. Salman Shah

I think that the momentum which we had last year we had over 8bn dollars in foreign investment with FDI over 5.5bn dollars I think we have to continue that. The economy is a very dynamic subject. We have lot of investment in the services sector in the financial services and some investment going into manufacturing services, I think more and more we should be looking at investments coming into our manufacturing sector because that's where the people are and that's where the jobs are and that's where our competitive advantage is also going to be so I think this is very important. The other area in the capital markets, REITs is one, private equity is going to be another one and the development of the bond market I think that is something which we are

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working on removing the levies and rationalizing the stamp duties and I think that will start with Islamabad and let's see how that develops, so I think the future for the capital markets is very bright. Our stock market is still very well priced and there is a lot of room for IPOs and I would expect that we should see a spate of IPOs also. The government is going to be putting out lots of IPOs wherever we can.

Question 8

If we may talk about the rupee dollar for a minute. Standard Chartered's economist a moment ago said he sees further weakening in the rupee and the SBP says that they see 60.40 to 61.40. What do you think is the future?

Dr. Salman Shah

I think the rupee is being valued, value is determined by market forces. I foresee that it will remain stable going into the future. In the longer term we have seen Goldman Sachs and other people projecting that the rupee should appreciate on the purchasing power parity basis at some point that adjustment has to take place. We are seeing that adjustment take place in India but in Pakistan I think we are competitively priced and we would like it to remain in this range.

Maheen

We'd like to now wrap up the economic part of our conference call. We'd like to now move to the energy sector. With this in mind I'd just like to pass over to Yasir Shafi who is our oil and gas sector analyst and he will take you through the E&P sector as well as OGDC.

BMA Research view on Energy Sector, by Yasir Shafi, Research Analyst, BMA Capital

Hello everyone. I'll start off with a brief introduction of the Pakistani oil and gas sector and then we'll move on to OGDC and give our view on the company. We currently have an overweight stance on the E&P sector backed by expectations of untapped reserves, strong demand, aggressive exploration activity, high oil prices, improving policy environment and insensitivity to economic slowdown and rupee depreciation. I'll briefly go through each of the above factors, starting with reserve potential. Pakistan currently has 353mn barrels of oil reserves and 32tcf of gas reserves based on 2p valuation. The economic survey of Pakistan implies that so far only 3% and 19% of total oil and gas reserves have been discovered. This is because exploration activity has not been very widespread historically, hence highlighting considerable growth potential in this area. However during FY07 a massive boost in exploration activity in the country was observed with two prominent E&P companies stepping up their exploratory efforts, namely OGDC and PPL. The companies made 12 discoveries and have maintained their exploration target for next year. The discoveries have led to strong production growth this year particularly by OGDC and PPL where last year production growth was mainly flat. Now in terms of oil prices, as mentioned by Maheen, they've made record highs and we expect them to maintain the current trend for second half FY08. Our Arab light oil price assumption for FY08 is **70** dollars and for FY09 is 68 dollars. The demand potential for the country is still very high. Over the next few years we forecast oil and gas demand to increase by on average of 9%-6% annually backed by expectations of continued economic growth. If you look at per capita energy consumption Pakistan sits at a very low energy consumption per capita of 0.1tons while the world average is 0.6tons per capita so there is a lot of room to grow there. The govt. has also provided a very supportive policy

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environment. It recently came out with a new policy in 2007 which is effectively removed the cap on gas wellhead prices and if you compare to the last policy, the gas prices it offers are 15% higher on average according to our estimates. We believe that all of the above factors will contribute significantly to the earnings growth and we expect financial year earnings growth for this sector to be 19% as opposed to only 5% last year. In terms of regional valuations, the sector trades at a significant discount. For FY08, P/E, EV/EBITDA and EV/barrel, the sector trades at a discount of 46%, 22% and 75%. The sector also offers a dividend yield of 7.2% as opposed to a very low dividend yield of the region of only 1.6%. Our top picks in the sector are OGDC and PPL. As we are focusing more on OGDC, I would like to talk about the company. We like the company as it's the largest and most aggressive explorer. It has a balanced revenue composition of oil and gas. Production is expected to grow at a 3 yr CAGR of 11.2%. Its fair value is currently at PKR 152 and its currently trading at about PKR 119 with a FY08 dividend yield of 8.4%. The key challenges that we think that OGDC faces is achievement of its drilling target for FY08 due to rig supply and security issues and in terms of stock price we have seen strong technical resistance at the level of PKR 130. In part we believe this is due to GDR conversions to increase the liquidity of the stock however indications are that approximately 80% of the GDR has been converted which bodes well for strong movement in the next 6 months. That's it for me. I would like to now pass the floor to Mr. Aftab Ahmed. He's the Chief Financial Officer of OGDCL. He will talk about the current and future operations of the company. Following that we will have a Q&A session.

OGDC Overview and Outlook for 2008, by Mr Aftab Ahmed, CFO OGDC

Good evening everybody. This is Aftab from OGDCL. What I can do is I can take you through the next five minutes quickly to what we are right now. OGDCL is the flagship of Pakistan's E&P sector. It was established as a statutory Corporation in 1961. It was then made self-funding or self-financing in July 1989. It was incorporated as a public limited company in October 1997. The local IPO, the first IPO was done in November 2003, then later the company was listed on London Stock Exchange in December 2006. Looking at the strength of the company we have got presence in all four provinces of Pakistan. We also have presence in offshore Pakistan due to oil exploratory effort. We have got a very robust financial balance sheet and our health is pretty good as the finance goes. We have got a very trained and experienced human resource. Talked about exploration, production, development a little while, engineers.... We've got sound equipment base which has really helped us in the last two years because we have 5 seismic crews of our own, four in number which has now increased to five and we eventually want to have six seismic crews. We've got the largest reserves and production share of oil and gas in the country. If you look at the exploration acreage we hold about 34% of the total area which is under exploration. There are about 28 companies operating in Pakistan which also include players like EMI, OMV, BP to name a few and there are other listed players as well, PPL and OGDCL. On the reserve side we hold about 45% of the total oil reserves. I think Yasir mentioned the total oil reserve numbers were 353mn barrels. Out of that we hold about 159mn barrels which is approximately 45% of total reserves found thus far. On the gas side we hold about 34% which is about 10.8 or 10.9tcf. On the production side the total country's production is about 70-71,000 barrels per

day and our share out of those 70-71,000 barrels is 44,500 barrels. So we bring to the market over 62% of the oil being produced in the country. On the gas side, the total production of the country is around 3-3.8tcf and out of that 3.8 we contribute like 0.9 or 1 tcf so 24% of total gas is being produced by OGDCL. On the physical performance side you know in 2003-04 we drilled total of 17 wells. Then in 2004-05 we drilled 18 wells. Year after that was 2005-06 we were able to complete 30 wells and now in 2007-08 sorry 2006-07 which was the last year we spudded 41 wells and now we're tuned to drill under 41 plus 9. 41 wells are firm and 9 are essentially those wells which we have to drill in the area where we've got some security constraints which is essentially in Baluchistan. The success ratio has been very good. Based on the completed well its about 1 out of **32 and a half wells we've drilled**. Though the size of discoveries is small as compared to international discoveries, yet we made 10 discoveries last year.

On the production side you know if you look at a snap of the last five years, in 2003-04 our oil production was around 20-21,000 barrels and now in 2007-08 we are targeting to produce on an average of 42,000 barrels and we mentioned earlier as of end of this year which was last year rather, 2007, December 2007 we were clocking around 44,000 barrels with average certainly is less than that, so we're targeting to achieve an average of 42,000 barrels and then on the gas side in 2003-04 we were producing 698 billion cubic feet and now we're targeting for the business plan 2007-08 that would be touching about a tcf. On the reserves side we plan to add some reserves into our existing portfolio and the reserves addition which we expect will get added to the reserve base in the business plan 2007-08 is about 40mn barrels of oil and around 134bcf of gas and this is net addition. When we talk about the business strategy we have given the guidance to the market that in the next three years our growth will be a double digit growth like 10-11% so that's a guidance we've already given to the market. On the financial side, if you look at our financials and if you just look at facts for the last five years, the sales revenue has increased from 52bn rupees, slightly under a billion dollar in 2003-04 to 100bn rupees last year which was fiscal year 2006-07 and we're now targeting that we will be able to touch 111-112bn rupees. Similarly, if you look at the EPS the earning per share has grown from a 5 rupee 31 paisa in the year 2003-04 to a 10 rupee 52 paisas in year 06-07 and as per our business plan we expect that we'll be above 11 rupees of EPS and in these years of course our contribution to national exchequer has also increased. On the major projects I would like to mention that you know few of our projects have been delayed because of the legal complications which are known to everybody. The projects we are focusing right now is Qadirpur capacity enhancement and we've looked at potential on Kunar Deep and Pathaki Deep and with these two coming on stream we can add another 280mmcf per day to our production and these are targeted to be on stream by September 2009. The work is continuing as you will appreciate in case of gas you have to wait a longer time to bring it to the production and similarly with this gas we can add another 3,000 barrels of condensate from these two fields which is essentially Qadirpur sorry Kunar Deep and Pathaki Deep. This is a time bound project. It was kicked off in September last year. It's a 24 month project so we will be able to deliver 280mmcf gas and 300 barrels of oil of condensate per day in September 2009. Now moving on to the future outlook, with a strong presence in length and breadth of the country, OGDC is actively exploring new E&P opportunities and that is true for Pakistan as well as international ventures. We are also looking beyond our geographical boundaries for E&P opportunities. We're going to countries like Yemen, Oman and you know we went to Egypt. We tried to bid for the recently held Libyan bid round. We just bid for one round and we could not win it because our bid was

not competitive. To sum it up, we've got established expertise in the offshore exploration production and with that background the company is also focusing to more challenging projects. We're also looking at options available where we can acquire a medium to small E&P company quoted internationally. This is something which we have been mandated by the board and we're looking at a few target companies. With that I come to end of my presentation, my talk on OGDCL and I'll be open to any question answer session.

Question 1 (To BMA)

Regarding the crude oil prices as well as the benchmark Arab light prices are going up. Would you give us any idea about what the light oil prices would be specifically for OGDC and other E&P companies for the current financial year as well as the forward financial years?

Yasir

You mean the realized oil prices?

Question 1 (cont'd)

Yes the realized oil prices because as you know there is some discount rate formula that is applicable to the actual crude oil prices that are prevalent in the region.

Yasir

The realized oil prices for OGDC would be much lower as opposed to other companies because around 80% of their oil fields are basically from old policies that are pre-1994 policies and those policies have significant discount on their oil prices so that's why, although we expect realized prices to go up by around 10-12% but again they will much be lower than other companies because of the fact that most of their oil production comes from oil fields.

Question 1 (cont'd)

Right. So lets say if the Arab light crude oil prices for FY08 are somewhere around \$80/barrel then what will be the realized price for OGDC?

Yasir

I would say it would be around \$65-70.

Question 1 (cont'd)

And for POL?

Yasir

POL would be much higher because only 20% of their production comes from oil fields so it will be much closer. If you're saying average prices of around \$80, then I would say they will easily get \$75.

Yasir

For PPL we are expecting the company to have the largest YoY growth this year as opposed to the whole sector because we're expecting around 21% earnings growth from them mainly because in the second half we're expecting increases in gas prices of around 9-10% and most of their gas production, around 90% of their gas production comes from fields that don't have any cap on gas prices so we will see, because oil price performance has been linked to gas prices and oil price over the last 6 month have shown very good performance, we expect the second half, OGRA to announce gas prices to increase by around 9-10%. So that's why were expecting in the second half

PPL's earnings will be much higher and overall growth should be around 21%. And our fair value for the company is PKR 289 and potential risks for the company I would say again are because of the short supply of rigs in the local E&P sector they would have difficulty achieving their drilling targets. That's I think one of the major risks and they also, a GDR of PPL also expected in CY08 so that will also be beneficial in terms of price performance and we also expecting production from Mela field that PPL has a stake in to substantially improve its oil production and for, if we look at the first 6 months production for PPL, their oil production has improved by almost 80% and their gas production has also seen some growth of around 2.6% so we're seeing that particularly for OGDC and PPL both have performed pretty well in terms of production growth. And the petroleum policy, if you look at the petroleum policy that the government approved last year, PPL I think would be one of the major beneficiaries as well because most of their production and revenues comes from gas and if you look at earnings growth as well I think they would be cushioned because most of their production comes from gas and revenues as well and if oil prices, volatile oil prices they won't have much impact on earnings so in that way they're a bit cushioned that's one of the advantages of having a more gas in their production mix as opposed to oil.

Question (Yasir)

For Mr. Aftab Ahmed: In terms of your drilling target for FY08 for 41 wells according to the data that we have the wells have been spudded around 7 wells so how do you see production for the next half of FY08

Aftab Ahmed

I think your question is..how it compares to last year. I would suggest if you look at last years performance I think at this time last year we probably had spudded same number of wells so we are very confident that we will be able to spud these 41 wells in next 5-6 months.

Question (Yasir cont'd)

But production from Mela how do you see it because at present you are also drilling a development well at Mela so at what levels do you see production from Mela at the end of the year.

Aftab Ahmed

We expect you know one of the wells in Mela probably will be finished sometime in June so we will have some increase in the last month of the fiscal year but of course that increase will only translate into the production numbers next year and the production volume we're expecting from this well is around the same number which we're getting from mela 1. As you know probably that we have got a facility which is being used for extended well testing right now to cater for those 10,000 wells of oil.

Question (Yasir cont'd)

And in the first quarter the royalties expenses you had were much higher because you had to pay some royalties for some previous fields but how do you see royalties expenses in the second quarter and the rest of the year?

Aftab Ahmed

I think adjustments had to take place. Major chunk of the investment has already made in the first quarter. There is some fine tuning which is still being done and we might see some sale of this coming into this second quarter. But I don't think there will be any other adjustments and if there are any we will

disclose them in the accounts we are closing right now. Either way.... Hopefully not but there will be some contingencies and those issues you will see in the contingencies.

Question (Yasir cont'd)

Ok so you plan to spread the rest of the amount over the three quarters or you will book them in the second quarter?

Aftab Ahmed

No. We will have it booked this second quarter.

Question (Yasir cont'd)

And what about the issue of Qadirpur, pricing on Qadirpur? Has that been resolved yet?

Aftab Ahmed

Not yet. Not yet its still going on.

Question (Yasir cont'd)

So you expect prices to b adjusted in the second half of FY08 or you think it will be delayed to first half of FY09?

Aftab Ahmed

I'll be very honest I really don't know. We've been trying our best to bring this to a close. Despite our best efforts we're still bit far from a resolution.

Maheen

Ok if there are no more questions from the floor I'd like to thank everyone for participating. We're sorry again about the technical problems, we'll try and resolve them for next time but thank you everyone from BMA Capital and thank you to all the participants, Marios as well as Mr. Aftab Ahmed for participating. Thank you all very much and I hope you will join us next time as well.