



RATINGS (JUNE 2010)

PAKISTAN NATIONAL SHIPPING CORPORATION (PNSC)

	Initial
Entity	
Long Term	AA-
Short Term	A1+

FINANCIAL DATA

PKR (mln)

	3QFY10*	FY09	FY08
Total Assets	18,263	18,372	22,502
Equity	16,780	16,477	20,497
Turnover	5,583	11,474	10,754
Net Income	697	2,359	2,449
Gross Margin %	17.0	26.7	32.3
ROA (%)	5.1	11.5	12.6
ROE (%)	5.6	12.8	14.1
EBITDA	1,410	4,215	3,622

* Based on unaudited accounts for the 9 months ended March 31, 2010.

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RATING RATIONALE AND KEY RATING DRIVERS

- The ratings reflect PNSC's sovereign ownership structure – majority (77%) owned by the Government of Pakistan (GoP) – and its strategic importance. The ratings incorporate the company's strong risk absorption capacity, emanating from a robust equity base and healthy liquidity position. Meanwhile, the monopolist position of PNSC, as the only domestic shipping company in the country, and the long-term nature of its contracts insulate the company to a certain degree from the inherent cyclical nature of the shipping industry.
- The ratings remain dependent upon the successful implementation of the company's fleet expansion/replacement plan and subsequent higher revenues, translating into strong cash flow generation. Adverse business developments, resulting in lower freight and charter revenues and/or excessive leveraging, impacting the financial profile, would have negative rating implications. In this regard, management's ability to proactively manage the company's financial obligations is important for the ratings. Meanwhile, upholding a strong governance framework would be critical.

ASSESSMENT

- The global shipping industry plays a vital role in world economics as it caters to around 90% of world trade volume and has a high correlation with global GDP. The industry is characterized by a cyclical demand pattern, an outcome of intense competition and capital intensiveness where ship availability goes through deficit/surplus cycle. Due to the commoditized nature of its services, industry players mainly compete on cost efficiency and geographical outreach. Since the early 2000s, the sector benefitted from the benign global economic environment, which gave impetus to fleet expansion. However, the recent financial turmoil halted progression and the subsequent economic downturn impacted demand and created a supply glut. As a result, freight and charter rates fell substantially, along with vessel prices. Amongst various international indices used internationally, the Baltic Dry Index serves as the main indicator for dry bulk transportation rates, while the Average Freight Rate Assessment system is employed to calculate liquid cargo rates.
- PNSC, the national flag carrier, is the sole ship owning company in the country and handles around 15% of the country's sea trade. PNSC's fleet currently consists of ten vessels, comprising 5 oil tankers, 5 combi vessels and 1 bulk carrier, with a total capacity of 633,273 DWT. The company generates revenues, denominated in USD and converted to PKR, through freight and chartering services. Liquid cargo, mainly crude oil, transportation constitutes majority of the freight income. The revenue base is concentrated in terms of customers, with three domestic refineries contributing around 47% to total income. However, long term contracts of affreightment (CoAs), with minimum guaranteed volumes, are in place with the refineries till 2013, ensuring steady capacity utilization and mitigating the associated risks to a certain extent.
- Fleet-related expenses constitute the majority of PNSC's costs. Around half of these can be attributed to fuel costs and chartering expenses. Fuel costs can impact margins in case shipping rates do not move in tandem with international fuel prices. PNSC witnessed adequate revenue growth and sustained profitability over the years, mainly on the back of rising shipping rates and sizeable interest income. However, rates and trade volume declined during FY09. Nevertheless, reported topline grew on account of the depreciating local currency. However, during 3QFY10, revenues dropped significantly (41%) due to the disposal of four vessels and a large decline in shipping rates. This, coupled with high operating expenses, resulted in subdued profitability. Going forward, the management is planning to expand its fleet size to 14 vessels (over 1mln DWT) by 2013. The company intends to buy a total of eleven ships during the next three years to replace some of its existing ships and upgrade its fleet. The composition of the fleet would change in favour of bulk carriers. Although the younger fleet is expected to improve margins, the management's business strategy to secure demand for the additional capacity would be critical.
- PNSC utilizes Enterprise Resource Planning software (Ship Management Expert System) for MIS reporting. It also employs Purple Finder, an international satellite system, to track vessels. The system generates several reports that adequately capture the operational performance of the company. However, the financial reporting mechanism needs further strengthening.
- PNSC, with a debt-free capital structure, enjoys a strong financial profile. The management is planning to incur significant debt in a phased manner to fund the fleet expansion. Incremental cash flow generation by the new fleet would be the primary source for debt repayment. However, unfavourable industry dynamics or inability to achieve the envisaged revenue growth could constrain cash flows and the company's ability to meet its future obligations.

PROFILE

- Incorporated under the provisions of the Pakistan National Shipping Ordinance, 1979, and the Companies Ordinance, 1984, the Pakistan National Shipping Corporation (PNSC) functions as the holding company with 19 subsidiary companies (18 wholly owned) and an associate company. PNSC and its subsidiaries, operating on a one ship one company model, are principally engaged in the business of charter of vessels and cargo transportation.
- The seven member board has five nominees of the GoP, including the Chairman, with the remaining two members elected by the minority shareholders. Brig. (R) Rashid Siddiqi, appointed as the Chairman and Chief Executive Officer in Nov. '09, has been a part of the management as an Executive Director since 2002. The CEO is supported by a team which consists of individuals with a blend of experience in the shipping industry and the Pakistan Navy.