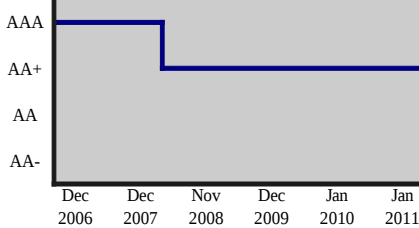


RATINGS (JANUARY 2011)
PAKISTAN STATE OIL COMPANY LIMITED

ENTITY	NEW	PREVIOUS
LONG TERM	AA+	AA+
SHORT TERM	A1+	A1+

PSO L.T. ENTITY RATING HISTORY

FINANCIAL DATA

PKR (MLN)

	30-Sep-10*	30-Jun-10
Total Assets	226,941	202,248
Total Equity	29,161	29,336
Turnover	170,362	742,758
Gross Margin %	3.94	3.93
Profit after Tax	810	9,050
ROE %	11.11	30.85
EBITDA Interest Cover (x)	1.95	2.97
Net Debt/ Free Cashflow from operating activities (x)	5.30	0.44
Net Debt/ Net Debt + Equity (%)	46.30	27.71

* Based on unaudited accounts

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RATING RATIONALE & KEY DRIVERS

- The ratings reflect the strong ownership structure of the company, with controlling interest vested in the Government of Pakistan, and high propensity of state support in distressed situations, considering the strategic nature of the company. With its leading status in the OMC sector, PSO retains pivotal position in the energy supply chain of the country, supplemented by an extensive distribution network, largest storage capacity, and adequate support structure. Meanwhile, ratings take cognizance of increasing short term leverage emanating from persisting circular debt issue in the energy sector, though comfort may be taken from PSO's stable cash flows and GoP's demonstrated commitment to keep the company afloat.
- Strengthening of the corporate governance profile of the company and timely resolution of the circular debt issue are critical for the ratings. Meanwhile, development and use of alternative energy sources leading to decline in demand for POL products and adverse regulatory changes may also impact the ratings negatively.

ASSESSMENT

- PSO's products are segregated into three broad categories (a) White Oils – comprising Motor Gasoline (Mogas), Kerosene Oil (SKO), High Speed Diesel (HSD), and Jet Petroleum (JP-1), (b) Black Oils – comprising Light Speed Diesel (LDO), and Furnace Oil (FO), and (c) Lubricants and Chemicals – comprising Lubes/ Greases, LPG and other chemicals. PSO is the market leader in all segments except the lubricants segment. The company has a cumulative market share of ~71% as at end-FY10. FO and HSD are the two main revenue generating products, representing 60% and 30% respectively of total volume sold.
- Overall sales volume of the company grew by 7.6% in FY10, in-line with the industry growth rate of 8%. The primary growth driver remained FO registering 17.7% growth YoY, enabling PSO to substantially increase its market share in this segment. Demand for FO has witnessed consistent growth over the years due to growing energy requirements of the country and increasing reliance on FO to meet those demands owing to non-availability of alternatives. Higher FO sales, in addition to providing impetus to PSO's topline, also remain the centerpoint of circular debt issue. This leads the company into procuring increased short term borrowings besides denting its profitability in the form of higher financial charges. Growing competition in the retail segment is driving down PSO's market share in HSD and Mogas. HSD sales declined at the industry level by 3%, whereas PSO faced 9.6% contraction in its HSD sales volumes. Demand for Mogas has increased during FY10 (+27% YoY), mainly due to CNG shortage in the country. PSO sales volume increased 22% leading to decline in Mogas market share of 2.1%.
- PSO continued its healthy growth trend in top line during FY10 – largely due to relatively higher POL prices during the year, as well as the 7.6% increase in volumes. The company was able to enjoy a healthy gross margin (FY10: 3.9%, FY09: -0.5%) due to relative stability in oil prices, in sharp contrast to highly volatile behavior observed during FY09, which led to record level of inventory losses and erosion of gross margins. Relatively persistent upward movement in oil prices enabled the company to book inventory gains of PKR 3.2bln in FY10. PSO maintained tight control over its operating expenses. This, coupled with significantly lower exchange losses compared to FY09, boosted the bottom line of the company.
- During IQFY11, revenues grew by a mere 1% YoY as the company took hit of recent floods in the country. PSO, due to its extensive outreach throughout the country, remained the main affectee of floods in the OMC sector as volumes declined 18%. However, gross margins remained intact at 3.9% due to absence of oil price volatility.
- Although PSO generates healthy amount of Free Cash Flows from Operations (FCFO), adverse working capital movement creates liquidity problems for the company. Resultantly, it resorts to short term borrowings and withholds payment to major suppliers to bridge temporary liquidity gaps. The cash cycle of the company has increased during FY10 and 1QFY11 mainly due to increase in receivable days, emanating from delayed payments from WAPDA, HUBCO, and KAPCO (comprising ~90% of total receivables). The circular debt issue is a major concern for the company and if unresolved, could further adversely impact its working capital management and relationship with suppliers. However, comfort may be taken from PSO's stable cash flows and GoP's demonstrated commitment to keep the company afloat.
- The company has also significantly cut down its dividend payment in FY10 in a bid to better manage its capital structure. As there are no long term borrowings, interest and debt service coverage ratios of the company essentially remain the same. The coverages, though improved in FY10, have again declined in 1QFY11 owing to higher short term borrowings.

PROFILE

- PSO, listed on all bourses in Pakistan, is primarily engaged in storage, distribution and marketing of Petroleum, Oil and Lubricant (POL) products in Pakistan. While being among the country's largest corporate entities, the company offers its products through a vast network of retail outlet (~3,600) across the country, including around 1,795 New Vision Retail Outlets. GoP, having ~44% ownership stake in the company through direct and indirect holdings, has complete authority in terms of appointment of the Board of Directors and Managing Director.
- The Managing Director, Mr. Irfan Khalil Qureshi, appointed in February 2009, is a veteran of the oil industry with local and international experience. PSO has a well defined organizational structure with clear segregation of responsibilities.