RATING REPORT

Pakistan State Oil Company Limited (PSO)

REPORT DATE:
December 03, 2021

RATING ANALYSTS:

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RATING DETAILS

Rating Category	Current Rating		Previous Rating	
	Long-term	Short-term	Long-term	Short-term
Entity	AA+	A-1+	AA+	A-1+
Rating Outlook	Stable		Stable	
Rating Date	*Dec 03, '21*		*Dec 08, '20*	

COMPANY INFORMATION

Incorporated in 1976	External auditors: **KPMG Taseer Hadi & Co.**
Listed Public Limited Company	**Chairman of the Board:** Zafar Ul Islam Usmani
Key Shareholders (with stake 5% or more): Government of Pakistan (direct and indirect) – 51%	**Managing Director & Chief Executive Officer:** Syed Muhammad Taha

APPLICABLE METHODOLOGY(IES)

Oil & Gas Industry (June 2019) https://docs.vis.com.pk/docs/Meth-OilGas201906.pdf
Industrial Corporates (August 2021) https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Pakistan State Oil Company Limited (PSO)

RATING RATIONALE

Pakistan State Oil Company Limited (PSO) is the country's largest oil marketing company (OMC). In terms of HSD, MOGAS and FO sales market share was reported at ~45.4% in FY21 as compared to 42.60% in FY20; PSO also possesses the most extensive retail network. The company's distribution and storage facilities showcase extensive geographic diversification and presence across the country supporting its competitive profile.

The company is engaged in storage, distribution and marketing of POL products. While being among the country's largest corporate entities, PSO offers its products through a vast network of retail outlets (more than 3,500), 9 installations, 23 depots, refueling facilities at 10 airports, 2 state-of-the-art lubricant manufacturing facilities and LPG storage & bottling facilities across the country. Government of Pakistan (GoP) holds ~50% stake and management control in PSO through direct and indirect holdings. GoP has complete authority in terms of appointment of the Board of Management and Managing Director. PSO holds strategic investments in Asia Petroleum Limited (49%), Pak Grease Manufacturing Company Limited (22%), Pakistan Refinery Limited (PRL) (ownership increased to 63.56% through purchase of unsubscribed portion of right shares), and Pak - Arab Pipeline Company Limited (PAPCO) (12%). Accordingly, the company's vertically integrated supply chain infrastructure supports business and market risk profile.

POL products are segregated into the following three categories

a) White oils – comprising high speed diesel (HSD), motor gasoline (MS), jet petroleum (JP-1), and kerosene oil (SKO),
b) Black oils – comprising furnace oil (FO), and light speed diesel (LDO), and
c) Lubricants and chemicals.

Barring lubricants, PSO possesses market dominance in other segments. Furthermore, the company is also engaged in supply of gaseous fuels including liquefied natural gas (LNG), liquefied petroleum gas (LPG) and franchising of compressed natural gas (CNG). The company has also established presence in the non-fuel retail segment with a wide network of convenience stores and other associated services. To enhance accessibility, the company is continuously revamping its Shop Stops, adding quick service restaurants and ATMs along with adding new vision retail outlets nationwide. Going forward in the medium to long term, PSO plans to continue to undergo an extensive overhaul of its existing storage and marketing infrastructure. Moreover, addition of new storages will also continue at strategic locations. In line with strategic objectives, PSO continues to diversify its businesses further in the mid-stream oil industry. PSO presently maintains integration into refining business through stakes in PRL which were enhanced to 63.56% from 60% previously. Improving customers' experience and loyalty continues to remain key focus areas.

Key Rating Drivers

Sovereign ownership and strategic national importance in the domestic energy sector.

The assigned ratings reflect sovereign ownership structure of the company with GoP being the largest shareholder, having a controlling stake. Ratings also incorporate PSO's strategic national importance in the domestic energy sector given its sizeable oil storage capacity (around half of country's total storage)

OVERVIEW OF THE INSTITUTION

Pakistan State Oil Company Limited (PSO) is a public company incorporated in Pakistan in 1976 and is listed on the Pakistan Stock Exchange Limited. Registered office of the company is located at in Karachi. Principal activities of the company are procurement, storage and marketing of petroleum and related products. It also blends and markets various kinds of lubricating oils.

Profile of Chairman

Zafar Ul Islam Usmani has held multiple C-level positions with multinational and national companies. He has worked as Chief Operating Officer in Cable & Wireless JV, Paktel; Chief Executive Officer in ExxonMobil JV in Pakistan; Senior Vice President Commercial in Pakistan International Airlines Corporation; Senior Executive Vice President in Pakistan Telecommunication Company Limited and Chief Operating Officer in CM Pak Ltd (Zong). He has overall 34 years of experience with 17 years in C-level positions, with exposure in the area of management, strategy, planning, marketing, sales, distribution, customer services and finance.

Profile of Managing Director & CEO

Syed Muhammad Taha possesses 20 years of executive-level management experience. Previously, he worked as an executive director at Oasis Energy whereby he headed the Program Management Office of Port Harcourt Electricity Distribution Company, Nigeria. Prior to Oasis Energy, he worked at K-Electric Limited as Chief Operating Officer (Distribution) and a member of the Senior Leadership Team. Mr. Taha has also worked for over 9 years at PSO, where he held several senior positions including Head of Corporate Affairs, Retail Fuel, Cards Business and Corporate Planning and worked directly under CEOs. Other corporates where he worked include Shell Pakistan, Caltex Pakistan (A Chevron Company) and Pakistan Steel Mills. Mr. Taha holds an Engineering degree, with an MBA in Finance from the Institute of Business Administration Karachi.

and extensive footprint across the country. Thus, unhindered supply of petroleum products in the domestic market and to strategic customers is contingent on smooth operations of PSO. VIS believes PSO will continue to be of strategic importance to the country and GoP over the rating horizon.

Improvement witnessed in industry volumes during FY21 owing to recovery in overall macroeconomic indicators across the globe and in Pakistan.

Industry sales volumes (HSD, MOGAS and FO) increased by 18% in FY21 primarily on account of recovery in macroeconomic indicators across the country post COVID-19. Pakistan continued to be a net importer of crude oil and petroleum products from Kuwait, Qatar, UAE and Saudi Arabia. A hike in FO volumes was noted (a growth of 37% in FY21) in the outgoing year due to higher electricity demand, shortage of natural gas for power generation and expensive prices for RLNG. Volumes for HSD and MOGAS depicted an increase of 18% and 13% respectively in FY21. Going forward, industry volumes are expected to depict growth momentum in view of greater demand from automobile and power sectors. Other factors that may impact industry performance over the medium term includes enhanced technological advancements towards introduction of electric vehicles impacting fuel consumption, and higher utilization of indigenous coal from the Thar region replacing LNG off-takes.

Industry Sales (MT)			
	FY19	**FY20**	**FY21**
Furnace Oil (FO)	3,536,100	2,368,100	3,239,200
High Speed Diesel (HSD)	7,359,200	6,633,200	7,794,900
Motor Spirit (MS)	7,685,100	7,509,700	8,513,100
Total	**18,580,400**	**16,511,000**	**19,547,200**

PSO continued to maintain leading market position in liquid fuels with growth in market share noted in the ongoing year. Ratings derive strength from established brand name in the oil marketing business. Diversified product portfolio projected to support revenues.

PSO is the largest OMC in Pakistan with ~45.4% market share in PMG, HSD and FO during FY21 (FY20: 42.6%) with an established brand name in the business. Improvement in market presence across all segments during the outgoing year was achieved through enhancement of consumer experience and forecourt improvements. Strategic initiatives over the medium term include undertaking significant investment in storage, marketing and refining infrastructure in order to retain market share given the increasingly competitive landscape.

Industry (PMG, HSD and FO)	**FY19**		**FY20**		**FY21**	
(in Metric Tons)	**Volumes**	**Share (%)**	**Volumes**	**Share (%)**	**Volumes**	**Share (%)**
PSO	7,522,400	40.49%	7,036,200	42.60%	8,874,600	45.40%
Others	11,058,000	59.51%	9,474,800	57.40%	10,672,600	54.6%
Industry Volumes	**18,580,400**	**100%**	**16,511,000**	**100%**	**19,547,200**	**100%**

<u>MS & HSD</u>

PSO's market share in retail fuels (MS & HSD) has increased during FY21 attributable to launching of Euro 5 standard fuels coupled with overall recovery in the market post COVID-19. The company continues to maintain market leadership in retail business. In order to retain its market share, initiatives envisaged marketing activities including addition of retail outlets, innovative offering- "DigiCash", revamping of C-Stores, and other promotional activities. Furthermore, the company successfully secured businesses from a number of industrial customers such as Shanghai Electric Engineering Consulting Co. Ltd., Thar mining project, Daewoo Pakistan Express Bus service, Frontier Works Organization, Frontier Constabulary etc. The company also signed a Fuel Supply Agreement with KE for provision of HSD as back-up fuel for their upcoming LNG units. Over the long-term, PSO also expects to recapture retail market share through ongoing upgrade of storage and marketing infrastructure.

Furnace oil

Owing to availability of RLNG/coal and GoP's strategy of switching priority (merit order) of existing power plants to RLNG/coal, FO demand has witnessed a declining trend since FY18. However, sales volumes of this segment reported a sizeable increase of 37% due to increase in demand from the power sector. In line with industry trends, management does not foresee any significant growth in this avenue and plans to focus on substitutes like LNG. Given increase in gas fired plants and GoP's focus towards renewable energy sources, volumes of this segment are projected to diminish in the long-term.

Jet fuel

PSO is engaged in business of supplying jet fuel to aviation sector. In FY18, PSO established refueling facility at the New Islamabad International Airport in collaboration with Attock Petroleum Limited with a 50% shareholding. The company's market share for JP-1 was reported on the higher side at 94.5%. In FY21, volumes of the jet fuel segment depicted a decline of 32.4% owing to mass-scale lockdowns and travel restrictions across the globe. Going forward, given gradual resumption in flight operations, volumetric sales of the aviation segment are projected to increase.

Gaseous fuels (LNG, CNG & LPG)

Liquefied Natural Gas

During the outgoing year, PSO entered into another agreement with Qatar Petroleum for supply of additional 3m MT/annum of LNG for 10 years. This contract is an addition to the existing arrangement of 15-year long term sales purchase agreement. Total supply capability of the company cumulates to 6.75m MT/annum enabling low cost power generation in the country possible. During FY21, PSO imported 71 (FY20: 74) LNG vessels with total of 4.4m MT of LNG against industry imports of 8.6m MT. Despite very thin regulated margin (due to high effective tax rate) and significant delays in receipts against LNG supplies, management plans to increase its share in the LNG business in order to offset revenue loss from FO business.

Compressed Natural Gas and Liquefied Petroleum Gas

In terms of market participation of CNG facilities under the PSO Franchise model, PSO has maintained its position in the industry with more than 140 CNG stations operating in the country. Given reduced price disparity between MS and CNG due to limited availability of indigenous gas; the CNG industry has been declining on a timeline basis and the trend is expected to remain the same till indigenous gas is unavailable.

The LPG segment grew by 7.3% in FY21 driven by cyclical demand from the domestic transport and industrial sectors in the winter season. Critical challenges faced in the LPG industry included influx of cheap smuggled products from land routes; efforts to reduce the risk are being taken through working closely with the GoP.

Lubricants

During the outgoing year, PSO's lubricants business depicted an uptick of 11.3% through launch of marketing campaigns to enhance availability and awareness of high-tier lubricants in the passenger car category. Sales focus remains on industrial, retail and high street segments. In line with industry trend, management plans to focus on higher end products with better margins although overall volumes may be lower in comparison to other product offerings.

Largest storage and marketing infrastructure in the country; storage conversion, rehabilitation and new development project along with retail outlet enhancement to strengthen infrastructure over the next two years.

PSO operates under the largest storage and marketing infrastructure in the country. Since FY18, the company is undergoing overhaul of its storage infrastructure through conversion of existing tanks (from products like LDO, SKO and FO) to more frequently used products like MS and HSD. Alongside, the company will install new tanks and rehabilitate existing tanks.

In terms of marketing infrastructure, PSO operates more than 3,500 retail branches across the country. The company is revamping old outlets under PSO's new branding regime. Under this scheme, the company has renovated sizeable number of 'New Vision Retail' outlets over the years with addition of 71 in FY21.

As a part of the company's long-term strategy for growth in infrastructure and storage capability, the company initiated projects for construction of storage tanks having total capacity of 198,000 MT. At end-FY21, 43,000 MT of capacity has been completed with 62,000 MT of capacity mechanically completed. Additional 47,000 MT of capacity is in advanced stages of completion. These capacities are expected to be operational by the end of ongoing calendar year 2021. The company is also undergoing rehabilitation plan of 164,000 MT storage at Kemari and ZOT. At end-FY21, 131,000 MT of the capacity has been rehabilitated.

Topline increased in FY21 and in the ongoing year being a function of both, higher average selling prices and greater volumetric sales. Overall profitability was supported by lower finance costs and markup income from late payment surcharge. Going forward, quantum of inventory gain/loss, and markup income on delayed payments will play an important role on profitability levels.

Net sales have increased at a compound annual growth rate (CAGR) (FY18-21) of 4.4%. Change in business mix was noted in the outgoing year with increase observed in proportion of FO sales in total sales mix of the company at 9% (FY20: 6%) with the proportion of LNG business declining to 21% (FY20: 27%) in FY21. This has been on account of greater power demand. Overall, growth in topline was a function of both increase in average selling prices and volumes. In FY21, gross margins were elevated due to favorable price regime and ability to pass on exchange losses on MS and HSD. While gross margins are expected to vary in accordance with sales volumes, inventory gains/losses and selling prices, CPI linkage of margins on retail fuels is expected to support margins.

Overall profitability profile was further supported by higher markup income on delayed payments (primarily from the power sector) to the tune of Rs. 12.7b (FY20: Rs. 6.9b), exchange gain of Rs. 1.7b (FY20: Nil) and lower finance costs to the tune of Rs. 10.2b (FY20: Rs. 13.4b) due to lower mark-up rates. Consequently, the company reported net profit after tax to the tune of Rs. 29.1b (FY20: Loss of Rs. 6.5b) during FY21.

Growth trend in profitability profile continued in 1QFY22 with net sales revenue reported at Rs. 459b, higher gross margins at 4.8% (FY21: 4.5%, FY20: 1.1%), other income of Rs. 1.8b, and net profit of Rs. 11.9b.

Liquidity profile is considered adequate in view of sufficient cash flow from operations and sizeable cash based sales. With circular debt continuing to be a liquidity constraint, an increasing quantum of trade debts has also been noted due to rise in LNG receivables.

Liquidity profile of the Company draws support from adequate cash flow from operations and sizeable proportion of retail sales in overall revenues. At end-June 2021, receivables from the Power Sector stood at Rs. 85.4b (FY20: Rs. 98.8b) reflecting a substantial reduction over the corresponding period last year. However, during 1QFY22, receivables from the power sector increased by Rs. 12.4b. Improvement in power sector receivables has been off-set by the mounting dues from Sui North Gas Pipelines Limited (SNGPL). The company is actively engaged with the ministries to devise strategies for recovery of these rising receivables from SNGPL. The liquidity gap is bridged through reliance on short-term borrowing from banks. The persistence of circular debt and the associated liquidity constraints remain an area of concern with respect to working capital management.

Gearing and leverage indicators have remained within manageable levels.

Total equity has grown on timeline basis (Sep'21- Rs. 152.1b; FY21: Rs. 139.9b; FY20: Rs. 113.1b) on account of internal capital generation. Dividend payout ratio (including bonus shares) was reported at 24% during FY21. Total debt comprises majorly of short-term borrowings and amounted to Rs. 93.2b (FY21: Rs. 61.1b; FY20: Rs. 70.8b) at end-Sep'21. Ongoing and future capex is planned to be funded by internal cash generation. Gearing and leverage ratios were reported at 0.61x (FY21: 0.44x, FY20: 0.63x) and 2.26x (FY21: 1.71x; FY20: 2.03x) respectively at end-Sep'21.

Pakistan State Oil Company Limited (PSO) Appendix I

FINANCIAL SUMMARY- Unconsolidated (Rs. in m)					
BALANCE SHEET	**FY18**	**FY19**	**FY20**	**FY21**	**1QFY22**
Fixed Assets	7,327	8,187	9,994	14,157	14,224
Long term Investments	4,784	11,440	4,736	5,216	5,164
Stock-in-Trade	81,615	89,665	57,215	79,029	123,769
Trade Debts	245,577	219,586	197,117	220,196	249,460
Cash & Bank Balances	4,637	4,593	3,909	2,902	44,461
Total Assets	402,562	417,080	342,872	379,260	495,384
Trade and Other Payables	192,146	180,043	147,817	167,694	239,568
Long Term Debt	-	-	4,352	5,062	5,171
Short Term Debt	89,847	106,977	66,433	56,043	87,994
Total Debt	89,847	106,977	70,785	61,105	93,164
Paid Up Capital	3,260	3,912	4,695	4,695	4,695
Total Equity	110,452	119,181	113,061	139,978	152,137
INCOME STATEMENT	**FY18**	**FY19**	**FY20**	**FY21**	**1QFY22**
Net Sales	1,063,744	1,154,298	1,108,358	1,204,247	459,224
Gross Profit	39,636	36,017	12,227	54,609	22,054
Profit Before Tax	27,160	17,477	(5,134)	44,056	17,802
Profit After Tax	15,461	10,587	(6,465)	29,139	11,994
RATIO ANALYSIS	**FY18**	**FY19**	**FY20**	**FY21**	**1QFY22**
Gross Margin (%)	3.7%	3.1%	1.1%	4.5%	4.8%
Net Margin (%)	1.5%	0.9%	-0.6%	2.4%	2.6%
Net Working Capital	91,159	93,854	75,911	100,920	112,875
FFO	12,544	8,988	(8,784)	43,838	14,797
FFO to Total Debt (%)	14%	8%	-12%	72%	64%
FFO to Long Term Debt (%)	NA	NA	-202%	866%	11.45
Debt Servicing Coverage Ratio (x)	3.43	2.07	0.24	13.03	21.76
Gearing (x)	0.81	0.90	0.63	0.44	0.61
Leverage (x)	2.64	2.50	2.03	1.71	2.26
Current Ratio (x)	1.32	1.32	1.35	1.44	1.34
STD Coverage	364%	289%	383%	534%	424%
ROAA (%)	4%	3%	-2%	8%	11%
ROAE (%)	14%	9%	-6%	23%	33%

**Ratios Annualized*

ISSUE/ISSUER RATING SCALE & DEFINITIONS Appendix II

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES					Appendix III
Name of Rated Entity	Pakistan State Oil Company Limited				
Sector	Oil & Gas				
Type of Relationship	Solicited				
Purpose of Rating	Entity Rating				
Rating History	**Rating Date**	**Medium to Long Term**	**Short Term**	**Rating Outlook**	**Rating Action**
	RATING TYPE: ENTITY				
	Dec-03- 21	AA+	A-1+	Stable	Reaffirmed
	Dec-08-20	AA+	A-1+	Stable	Maintained
	May-04-20	AA+	A-1+	Rating Watch-Developing	Maintained
	Jun-19-19	AA+	A-1+	Stable	Initial
Instrument Structure	N/A				
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.				
Probability of Default	VIS ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.				
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Due Diligence Meetings Conducted		**Name**	**Designation**	**Date**	
	1	Mr. Zubair Ahmed Qureshi	Deputy GM Financial Reporting & Taxation	11- Nov- 2021	
	2	Mr. Wajeeh Ahmed	Deputy GM Corporate Planning	11- Nov- 2021	
	3	Mr. Zeeshan Haider	Acting GM Finance	11- Nov- 2021	
	4	Mr. Tariq Hussain	Acting GM Compliance & Reporting	11- Nov- 2021	