Financial Management

Pakistan Oilfields Limited

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Executive Summary:

Pakistan Oilfields Limited is one of the leading oil companies in Pakistan. POL has 12% share in country's overall oil reserves while it enjoys 6% market share in crude oil business. POL has the following products: Crude oil, Natural gas, Liquefied petroleum gas, Solvent oil, Sulphur (by product). Currently, Pakistan has about 45 rigs from which the country's oil and gas demands are met. The oil industry must prepare for the challenges of free market and sensitive consumers to the new era. As per OPEC long-term estimates that the needs of oil demand over the next 5years will increase by 33% to a volume of 22.345 million tones, compared to 16.805 million tones in 1998-99 real. Given the high level of imports, the economy is vulnerable to fluctuations in world market prices of crude oil and products. During the recent period of high international prices annual petroleum imports accounted for a major portion of total imports. After the financial analysis it was discovered that the net profit for FY09 is about 33% down from the previous year's. The earnings per share decreases can be attributed to the lower net income and the demand for retained earnings for the various explorations and other activities the company is looking forward to. The decrease in profitability is primarily attributable to the decrease in production and the impact of the relatively higher exploration expenditure. For future years, there is considerable oil demand and oil price uncertainty, but still a very strong possibility that oil will trend higher. Against all odds, the Pakistan oilfields limited has managed to stay profitable in turbulent times.

Company profile:

Pakistan Oilfields Limited is one of the leading oil companies in Pakistan and is listed on all three stock exchanges of Pakistan. It is a subsidiary of The Attock Oil Company Limited (AOC) which was founded in 1913 and made its first oil discovery in 1915 at Khaur, District Attock. POL was incorporated on November 25, 1950. In 1978, POL took over the exploration and production business of AOC. Since then, POL has been investing independently and in joint ventures with other exploration and production companies for the search of oil and gas both within the country and outside Pakistan. POL is heavily dependent on its oil production for revenues. The major exploration interests of the company include Tal block, Ikhlas, Gurgalot, Kotra and Kirthar South.

For the year ending June 30, 2007, POL earned a profit of Rs 6.3 billion, the highest ever profit in its history and the fifth consecutive year of record breaking results. For the same year, the total cash dividend payout to the shareholders reached Rs 2.96 billion, an increase of over 20% as compared to the previous year. (Pakistan Oilfields Limited)

Market share:

POL has 12% share in country's overall oil reserves while it enjoys 6% market share in crude oil business. Out of 83 oil wells in Pakistan POL has 9, operating in Punjab.(rank 3) and out of 82 gas wells in Pakistan POL has 6, operating in Punjab.(rank 3). (Pakistan: Oil and Gas Sector Review, 2003)

Products

POL has the following products:

- Crude oil
- Natural gas
- Liquefied petroleum gas
- Solvent oil
- Sulphur (by product)

POL markets LPG under its brand name POLGAS as well as through its subsidiary CAPGAS(Private) Limited.

The net sales earned by POL through these products through 2006-2011 are shown below:

	2006	2007	2008	2009	2010	2011
Crude oil	9,034	7,676	9,811	7,052	8,238	11,804
Natural gas	3,187	3,187	3,185	3,734	5,587	8,166
POL GAS-refill of cylinders	2,164	3,116	3,437	2,984	3,784	4,745
LPG	31	4	3	4	1	-
Solvent Oil	214	237	231	228	224	212
Sulphur	20	19	72	45	11	24

Industry background

The industry of exploration and production of oil and gas in Pakistan existed before the partition of 1947.According government sources, 66 exploration wells existed in the country before its creation. To date, 725 wells are drilled in the country for the purpose of exploration. These drilling operations have produced 219 wells, of which 54 were oil and 165were oil and gas condensates.

It is relevant to mention that the success rate of finding a commercially feasible well in Pakistan is much higher than international success rates. In every three to four drillings, there is a find, while at the international level discovery comes after eight to 10 attempts. In case of Pakistan it has so far 960 appraisal wells, which is a clear indicator of the potential Pakistan has in terms of oil and gas.

Currently, Pakistan has about 45 rigs from which the country's oil and gas demands are met.

The local gas production is 4 billion cubic feet per day (MMcfd) and production of oil is37,000 barrels per day (bpd) compared to the demand of 10.9 million cubic feet of gasand 77,000 barrels of oil per day. This shows that there is excess demand that will remainso in the foreseeable future.
All these supplies come from onshore drilling sites, as Pakistan's offshore drilling areas have not seen substantial activities till recently.

Industry analysis:

Historically, demand for petroleum products increased at an average rate of 7.5 percent per year (4 years 4.25%). Estimates of long-term growth are expected to range from 4.5 to 5%. The maximum growth of 9% has been forecasedt in oil and gas consumption in the transport sector. The consumption of heating oil however, is expected to double itself mainly in power generation.
The several refinery projects in various stages of development, at maturity should result in a substantial increase in refining capacity in the country. The recent repair of Pakistan Refinery Limited (PRL) and units of the park-Arab Refinery Limited Production (Parco) increased the production of HSD and FO during July-Oct2007, which grew by 21 percent and 26 percent compared to corresponding months last year, respectively. But as they are deficit product their local production covers only 45 percent and 47 percent of local demand for HSD and FO, respectively.

The oil industry must prepare for the challenges of free market and sensitive consumers to the new era. As per OPEC long-term estimates that the needs of oil demand over the next 5years will increase by 33% to a volume of 22.345 million tons, compared to 16.805 million tons in 1998-99 real. (Scribd Inc., 2011)
At present, demand is met through imports of refined products, 63% through mainly fuel oil and HSD and 37%of demand is achieved by processing imported and indigenous crude. The cost of petroleum imports in the current and next year is expected to be about $ 7 billion, which is higher than in previous years and $ 1.2 billion is much more than the revised estimates for the current year of $ 6.6billion. The total consumption of crude oil for next year is at 73.3million tons. The cumulative cost of diesel and heating oil is estimated at $ 2.25billion for the next year compared to $ 2.7 billion during the year. For the current year, amount of

$ 6.4billion is expected for the import of about 64.75million tons of crude oil, 4.6 million tons diesel and 2 million tons of heating oil. (Scribd Inc., 2011)

Competitors:

The competitors of POL are listed below:

- Oil and Gas Development Company ltd.
- Pakistan Petroleum ltd.
- Mari Gas Company ltd.
- BHP Billiton
- OMV
- MOL

Suppliers:

POL depends on is suppliers for certain rigs and drilling equipment, these suppliers are mentioned below:

- Schlumberger
- Weatherford
- Halliburton
- Baker Hughes

Customers:

Major customers of POL through which 75% of their sales depend are:

- Attock refinery limited
- Sui northern gas pipelines ltd.

The remaining 25% comes from:

- Attock petroleum ltd.
- Other various distributors of LPG, Solvent oil and sulphur.

Macro-environmental analysis:

The economic analysis can be explained through the following:

- OPEC
- Government policies
- Effect on GDP
- Inflation
- Supply and demand

Macroeconomic impact:

Given the high level of imports, the economy is vulnerable to fluctuations in world market prices of crude oil and products. During the recent period of high international prices annual petroleum imports accounted for a major portion of total imports.

OPEC (The Organization of Petroleum Exporting Countries):

OPEC- The Organization of Petroleum Exporting Countries' membership is open to any country that is a substantial exporter of oil and that shares the ideals of the organization. As of 2011, OPEC had 12 member countries, including founder members Iran, Iraq, Kuwait and Venezuela.

OPEC's influence on the market has been widely criticized. Because its member countries hold the vast majority of crude oil reserves (about 80%) and nearly half of natural gas reserves in the world, the organization has considerable power in these markets.

Goals

Certain goals of OPEC are:

- To stabilize the oil price in international oil markets to avoid fluctuations that might affect the economies of both producing and purchasing countries.
- To provide an efficient and regular supply of petroleum to consuming nations.
- To earn a fair return on investor's capital.

Government policies:

The government has a major stake in the oil and gas sector, both as policy maker and regulator, as well as owner and manager of many of the operating entities. While the private sector is active, government entities dominate the oil and gas business. (Pakistan: Oil and Gas Sector Review, 2003). Government shareholding in Oil and Gas sector is shown in Table 1 in annexure 1.

MINISTRY OF PETROLEUM AND GAS PAKISTAN

- Petroleum policy 2009
- Regulating laws of petrol and gas in Pakistan
- Pricing formula for refineries
- The ex-refinery prices will be set on a calendar monthly basis.
- Crude imports will be exempt from customs duties and taxes.

Current scenario:

In the year 2011, a decrease from 50% to 48%in share of gas in energy contribution was seen. (FY 11) that created an energy demand supply gap. Also the oil dependence increased from 28% to 32% and hence dependence on imported oil rose from 81% to 86%.

Budget deficit and raising inflation rate is a major concern for Pakistan’s economy. Due to the increasing imports of oil, Pakistan’s total imports now are of huge values. And in response to this, the petroleum prices have also increased. Because of this scenario Pakistan’s economy is at all-time low level and is expected to go further down.

Supply demand (petroleum):

After witnessing a slump in oil consumption on account of devastating floods in 2010, the local oil demand pattern continues to show growth. During March 2011, the country's oil consumption rose by a significant 21 percent monthly. This spike in consumption has increased country's reliance on imported resources to 75 percent compared to 68 percent the previous month and because of this petroleum prices have also increased.

The transport sector is the largest user of petroleum products (48 percent), followed by power generation (35 percent) and industry (11 percent), and the balance largely by the residential sector and all these sectors being largely dependent on the petroleum, have to suffer a lot in this decrease in supply and increase in demand scenario.

Supply demand (natural gas):

Natural gas is a source of wealth for Pakistan. The demand for gas has been growing at a rapid rate of nearly 7 percent over the past decade.

The largest use of gas is for power generation (35 percent), the balance being shared approximately equally (21 percent each) by fertilizer producers, other industrial applications and households (Pakistan: Oil and Gas Sector Review, 2003). The gas requirements of households strongly fluctuate throughout the year–during the three to four winter months, household demand increases considerably which results in gas shortages. As a result, gas supply to industrial, power and fertilizer plants is curtailed during the heating season and hence their business also gets affected to a great extent.

Supply and Demand (LPG):

Liquefied Petroleum Gas (LPG) is a naturally occurring hydrocarbon fuel in gas and oil fields or extracted in oil refineries.

LPG is most commonly referred to as the poor man's fuel. It is largely used domestically for cooking and heating where there is no availability of natural gas. The rising trend in petroleum prices over the years has encouraged its usage in the auto sector. To some extent, it is also consumed in industrial units. Around 50% of its total consumption is in Punjab followed by Sindh, Khyber-Pakhtoonkhwa and Balochistan. In an effort to control deforestation and promote the cause of environment friendly fuel, the Government of Pakistan has made it mandatory for marketing companies obtaining LPG from Sindh, to supply at least 10% LPG in Balochistan and companies receiving LPG from Punjab to supply 7% in AJK and 6% in FATA.

A graph showing the production and consumption of LPG is given in Annexure 2.

Effect on GDP:

GDP declines in oil importers reflect a decline of real income as the cost of oil and related goods and services rise. This will raise inflation and interest rates, which in turn will lower the demand and will reduce the competitiveness resulting in a decline in the output received.

Pakistan's real GDP growth in 2010 was around 2.4%, with an average annual increase of 3.4% forecasted for 2011-2015. Several state-controlled oil and gas companies are in the throes of privatization, and already work with international oil companies (IOCs) in the upstream segment.

Oil Prices and Inflation:

As now a days oil prices have been increasing therefore inflation will also increased to some extent in response to the increase in the price of oil.

FINANCIAL ANALYSIS OF PAKISTAN OILFIELDS LIMITED PAKISTAN:

The Net profit for FY09 is about 33% down from the previous year's. There are many apparent reasons for the decline in profitability of the company. During the year, the international oil prices saw considerable fluctuations, the prices of Arabian light ranging from a low of US $35 to a high of US $141 per barrel amid economic uncertainty and poor global economic projections. The rupee also ended weaker against various foreign currencies, specially the greenback. These external situations, coupled with 27% less crude production this year have adversely affected the profitability. Both ROA and ROE of the company can be brought up from its current levels to that of its competitors, thus indicating the untapped potential of POL.

In FY10 cash and bank balances make around 33% percent of the total current assets. The current ratio has increased from 3.54 in 2009 to 3.69 in 2010, a slight change over the previous year. Liquidity position of the company, which had dropped below the industry s average last year, has declined slightly again. The current ratio has shown a decline of about 15% due to 20% decline in POL s current assets and a 5% decrease in current liabilities the decrease in current assets being mainly due to the cash at hand which stood at PKR 4.074 billion, 45% down from FY08 (PKR 7. 5 billion).

The **Market Performance** of POL has been commendable for a long period of time. The **Earnings per Share** of the company stood at PKR 23.59 per share in FY09. This is lower than the previous year's earnings per share of PKR 35.57. This can be attributed to the lower net income and the demand for retained earnings for the various explorations and other activities the company is looking forward to. This year, the company announced an interim dividend of 80% per share i.e. PKR 8 per share and further recommended a dividend of 100% i.e. PKR 10 per share. The cash dividend is higher this year as compared to FY08 s dividend per share of PKR 16 and 20% bonus shares. The dividends per share for FY09 and FY10 have increased to 18 and 25. 5. An increase in dividends per share shows that the company is making good profits. The book value fell in FY09 and later increased back in FY10 from 109.5 to 123. 13. The EPS for 2010 is 31. 44. The price/earnings ratio has also increased to 6.87 in 2010.

Ratio analysis:

	2006 POL	2006 Ind. Avrg	2007 POL	2007 Ind. avrg	2008 POL	2008 Ind. avrg	2009 POL	2009 Ind. avrg	2010 POL	2010 Ind. avrg
Current ratio	2.125144	4.098381	4.295803	5.098601	4.218227	3.576076	3.539045	3.549682	3.684922	3.451641

In 2006 POL's current ratio is 2.125 which is well below the industry average 4.098 so its liquidity position is rather weak. As the current assets are supposed to be converted to cash in a year, it is likely that they could be liquidated at close to their stated value. In 2007 POL's current ratio increased to 4.295 and came closer to the industry average of 5.098. Further POL's position got a lot better in 2008 till 2010 where its current ratio increased its industry average showing that its current liabilities are decreasing compared to its current assets.

	2006	2006	2007	2007	2008	2008	2009	2009	2010	2010
	POL	Ind. Avrg	POL	Ind. avrg	POL	Ind. Avrg	POL	Ind. avrg	POL	Ind. avrg
Quick ratio	2.10925	3.67975	4.259549	4.596516	4.198566	3.249522	3.506768	3.222256	3.658654	3.252885

In 2006 the industry average quick ratio was 3.679 and POL's ratio was 2.109 which was quite low in contrast with other firms in its industry. But it seems like the company was able to pay off its current liabilities as its quick ratio increased each coming year till 2010 where it was greater than the industry average which was 3.25 less than POL's 3.65 quick ratio.

	2006	2006	2007	2007	2008	2008	2009	2009	2010	2010
	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. Avrg	POL	Ind. avrg	POL	Ind. avrg
inventory turnover ratio			-86.42	-86.42	-97.086	-97.086	-78.302	-78.302	-78.6661	-78.6661

POL's turnover over ratio is equal to the industry's turnover ratio since 2007. This shows that POL has been productive since the past years.

	2006	2006	2007	2007	2008	2008	2009	2009	2010	2010
	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. avrg
Average account receivable			6.757363	6.757363	8.806175	8.806175	8.317382	8.317382	8.75526	8.75526

POL's accounts receivable are equal to the industry average showing that it is not being underproductive.

	2006	2006	2007	2007	2008	2008	2009	2009	2010	2010
	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. Avrg	POL	Ind. avrg	POL	Ind. avrg
days sales outstanding			53.27522	53.27522	40.8804	40.8804	43.28285	43.28285	41.11814	41.11814

This is also known as "average collection period". Since the days sales outstanding remains the same as industry average that shows that customers are paying their bills on time, company is receiving funds on time etc.

	2006	2006	2007	2007	2008	2008	2009	2009	2010	2010
	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. avrg
fixed asset turnover ratio	1.98	2.305	1.031413	1.799974	0.977603	1.734111	0.663936	1.429712	0.742984	1.205938

POL's fixed asset turnover ratio is slightly less than the industry average and it has remained like this from 2006 till 2010. It shows that POL is using its fixed assets approximately equal to other firms in the industry.

	2006	2006	2007	2007	2008	2008	2009	2009	2010	2010
	POL	Ind. avrg	POL	Ind. Avrg	POL	Ind. Avrg	POL	Ind. avrg	POL	Ind. avrg
total asset turnover ratio	0.77	0.803333	0.676774	0.758925	0.63038	0.77346	0.446272	0.698757	0.52145	0.61715

Overall the total asset turnover ratio has remained less than the industry average for the past couple of years. This indicates that it is not generating enough sales given its total assets and that it sales should be increased.

	2006	2006	2007	2007	2008	2008	2009	2009	2010	2010
	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. avrg	POL	Ind. avrg
debt ratio	0.370753	3.460251	0.221587	2.957196	0.22812	2.666042	0.253139	1.98438	0.259331	1.45311

The debt ratio has remained low throughout 2006 till 2010 which shows lower rate of risk for the company. This might attract the creditors since they prefer larger cushion against losses.

	2006 POL	2006 Ind. Avrg	2007 POL	2007 Ind. Avrg	2008 POL	2008 Ind. avrg	2009 POL	2009 Ind. avrg	2010 POL	2010 Ind. Avrg
Return on Assets	0.263568	3.460251	0.25237	0.296189	0.262155	0.286078	0.161796	0.250898	0.189124	0.239562

Return on assets has remained low for POL as compared to industry average which is not good but it is also not necessarily bad since it might have resulted from some sort of decision to use a lot of debt, and in that case there would've been high interest expenses which caused net income to be low.

	2006 POL	2006 Ind. Avrg	2007 POL	2007 Ind. Avrg	2008 POL	2008 Ind. Avrg	2009 POL	2009 Ind. avrg	2010 POL	2010 Ind. Avrg
Return On Equity	0.418862	0.429431	0.252378	0.336189	0.339634	0.394817	0.216634	0.328317	0.255342	0.272671

The return for equity ratio for POL is low than the industry average but it is not far below as the return on assets ratio.

	2006 POL	2006 Ind. avrg	2007 POL	2007 Ind. avrg	2008 POL	2008 Ind. avrg	2009 POL	2009 Ind. avrg	2010 POL	2010 Ind. avrg
Price/earnings ratio	10.77	13.11667	10.52	12.49667	8.35	10.94667	6.14	6.346667	6.87	8.35

POL's Price/earnings ratio has remained lower than its industry average sowing that the company is fairly riskier than others in the industry and having poor growth prospects.

Six Years at a Glance:

The six years sales, profit and performance of the company is shown in the graphs in annexure 2.

Future outlook of the economy:

For future years, there is considerable oil demand and oil price uncertainty, but still a very strong possibility that oil will trend higher. Between 2010 and 2020, a decrease is forecasted in Pakistani oil production of 42.50%. Oil consumption between 2010 and 2020 is set to increase by 22.49%, with growth slowing to an assumed 1.5% per annum during the period. Gas production is expected to rise from an estimated 38bcm in 2010 to a possible 48bcm by 2020. With demand growth of 44.27%, this will require imports rising to almost 7bcm by the end of the forecast period.

The government, in July 2007 announced new five-year energy policy. The new policy provides a 6-8% increase in oil and gas production prices on new discoveries the petroleum exploration and development companies would make in future.

Against all odds, the Pakistan oilfields limited has managed to stay profitable in turbulent times. The decrease in profitability is primarily attributable to the decrease in production and the impact of the relatively higher exploration expenditure in this nine-month period, incurred primarily in Kirthar South, Ikhlas and Margala blocks. This has, however, been offset by a favorable exchange rate variance between the rupee and the dollar and recognition of revenue upon the finalization of long outstanding crude oil sales agreements of certain fields.

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Annexure 1:

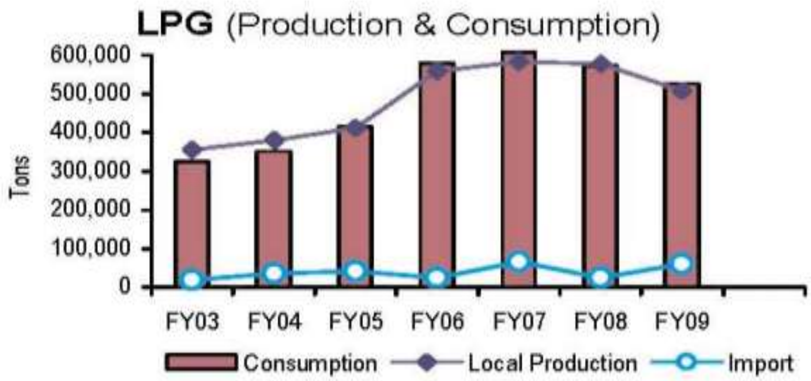
Table 1: Government Shareholding in the Oil and Gas Sector

Name	Business	Direct and Indirect Shareholding*
Oil & Gas Development Co Ltd	Exploration & Production	100.00%
Pakistan Petroleum Ltd.		93.40%
Mari Gas Co. Ltd.		40.00%
Pakistan Oilfields Ltd.**		11.00%
National Refinery Ltd.	Oil Refining	55.00%
Attock Refinery Ltd.**		26.00%
Pak-Arab Refinery Co. Ltd.		60.00%
Pakistan State Oil Co. Ltd.	Oil Marketing and Distribution	55.22%
Sui Northern Gas Pipelines Ltd	Gas Transmission and Distribution	59.47%
Sui Southern Gas Co.		88.62%

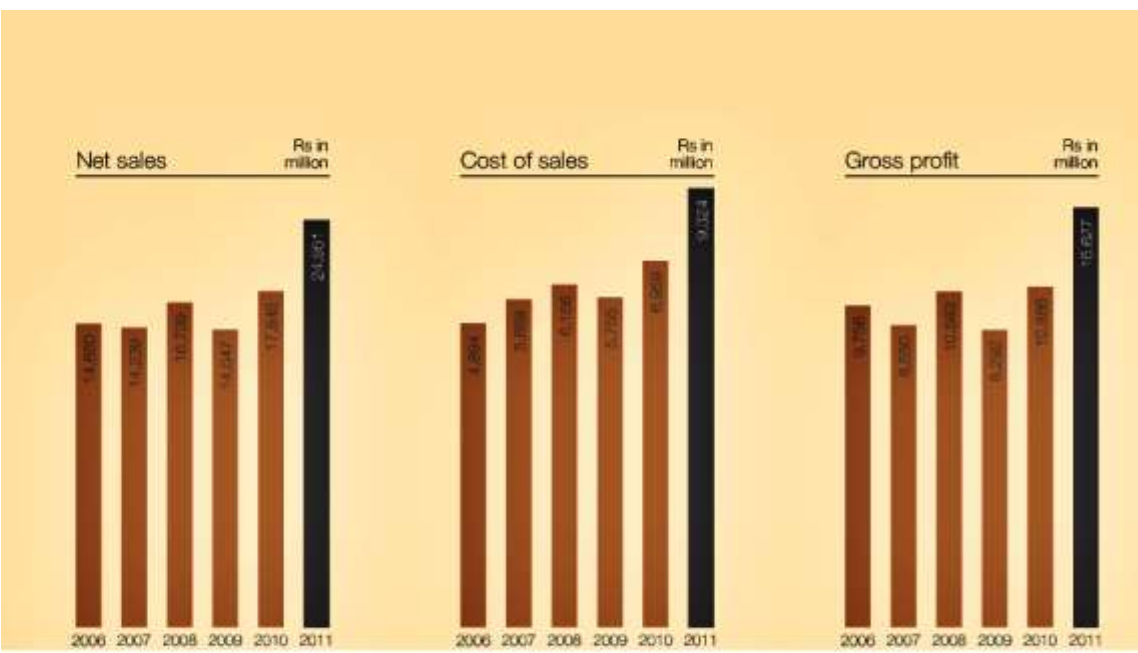
Government Shareholding and Market Shares of Public Sector Entities

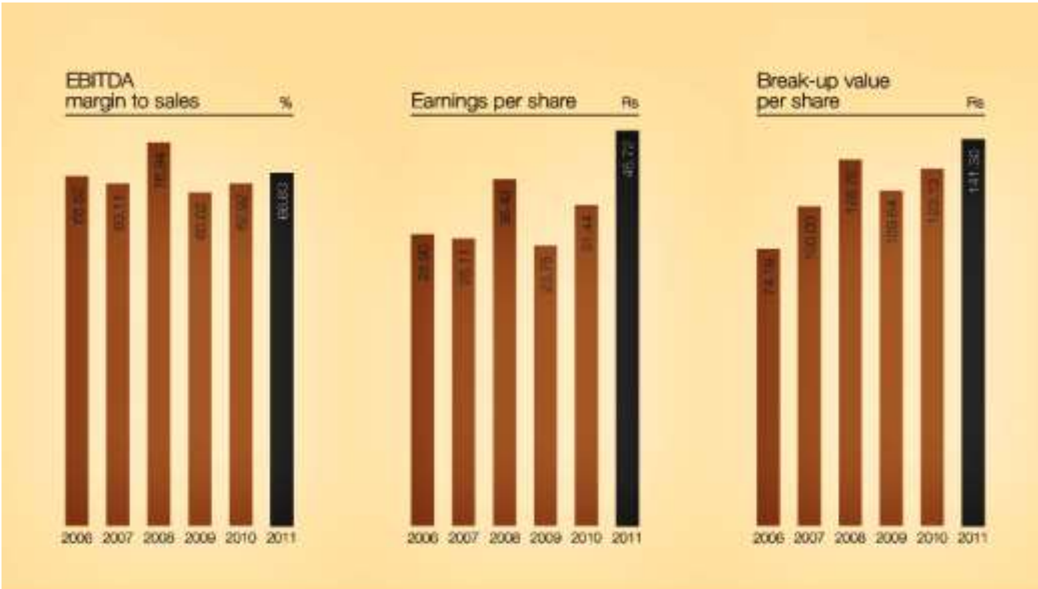
Name	Business	Direct Holding (%)	Indirect Holding[1] (%)	Total (%)	Market Share
Oil & Gas Development Co Ltd	Exploration & Production	100.0	0.00	100.0	70% of all production
Pakistan Petroleum Ltd.		93.40	0.00	93.40	
Mari Gas Co. Ltd.		20.00	20.00	40.00	
Pakistan Oilfields Ltd.		11.00	0.00	11.00	
National Refinery Ltd.	Oil Refining	16.26	38.74	55.00	75% of refinery production
Attock Refinery Ltd.		26.00	0.00	26.00	
Pak-Arab Refinery Co. Ltd.		60.00	0.00	60.00	
Pakistan State Oil Co. Ltd.	Oil Marketing and Distribution	25.51	29.71	55.22	70% of OMC
Sui Northern Gas Pipelines Ltd	Gas Transmission and Distribution	36.00	23.47	59.47	100% of T&D
Sui Southern Gas Co.		70.43	18.19	88.62	

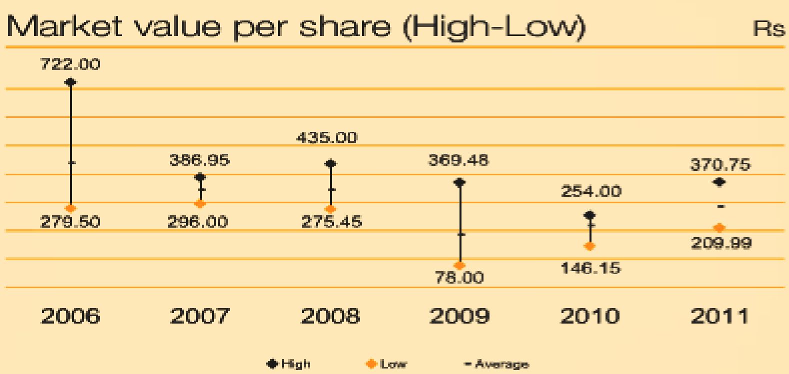
Annexure 2:



Annexure 3:




EBITDA
margin to sales
%
2006 2007 2008 2009 2010 2011
Earnings per share
Rs
2006 2007 2008 2009 2010 2011
Break-up value
per share
Rs
2006 2007 2008 2009 2010 2011


Market value per share (High-Low)
Rs
722.00
279.50
386.95
296.00
435.00
275.45
369.48
78.00
254.00
146.15
370.75
209.99
2006 2007 2008 2009 2010 2011
High
Low
Average


Return on capital employed
%
47.57
34.59
38.22
21.90
27.01
34.58
2006 2007 2008 2009 2010 2011