AUDITOR GENERAL'S DEPARTMENT

FINANCIAL STATEMENTS ASSESSMENT OF PUBLIC BODIES

PETROJAM LIMITED

The Auditor General is appointed by the Governor General and is required by the Constitution, Financial Administration and Audit Act, other sundry acts and letters of engagement, to conduct audits at least once per year of the accounts, financial transactions, operations and financial statements of central government ministries and departments, local government agencies, statutory bodies and government companies.

The Department is headed by the Auditor General, Pamela Monroe Ellis, who submits her reports to the Speaker of the House of Representatives in accordance with Section 122 of the Constitution of Jamaica and Section 29 of the Financial and Administration and Audit Act.

This report was prepared by the Auditor General's Department of Jamaica for presentation to the House of Representatives.

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The Board of a public body is required to submit the annual report including audited financial statements of the public body, to the responsible Minister as soon as possible after the end of each financial year, but not more than four months thereafter. The responsible Minister 'shall cause the report and statements to be laid on the Table of the House of Representatives and of the Senate'.

This report comprises the assessment of audited financial statements for Petrojam Limited under the Ministry of Science, Technology, Energy and Mining.

The review, which involves ratio analyses, was undertaken to inform Parliament, and guide the Public Accounts Committee (PAC) in their review of the financial performance of public bodies. In accordance with the Public Bodies Management and Accountability (PMBA) Act, public entities are required to demonstrate prudent financial management of public resources in the context of the Fiscal Responsibility Framework.

Pamela Monroe Ellis, FCCA, FCA, CISA
Auditor General

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MINISTRY OF SCIENCE, TECHNOLOGY, ENERGY AND MINING

PETROJAM LIMITED

Petrojam Limited

Disclaimer

The Financial Statements Assessment is solely, an analytical review of the audited financial statements of Petrojam as no audit of the operations of the entity was conducted. In this regard, the calculation of ratios was intended to enable trend analyses of key financial items in the balance sheets and income statements of the entity, along with notes provided. Further, owing to the unavailability of Petrojam's audited financial statement for FY2014/15, our review was restricted to FY2013/14 which does not imply the current financial performance.

Financial Assessment

1.1 This report was prepared using information from the Petrojam's audited annual financial statements for FY2009/10 to FY2013/14, annual reports and other supplementary information.

Profile of the Entity

1.2 Petrojam is a limited liability company; jointly owned by PDVCaribe (49 per cent) a subsidiary of Petróleos de Venezuela (PDVSA), and the Petroleum Corporation of Jamaica (PCJ) (51 per cent). The entity conducts its operations under the policy guidance of the Ministry of Science, Technology, Energy and Mining. Its main business is refining crude oil into finished products such as, heavy fuel oil (HFO) diesel, gasoline and kerosene among others.

Mission Statement

1.3 "To refine and supply petroleum products at internationally competitive prices and quality, acting in the best interest of Jamaica and all other stakeholders"

Vision

1.4 "To be the petroleum product supplier of choice in the region"

Funding classification

1.5 The company generates a significant portion of its revenue from the sale of refined petroleum products. Other income is earned from management fees and interest on investments.

Legal and regulatory framework

1.6 The company is governed by the following statutes and regulations:

i. Jamaica Companies Act
ii. Petroleum Act
iii. Petroleum Act (Prescribed Articles) Regulations
iv. Public Bodies Management and Accountability (PBMA) Act
v. Other statutes - GCT Act, Income Tax Act etc
vi. Various other policy papers and pronouncement which provide guidance

Industry and macro-economic environment

1.7 The company operates within the energy sector in Jamaica and internationally within the oil and gas industry. Given its high dependency on imported crude oil, Petrojam is exposed to volatility in oil price movements. The state of the global economy, particularly oil producing countries, also impacts world oil prices.

1.8 Petrojam trades heavily with foreign suppliers for the purchase of raw materials and refined petroleum products and in this regard, the financial position is impacted by fluctuations in the exchange rate.

Summary of Findings

1.9 Petrojam experienced a downturn in profitability between FY2009/10 and FY2013/14. For FY2013/14 the net profit margin was negative 0.002 relative to the ratio of 0.01 for FY2012/13, but declined more sharply relative to the ratio of 0.03 for FY2009/10. The reduction in profitability over the assessment period was attributable to the faster increase in cost of sales relative to growth in sales revenue over the period.

1.10 Petrojam's return on capital employed fell to negative 0.01 in FY2013/14 from 0.14 the previous year and 0.61 in FY2009/10, reflecting the effects of oil price movements over the period. Whereas the fall in the ratio for FY2013/14 was less sharp given a marginal decline in oil prices in that year, the general deterioration in the ratio was consistent with the upward trend in oil prices over the assessment period.

1.11 Petrojam's receivables turnover ratio fell to 9.36 for FY2013/14 from 10.46 the previous year and was well below the average of 10.35 for the five-year assessment period. The fall in the ratio occurred in a context where payments for goods sold (sales revenue) fell relative to the previous year despite an increase in sales (receivables). Debtor days, that is, the number of days customers take to pay their bills, averaged 39 days in FY2013/14 compared to 35 days in FY2012/13, exceeding the established standing of 7 to 30 days**.**

1.12 Petrojam's inventory turnover ratio reflected a steady increase in the sale or utilisation of stocks between FY2009/10 and FY2013/14. The ratio of 10.03 for FY2013/14 improved only marginally relative to the previous year, but compared more favourably to the 9.54 for FY2009/10 and the average of 9.68 for the five year assessment period. The inventory turnover ratio indicated that the stock was utilised and replenished an average of 10 times in FY2013/14.

1.13 Petrojam's fixed assets turnover ratio declined in FY2013/14 relative to the previous year but was marginally higher relative to FY2009/10. The decline in the fixed assets turnover ratio in FY2013/14 was attributable to a larger increase in fixed assets relative to a decline in sales. Notably, the ratio for FY2013/14 was significantly lower relative to previous years and in particular, FY2011/12. The reduction in the ratio relative to previous years was due to increased expenditure on projects in progress, related to the routine maintenance of equipment and other capital projects in the latter.

1.14 **Petrojam's current ratio increased to 1.04 at end FY2013/14 from 0.95 in FY2009/10 but fell relative to the 1.08 for the previous year**. The fall in FY2013/14 was in a context where current assets, in particular cash and cash equivalents fell more sharply relative to a decline in current liabilities, in particular 'due to related parties'. Petrojam's quick ratio fell to 0.64 in FY2013/14 from 0.71 the previous year but exceeded the ratio of 0.58 for FY2009/10. The quick ratio focuses on the impact that assets (excluding inventory) readily converted to cash (namely debtors and cash balances) will have on the business performance.

1.15 **Petrojam's debt to equity ratio of 3.42 at end FY2013/14 reflected an improvement over the five year assessment period**. The ratio at end FY2013/14 indicated that debt was more than three times equity. The relatively high debt to equity ratio was however not surprising as the company operates in a capital intensive industry which requires regular maintenance and upgrade of existing plant and machinery in order to keep up with the demand requirements of oil consumers.

FINANCIAL STATEMENTS ASSESSMENT

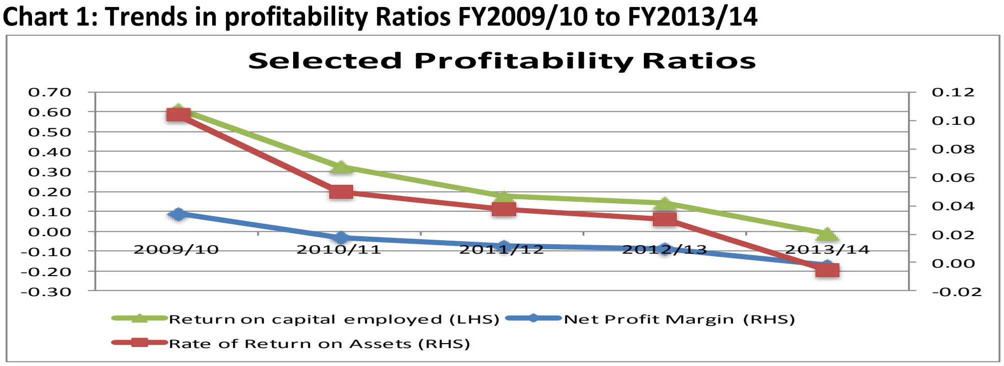
Net Profit Margin & Return on Assets

Table 1: Selected Profitability Ratios FY2009/10 to FY2013/14

Profitability Ratios	2013/14	2012/13	2011/12	2010/11	2009/10
Net Profit Margin	0.00	0.01	0.01	0.02	0.03
Rate of Return on Assets	-0.01	0.03	0.04	0.05	0.10
Rate of Return on Equity	-0.03	0.14	0.19	0.26	0.60
Return on capital employed	-0.01	0.14	0.18	0.33	0.61

1.16 **Petrojam experienced a downturn in profitability between FY2009/10 and FY2013/14**. For FY2013/14 the net profit margin was negative 0.002 relative to the ratio of 0.01 for FY2012/13 but declined relative to the ratio of 0.03 for FY2009/10 (**Table 1**). The reduction in profitability over the assessment period was attributable to a faster increase in cost of sales relative to growth in sales revenue.

Chart 1: Trends in profitability Ratios FY2009/10 to FY2013/14



Source: AuGD's computations

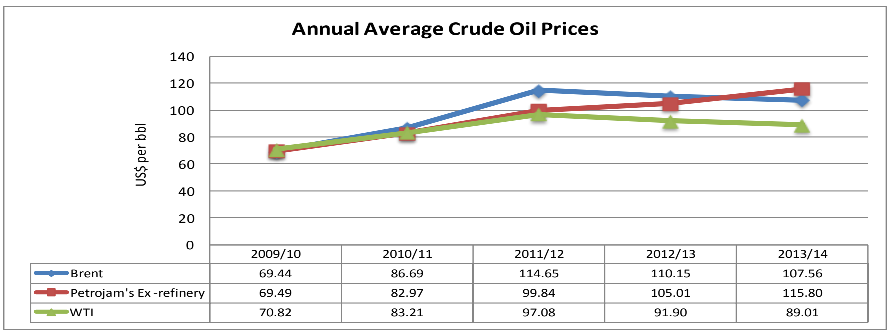
1.17 For FY2013/14, cost of sales was US$1.8 billion, reflecting a 3.3 per cent decline relative to the previous year (**Table 2**). However cost of sales grew by 49.2 per cent relative to FY2009/10 reflecting the impact of a rise in crude oil prices over the assessment period. Sales revenue for FY2013/14 fell by 3.6 per cent relative to FY2012/13 but increased by 44.1 per cent relative to FY2009/10, consistent with increases in the price for oil (**Chart 2**).

Table 2: Operating results (US$ millions) FY2009/10 to FY2013/14

	2013/14	2012/13*	2011/12	2010/11	2009/10*
Sales Revenue	**1,805.4**	**1,872.7**	**1,952.9**	**1,462.0**	**1,252.9**
Cost of sales	**1,770.8**	**1,831.4**	**1,908.5**	**1,413.7**	**1,186.6**
Gross Margin	*34.6*	*41.4*	*44.4*	*48.3*	*66.3*
Operational expenses (net)	**39.1**	**14.3**	**13.2**	**12.2**	**3.0**
Operating (loss)/profit	**(4.5)**	**27.1**	**31.2**	**36.1**	**63.3**

Source: Petrojam's audited and unaudited financial statements *Balances restated

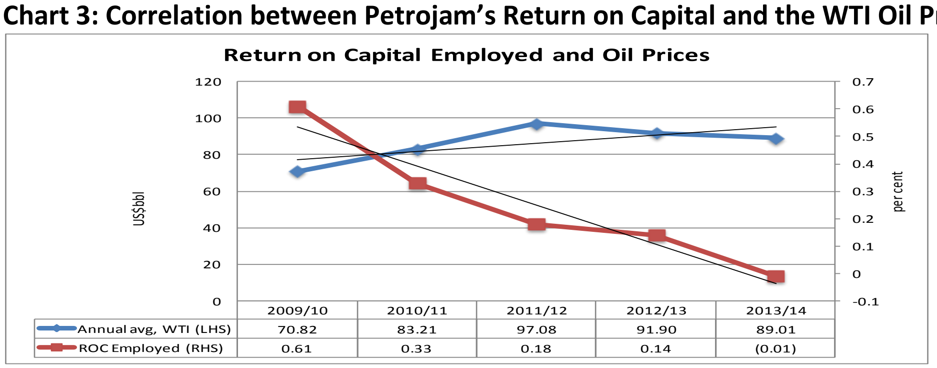
Chart 2: Trends in Annual Average Crude Oil Prices FY2009/10 to FY2013/14



Source: Petrojam's website (www.petrojam.com) U.S. Energy Information Administration (www.eia.gov) *Brent is considered to be the leading global price benchmark for crude oil prices.*

1.18 **Petrojam's return on capital employed was negative 0.01 in FY2013/14 compared to 0.14 for FY2012/13 and 0.61 for FY2009/10.** Whereas the fall in the ratio for FY2013/14 was less sharp given a marginal decline in oil prices in that year, the general deterioration in the ratio was consistent with the upward trend in oil prices over the assessment period. Average oil prices as indicated by WTI rose to US$97.08 per barrel in FY2011/12 from US$70.8 per barrel in FY2009/10, before falling to an average US$89.0 per barrel in FY2013/14 (**Chart 3**).

Chart 3: Correlation between Petrojam's Return on Capital and the WTI Oil Price

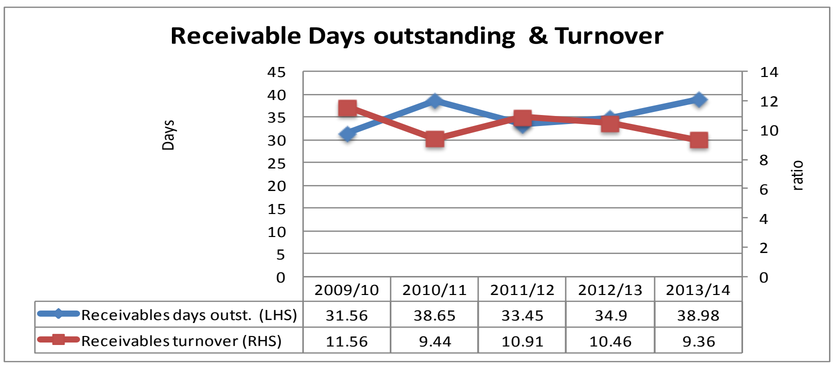


Source: AuGD's computations

Receivables

1.19 **Petrojam's receivables turnover ratio fell to 9.36 for FY2013/14 from 10.46 the previous year and was well below the average of 10.35 for the five-year assessment period (Chart 4).** The fall in the ratio in FY2013/14 relative to FY2012/13 occurred in a context where payments for goods sold (sales revenue) fell despite an increase in sales (receivables). This was in contrast to FY2011/12 when sales revenue rose more sharply than sales. Receivables turnover, that is, the number of days customers take to pay their bills, averaged 39 days in FY2013/14 compared to 35 days in FY2012/13. The sharpest rise in the average number of debtor days was observed in FY2010/11 when receivables were outstanding for an average 39 days, up from 32 days in FY2009/10. This was in a context where many entities including independent power providers and bauxite companies (the company's largest customer segment) had reduced or shortened credit lines consequent on the global financial crisis.

Chart 4: Receivables Performance FY2009/10 to FY2013/14



Source: AuGD's computations

Inventory Turnover

1.20 **Petrojam's inventory turnover ratio reflected a steady increase in the sale or utilisation of stocks between FY2009/10 and FY2013/14.** The ratio of 10.03 for FY2013/14 improved marginally relative to the previous year but compared favourably to the 9.54 for FY2009/10 and the average of 9.68 for the five-year assessment period. The inventory turnover ratio indicated that the stock was utilised and replenished an average of 10 times in FY2013/14. Of note, the sharp decline in turnover to 8.98 in FY2010/11 from 9.54 the previous year reflected a higher level of stock at year end due to goods in transit. Further, as companies responded to the lingering effects of the recession, oil volumes fell below FY2008/09 volumes (**Table 3**).

Table 3: Oil volumes ('000) FY2008/09 to FY2013/14

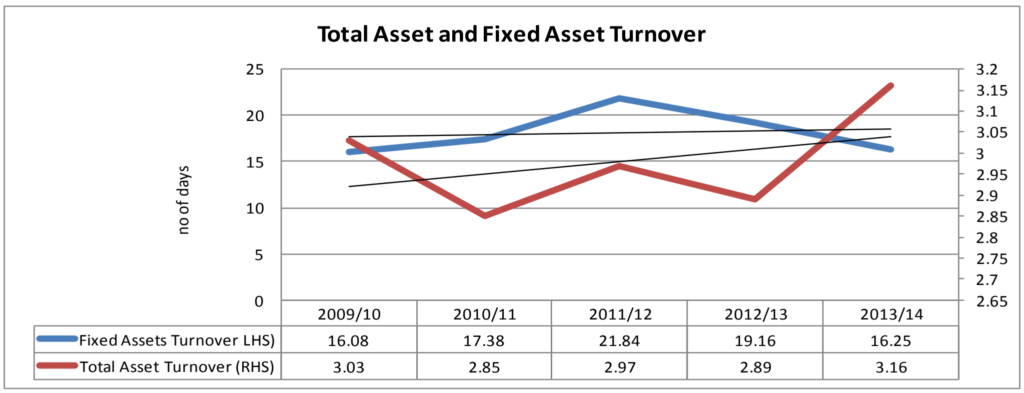
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Volume sold at year end (barrels)	17,368	15,988	15,712	15,919	15,523	15,389

Source: Petrojam supplementary

Asset Turnover

1.21 Petrojam's fixed assets turnover ratio was 16.25 in FY2013/14 reflecting a decline relative to the previous year but a marginal increase relative to FY2009/10. The decline in the fixed assets turnover ratio for FY2013/14 relative to the previous year was attributable to 13.7 per cent increase in fixed assets compared to a 3.6 per cent decline in sales. Notably the ratio for FY2013/14 was significantly lower relative to earlier periods, particularly for FY2011/12 when the ratio peaked at 21.84. The reduction in the ratio relative to the previous periods was due to increased expenditure on projects in progress, related to the routine maintenance of equipment and other capital projects in the latter period **(Chart 3)**.

Chart 5: Petrojam's Fixed and Total Asset Turnover FY2009/10 to FY2013/14



Source: AuGD's computations

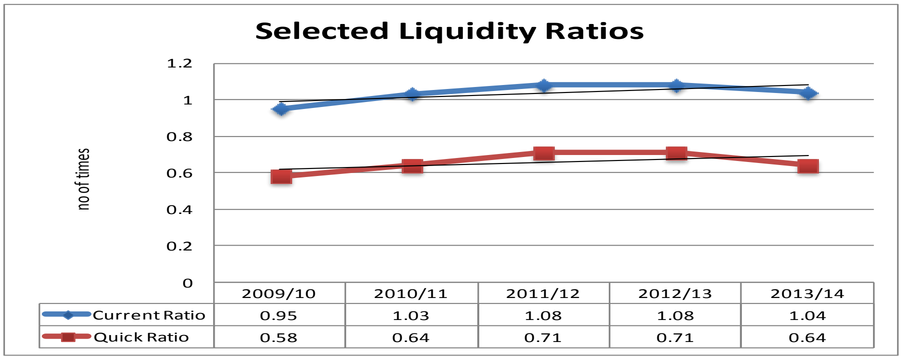
1.22 Petrojam's total asset turnover ratio rose to 3.16 in FY2013/14 from 2.89 the previous year and averaged 2.98 for the five-year assessment period[1]. The increase in the total assets turnover ratio for FY2013/14 relative to FY2012/13 was attributable to a significant decline in assets caused by a reduction in cash balances (62.4 per cent) relative to the 3.6 per cent decline in sales. Of note, the fall in the total assets turnover ratio to 2.85 in FY2010/11 from 3.03 in FY2009/10 reflected the adverse effects of the global economic downturn which also impacted Petrojam's sales (**Chart 5).**

Liquidity

1.23 Petrojam working capital ratios increased significantly as the current ratio rose to 1.04 at FY2013/14 from 0.95 in FY2009/10 (Chart 6). The current ratio however fell in FY2013/14 relative to the previous year as current assets, in particular cash and cash equivalents, fell more sharply (62.4 per cent) relative to a decline in current liabilities, in particular 'due to related parties' (16.0 per cent). Petrojam's cash balances fell to its lowest level of US$57.5 million at end FY2014/15 from US$63.0 million in FY2009/10 after peaking at US$158.6 million in FY2011/12.

[1] The asset turnover ratio reflects a general utilisation of all assets; hence a lower ratio value was derived when compared with the ratio on fixed asset.

Chart 6: Liquidity ratios FY2009/10 to FY2013/14



Source: AuGD's computations

1.24 **Petrojam's quick ratio fell to 0.64 in FY2013/14 from 0.71 the previous year but exceeded the ratio of 0.58 for FY2009/10.** The quick ratio focuses on the impact that assets readily converted to cash (namely debtors and cash balances) will have on the business performance. This excludes inventory as it is harder to liquidate and does not show a clear picture of whether the company can meet short-term debt. For FY2013/14, the ratio of 0.64 indicated that Petrojam could clear 64 per cent of its current liabilities using short-term assets relative to 71 per cent in FY2012/13 and 58 per cent in FY2009/10.

Debt to Equity

Table 4: Capital Structure (US$ millions) FY2009/10 to FY2013/14

	2013/14*	2012/13*	2011/12	2010/11	2009/10
Total Assets	**572.0**	**647.3**	**658.4**	**513.0**	**412.9**
Total Liabilities	**442.5**	**513.6**	**538.4**	**416.0**	**341.6**
Interest bearing liabilities	*23.3*	*56.0*	*68.9*	*32.4*	*33.3*
Total Equity	**129.5**	**133.7**	**120.0**	**96.9**	**71.3**
Debt to equity	**3.42**	**3.84**	**4.49**	**4.29**	**4.79**

Source: Petrojam's audited and *unaudited financial statements

1.25 **The debt to equity ratio of 3.42 at end FY2013/14 reflected an improvement over the five-year assessment period.** Petrojam's debt to equity ratio at end FY2013/14 indicated that debt was more than three times equity but when compared to the previous four years, was significantly improved (**Table 4**). The relatively high debt to equity ratio was however not surprising as the company operates in a capital intensive industry which requires the regular maintenance and upgrade of existing plant and machinery in order to keep up with the demand requirements of oil consumers[2].

[2] To meet increasing demand for oil, Petrojam, through the PetroCaribe Energy Cooperation Agreement, purchases refined crude oil from Venezuela under the agreement as well as from other suppliers. In order to facilitate the expansion of their refinery, the company entered into an interest free loan agreement for US$32 million from the PetroCaribe Development Fund. This loan remained interest free until FY2011/12 when, due to the project being put on hold, it was converted to an interest bearing loan at 5

Appendices

Appendix 1: Definition of Ratios

Activity Ratios

Accounts Receivable Turnover – refers to the ratio of net credit sales to accounts receivable. This indicates the number of times during the period that credit sales have been made and collected on.

$$Formula = \frac{Credit\ Sales}{Accounts\ Receivable}$$

Accounts Receivable Days – refers to the number of days it takes, on average, for an entity to collect its accounts receivables.

$$Formula = \frac{Accounts\ Receivable}{Credit\ Sales/365}$$

Fixed Asset Turnover – refers to the ratio of sales to fixed assets and indicates the ability of the entity to use fixed assets to generate sales.

$$Formula = \frac{Sales}{Fixed\ Assets}$$

Inventory Turnover – refers to the ratio of cost of goods sold to inventories. The ratio indicates how many times inventory is created and sold during the period.

$$Formula = \frac{Cost\ of\ goods\ sold}{Inventory}$$

Total Asset Turnover – refers to the ratio of sales to assets and indicates the extent to which an entity's investment in total assets results in sales.

$$Formula = \frac{Sales}{Total\ Assets}$$

Liquidity Ratios

Cash Ratio – refers to the ratio of cash and cash equivalents to current liabilities and measures an entity's ability to pay off its current liabilities with only cash and cash equivalents.

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per cent. Of note, in FY2015/16, the Government purchased from Venezuela, at a 50 per cent discount, PetroCaribe debt outstanding at December 31, 2014.

$$Formula = \frac{Cash + Cash\ equivalents}{Current\ Liabilities}$$

Current Ratio - refers to the ratio of current assets to current liabilities and indicates an entity's ability to meet current liabilities with its current assets.

$$Formula = \frac{Current\ Assets}{Current\ Liabilities}$$

Quick Ratio – refers to the ratio of quick assets (current assets *less* inventory) to current liabilities. This ratio indicates the ability of an entity to pay its current liabilities when they become due with only quick assets.

$$Formula = \frac{Current\ Assets - Inventory}{Current\ Liabilities}$$

<u>Debt and Solvency Ratios</u>

Debt-to-Assets – refers to the ratio of an entity's debt to total assets and measures the proportion of assets that are financed with debt.

$$Formula = \frac{Debt}{Total\ Assets}$$

Debt-to-Capital – refers to the ratio of an entity's debt to the total capital employed. It measures the proportion of the capital employed that is debt.

$$Formula = \frac{Debt}{Total\ Capital} = \frac{Debt}{Total\ Equity + Debt}$$

Debt-to-Equity – refers to the ratio of an entity's debt to total equity and indicates the relative use of debt and equity as sources of capital to finance the entity's assets.

$$Formula = \frac{Debt}{Total\ Equity}$$

Times Interest Earned/Interest Cover – this ratio compares the earnings available to meet interest obligations with the interest obligation.

$$Formula = \frac{Earnings\ before\ Interest\ \&\ Taxes\ (EBIT)}{Interest\ Expense}$$
$$= \frac{Net\ Income + Interest\ Expense + Taxes}{Interest\ Expense}$$

Profitability Ratios

Net Profit Margin – refers to the ratio of an entity's net income to sales and measures how much of each dollar of sales is left over after all expenses.

$$Formula\ = \frac{Net\ Income}{Sales}$$

Operating Profit Margin – refers to the ratio of an entity's operating income to sales and indicates how much of each dollar of sales is left over after operating expenses.

$$Formula\ = \frac{Operating\ Income}{Sales}$$

Rate of Return on Assets – refers to the ratio of net income to total assets. This indicates the amount earned on each dollar of assets.

$$Formula\ = \frac{Net\ Income}{Total\ Assets}$$

Rate of Return on Equity – refers to the ratio of net income to total equity and measures the ability of an entity to generate profits from owners' investments.

$$Formula\ = \frac{Net\ Income}{Total\ Equity}$$