



Verité Research is an independent think-tank based in Colombo that provides strategic analysis to high level decision-makers in economics, law, politics and media.

Anushan Kapilan
Deshal de Mel

Researcher

Nishan de Mel

Series Editor



Image courtesy of Wikimedia Commons

Ceylon Petroleum Corporation: What drives the losses?

Ceylon Petroleum Corporation (CPC) is the state-owned enterprise in Sri Lanka with the largest accumulated losses – estimated at LKR 335 billion as of 2020. The analysis finds that the CPC sells fuel at prices higher than the cost of purchasing, processing and taxes; and that the accumulated losses can be entirely attributed to poor treasury management (interest costs and exchange rate losses).

The Ceylon Petroleum Corporation (CPC) is a fully state-owned enterprise (SOE) that engages in the selling and distribution of fuel in Sri Lanka. The CPC controls 86% of market shares in the retail petroleum sector. At the end of 2020, the CPC's debts amounted to LKR 529 billion – among the highest levels of debt for an SOE in Sri Lanka. Meanwhile, the cumulative net loss of the corporation is estimated to be LKR 335 billion by 2020 (the latest audited figure is LKR 326 billion in 2018, and a further loss of LKR 9 billion has been reported since).

By contrast, Lanka IOC – which also sells and distributes fuel to the retail market in Sri Lanka – made profits every year in the last 10 years, except for 2018. Lanka IOC also had positive retained earnings of LKR 11.8 billion as at the end of March 2020. This gives rise to a puzzle: the CPC has large accumulated losses, but its competitor that charges similar fuel prices has accumulated profits.

This *Insight* shows that the CPC has been operationally profitable in the past. However, the recorded accumulated losses can be entirely attributed to poor

<p>29 LKR Billion</p> <p>Cumulative operational profit of CPC (2010 to 2020)</p>
<p>335 LKR Billion</p> <p>Cost of finance and exchange rate loss (2010 to 2020)</p>
<p>335 LKR Billion</p> <p>Total accumulated losses estimated (December 2020)</p>

Over the last 10 years, the CPC recorded a gross profit of LKR 281 billion. Therefore, the CPC losses cannot be attributed to a fuel subsidy

treasury and financial management, which is reflected in the interest costs, and exchange rate related losses

through carrying large local currency liabilities and financing them through foreign currency debt.

CPC is operationally profitable

Data from the Ministry of Finance show that the CPC made gross profits every year since 2013. That is, the revenue exceeded the cost of sales, including sales related taxes paid to

the government (see Exhibit 1). Over the last 10 years, the CPC recorded a gross profit of LKR 281 billion. Therefore, the CPC losses cannot be attributed to the company's cost of sales exceeding revenue.

When all the other operational costs relating to sales and distribution, administration, and depreciation are added, the CPC still made positive profits in most years, and generated

Exhibit 1: Ceylon Petroleum Corporation financials

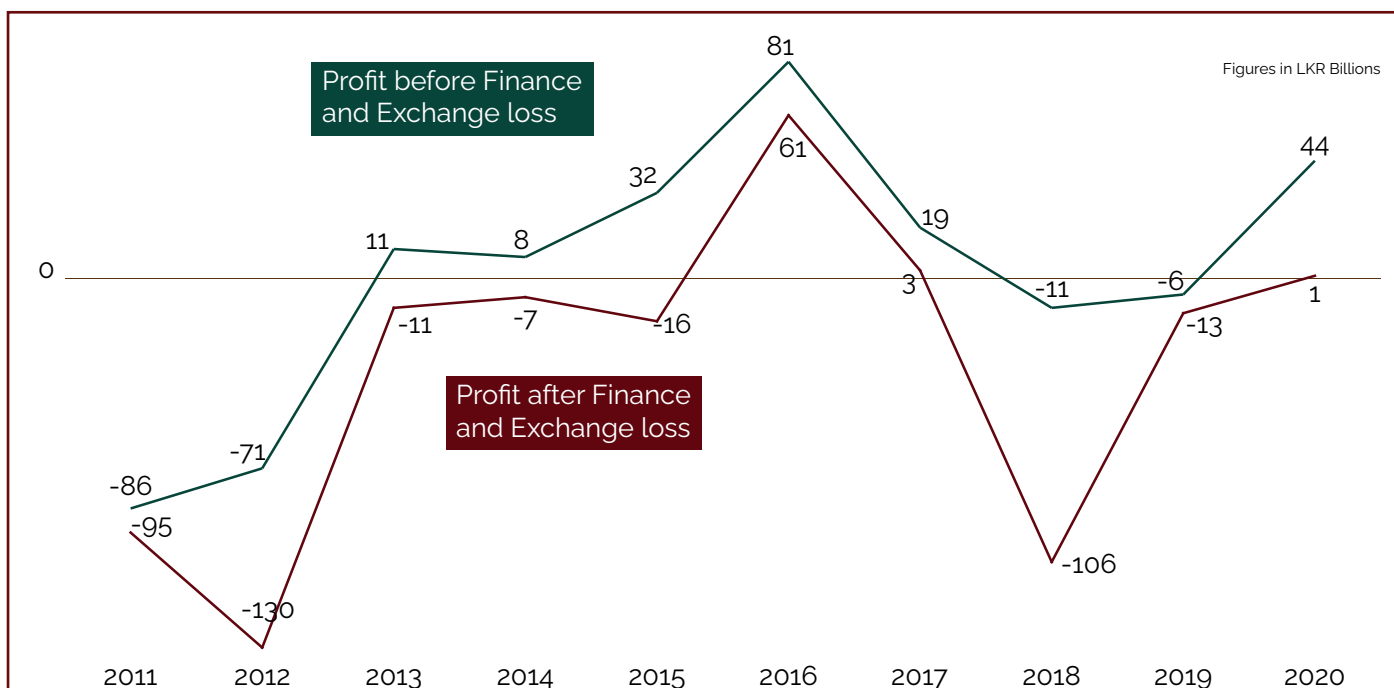
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total
(a) Revenue	357	521	494	533	386	435	458	606	661	531	4,982
(b) Cost of Sales (inclusive of taxes)	427	574	468	501	337	335	419	596	643	464	4,764
(c) Gross Profit (a-b)	-70	-53	26	32	49	100	39	10	18	67	218
(d) Sales and distribution, Administration and Depreciation cost	16	18	15	16	17	19	20	21	24	23	189
(e) Operational Profit (before finance/exchange cost) (c-d)	-86	-71	11	16	32	81	19	-11	-6	44	29
(f) Finance Cost	9	26	19	14	15	11	11	12	15	21	153
(g) Exchange Rate loss	1	33	3	1	33	9	5	83	-8	22	182
(h) Net profit/Loss (after finance/exchange cost) (e-f-g)	-95	-130	-11	1	-16	61	3	-106	-13	1	-305

Source: Ministry of Finance Annual Reports (2011-2020), Ceylon Petroleum Corporation Annual Reports (2011-2014) – for exchange rate loss

Note 1: Cost of sales calculations include the sales taxes paid to government by way of excise duty and NBT.

Note 2: Profit/loss was calculated after deducting from revenue the expenses including taxes provided in the MoF Annual Report. There were several small discrepancies in reported numbers that could not be reconciled. For some years, the direct Profit/loss published in the MoF Annual Report differs from the above calculation, and both of these also differ from the figures in the CPC Annual report.

Exhibit 2: CPC's main losses driven by exchange loss and finance cost



Source: Ministry of Finance Annual Reports (2010 - 2020), Exchange variation data prior to 2017 from CPC annual reports (2010 - 2017)

Exhibit 3: Exchange rate impact on CPC's profit/loss

	Value as at December 2018 (USD Million)	Negative Impact on CPC profit of 1% LKR depreciation (LKR Million)
Loans and Borrowings (USD)	USD 1,597 million	LKR 2,947 million
Trade and other payables (USD)	USD 1,527 million	LKR 2,818 million
Total	USD 3,124 million	LKR 5,765 million

Source: CPC Annual Report 2018, p. 145.

an accumulated operational profit of LKR 29 billion over the last 10 years (2011–2020). Therefore, operationally (including all direct purchasing costs, overheads, operational costs, taxes and asset depreciation), the CPC still made a positive profit over the last 10 years.

CPC's net profit mainly hindered by exchange rate loss and interest cost.

The CPC registers net losses mainly when finance costs and exchange rate losses are included in the profit calculation (Exhibit 2). Costs arising from finance charges and exchange rate losses add up to LKR 335 billion over the last 10 years. The estimated accumulated loss up to December 2020 is, coincidentally, the same amount.

Details on exchange rate loss

The CPC's exchange rate losses arise out of a currency mismatch in its balance sheet. The corporation has trade receivables predominantly denominated in Sri Lankan rupees, while the CPC's current liabilities are mainly denominated in foreign currency.

As at 2018, 70% of the LKR 86 billion in trade receivables were denominated in Sri Lankan rupees, and 30% were in foreign currency. Trade receivables as at December 2018 primarily arise from (i) Sri Lankan Airlines—LKR 25.6 billion, (ii) Ceylon Electricity Board—LKR 47.6 billion, (iii) Independent Power Producers (IPPs)—LKR 6.7 billion, and (iv) the armed forces—LKR 0.82 billion.

At the same time, the CPC has foreign bills payable to the value of LKR 245 billion. It also has US dollar-denominated short term bank loans from the People's Bank and the Bank of Ceylon amounting to LKR 295 billion (backed by a treasury guarantee of USD 1,800 million). These foreign currency loans have been used to finance import bills payable to suppliers.

Given the currency mismatch between current assets and current liabilities, every time the Sri Lankan rupee depreciates against the US dollar, there is a significant adverse impact on CPC's financials, which are reflected in the income statement as a loss to the corporation. For example, when the rupee depreciates by 1% in a year,

The Ministry of Finance figures show that the CPC made gross profits every year since 2013—that is, the revenue exceeded the cost of sales, including sales related taxes

the profit to CPC reduces by LKR 5,765 million (calculated on the value of foreign liabilities at the end of 2018). This currency mismatch would make financial sense for CPC only if the rate of depreciation, plus the rate of interest of the foreign currency debt/liabilities that it holds was less than the interest rate on rupee debt.

Conclusion

Reducing financial losses of SOE's are key to improving the overall fiscal position of the country. In some instances, SOE losses have been justified as necessary for providing goods and services at concessionary prices to the public. In the case of the CPC, it is evident that financial losses do not arise from concessionary pricing to consumers. This Insight shows that despite not providing any overall subsidy to the public, the CPC's weak treasury and financial management has resulted in it having one of the largest accumulated losses among Sri Lankan SOE's. ♦