

Risk Factors



Implementing its continued risk management efforts, PTT managed its risk factors reasonably well in the past year. New risk factors have been identified and managed under the current year's risk management plan. Therefore, PTT continues to improve this Risk Factors section to better reflect risks apparent to investors. The main risk factors are described below.

1. Strategic Risks

1.1. Business strategy implementation

To preserve continuous business growth while fostering energy security, PTT has set a goal of becoming a leading energy company among the top 100 companies in sales worldwide by the year 2012 as ranked by Fortune Magazine, as well as its international-business goals. Therefore, strategic plans have been defined by each business unit with a focus on preserving its competitiveness, investment expansion to supplement business value, internationalization of business through investment in properties, mergers and acquisitions of entities that are capable to competing but are faced with problems during the ongoing crisis, and investment in new, related businesses.

The fierce competition and repercussions of the global economic slowdown could produce the risk that PTT would be unable to attain these goals and business strategies resulting from the likes of energy demand uncertainty, product price fluctuation, investment risks resulting from overseas investment and in new businesses. These could impact PTT's overall performance and return on investment alike.

To cope with this, the Company has initiated a so-called Strategic Thinking Session among Senior Executives of PTT Group to define and review the vision, direction, and business strategies in line with economic and energy circumstances, and a business plan in the form of scenario planning, in which assumptions were made for different economic growth figures and oil prices and for PTT to have plans for future changes and uncertainty. In addition, at least every quarter, Senior Executives of the Group meet to monitor Group performance and exchange views on adjusting business plans and short-term strategies to ensure confidence in reaching such goals.

1.2. Management of PTT Group

To date, PTT has undertaken business group management restructuring, mergers and acquisitions, joint venturing in companies, domestic and international business expansion, and foster competitive advantages and the synergy of PTT Group. As a result, the management of PTT affiliates has become so complicated that, without effective and efficient management, the Company and its affiliates might apply inconsistent strategies and end up competing among themselves because of conflicts of interest, thus compromising its own overall business performance.

The Company has therefore focused on the management of PTT Group while being committed to good corporate governance; PTT executives have been appointed Presidents or Senior Executives of affiliates for consistency in policies, business directions, and strategies, and closer supervision of business expansion. Further, executives of PTT Group have jointly taken part in drafting a master strategic plan as a framework for developing individual business plans. And to this end, CEO meetings have been regularly held for Senior Executives of PTT Group to supervise overall management and monitor overall results to ensure compliance with the policy of PTT Group.

1.3. Personnel management system in support of business operation under economic uncertainty and business growth opportunities

Likened to a chain, PTT's business diversity and international investment expansion produce considerable complexity for the management of the Group. Compounded by the downturn in the global economy, which has an effect to market demand and related products' prices. This could disrupt its business unless its personnel are adequately prepared to cope with the economic crisis and business base expansion.

To mitigate such personnel risks, PTT has relied on two career management mechanisms. First, for the management group, the PTT Group format is applied under the care of an executive and management development committee; this committee supports the needs of senior executives in both quantity and quality. Second, for other employees, it takes the form of line management with a similar approach as the first, which is supervised by a career advisory panel; here, a career management consultation committee ensures that, for each career path, a manpower requirement plan is prepared, in which key positions are stated, and individual development plans are both prepared and implemented. Both of these ensure that PTT will consistently command an adequate supply of quality executives and employees.

2. Business Risks

2.1. Risks associated with sourcing of natural gas

During the past year, PTT kept up its sourcing negotiation efforts for additional gas supplies from domestic sources and Myanmar, as well as negotiations for supply of LNG (liquefied natural gas) from sellers in assorted regions to meet the projected gas demand. These contracts are made in advance. This included the demand to sustain the expansion of its petrochemical plants, which rely on feedstock from gas separation plants.

Each gas sales agreement (GSA) specifies a minimum annual contractual quantity to be taken by PTT as the buyer; otherwise, PTT is required to pay in advance for the volume not taken during that contract year under the so-called 'take or pay' condition. The Company may take this pre-paid gas in later years as 'make up' gas if it has already paid the minimum contracted amount for the year in question. As of year-end 2008, such take-or-pay sums were paid out by PTT under the terms of the Yadana and Yetagun GSAs of Myanmar and Block A18 GSA of the Malaysia-Thailand Joint Development Area (JDA).

As a result of the current global economic downturn, the demand for natural gas has fallen across the board, oil prices have plummeted, with considerable volatility in future. Risks therefore arise from such factors as the current and future demand for natural gas, the completion dates of transmission pipelines or new gas-fired power plants, the inability to receive the gas for which pre-payment has been made, and the fluctuation in oil price that could affect the price of natural gas. These could put the competitiveness of natural gas against competing fuels into jeopardy. These risks could affect PTT's financial bottom line and performance.

To address these risks, PTT monitors movement concerning the supply and demand for natural gas while closely coordinating with the sellers and buyers on preparing efficient gas supply plans for the long term, and regularly reviews them to identify solutions to possible crises. To date, gas demand has exceeded

minimum contract quantities, thus enabling PTT to accumulate volumes for instant use if it cannot take delivery of the so-called ‘carry forward’ gas, specified in certain GSAs. As for the ‘make up’ gas volume from Yadana and Yetagun, for which PTT has paid, this portion of gas cost less than the current prices; such price margin has alleviated the interest burden that has arisen.

2.2. Fee changes for gas supply procurement, distribution, and throughput tariffs

The prices of gas sold to power generators, which represent major customers, are supervised by the Energy Business Regulators, by virtue of the Energy Business Act. Each price consists of the price of physical gas and the throughput tariff. The former is a sum of the average price paid by PTT to the sellers and a business return for supply and distribution. The latter consists of a fixed-cost demand charge, which comes from the capital investment in the gas transmission system, fixed operating costs, and gas demand throughout a given project. Returns on investment are decided, as is a commodity charge, which is based on the variable costs of transmission. Today, such tariffs and returns follow the guidelines set by the National Energy Policy Office.

With the completion of the Third Gas Pipeline, PTT sent letters to the Energy Business Regulators to seek approval for gas throughput tariffs under fixed costs for the offshore transmission pipeline at Rayong (Area 1), the onshore transmission pipeline (Area 3), the onshore transmission pipeline at Chana (Area 4), and the onshore transmission pipeline at Nam Phong (Area 5), along with the tariffs under variable costs for Fiscal Year 2008. Yet, PTT cannot guarantee when the switch in the tariffs will take place; if it cannot levy these new tariffs, its financial and operating performance may suffer.

2.3. Feedstock and product price fluctuation

Reflecting world market prices, the prices of feedstock and products of PTT and its affiliates in domestic and foreign markets - namely natural gas, condensate, crude oil, refined petroleum products, and petrochemicals - have recently proved highly volatile because of diverse factors beyond the Company’s control, including gross refining margins (GRMs) and petrochemical prices entering down-cycles, thus inevitably affecting PTT’s business, financial standing, planning, investment, and operating performance.

To alleviate such risks and bring about maximum benefit, PTT has focused on optimizing risk management for PTT Group as a whole by appointing a Price Risk Management team within the group. Today, to manage price risks, the group is engaged in hedging, including both short-term and long-term derivative contracts with its business partners, with target for suitable risk management in line with PTT Group business plans. To minimize risks from price fluctuation on PTT Group’s performance, each instance of such engagement is supported by the physical volume of PTT Group’s raw materials and products to management the costs of buying and selling.

2.4. Government action creating potential conflicts of interest with shareholders

In line with the Cabinet resolution on September 25, 2001 that decided the Ministry of Finance should retain its shareholding in PTT at no less than 51% of all voting shares after the sale of recapitalization shares, the Company retained its state enterprise status, with the Ministry of Finance serving as its major shareholder. As long as the public sector still holds its majority shares, it will not only designate the majority of Directors and senior management that are accountable for PTT’s day-to-day business, but will also ensure that the Company takes actions in line with the country’s economic and social policies. This could not only cause conflicts of interest with other shareholders, but affect PTT’s management for maximum profitability as well, particularly the price caps on LPG and NGV.

2.5 The abolishment and limitation of the State Enterprise Corporatization Act of former authority, privileges, and benefits of PTT Plc, provided under the law on the Petroleum Authority of Thailand, in favor of the PTT Plc Authority Regulation Board

With the publication of a decree on the authority, privileges, and benefits of PTT Plc (No. 2) B.E. 2550 (2007) in the Royal Gazette on February 16, 2007 with effect from March 18, 2007, below were the essences of this decree:

1. Revoke the authority, privileges, and benefits formerly provided to PTT Plc, namely the privileges and benefits as a virtual concessionaire under the Petroleum Authority of Thailand Act B.E. 2521 (1978) (Section 8); the privileges of PTT Plc properties not subject to liability under execution (Section 5, Royal Decree on the Authority, Privileges, and Benefits B.E. 2544 (2001)); and the authority to expropriate properties under the law on real-estate expropriation (Section 38, Petroleum Authority of Thailand Act B.E. 2521 (1978)).

2. Transfer the authority, privileges, and benefits of PTT Plc under the Petroleum Authority of Thailand Act, including the survey and designation of petroleum transmission pipeline rights of way, and pipeline laying under, over, or through individuals' properties, to the PTT Plc Authority Regulation Board, who will define the criteria and terms and conditions for implementation in the Royal Gazette.

3. The PTT Plc Authority Regulation Board is chaired by the Permanent Secretary of Energy along with a representative of the Ministry of Interior, a representative of the Council of State, up to three experts appointed by the Minister of Energy, and the Director-General of the Energy Policy and Planning Office serving as Secretary to the Board.

The Regulators has posted four announcements regarding the authority of PTT Plc in the Royal Gazette, namely:

- Criteria and conditions for the construction and maintenance of petroleum transmission pipeline systems
- Their own identification cards and Board-appointed subcommittee members' identification cards
- Deliberation of the compensation for operating in the petroleum transmission pipeline rights of way
- Other conditions for survey leading to the construction of petroleum transmission pipeline systems.

On December 11, 2007, the Energy Business Act B.E. 2550 (2007) was promulgated, under which the nation's natural gas business included PTT's former gas transmission pipeline network. Once this law came into effect, an Energy Business Regulatory Board was appointed by His Majesty the King to provide oversight of the energy business, mainly electricity and natural gas, and ensure that they comply with the spirit of the law, which included the authority to define the criteria for service fees by authorized parties and their application of land and other real estates. The interim clause also said that to allow PTT's energy business to proceed, the royal decree defining the authority, privileges, and benefits of PTT Plc of 2007, amended by another royal decree (No. 2), would be enforceable until PTT acquired a license under the Energy Business Act. On February 19, 2009, PTT already acquires a Natural Gas Business Operating License under the Energy Business Act., and currently is acquiring for a Power Business Operating License.

3. Project Execution Risks

3.1. Development of gas transmission system, gas separation plants, and petrochemical plants

The key factors for PTT's successful business expansion include a continuous rise in natural gas consumption, the ability to expand its gas transmission system and to cover all consumption areas, the ability to expand its gas separation capacity, and the success in building PTT Group's petrochemical plants, which rely on natural gas for their processes. Projects may experience delays for various reasons, including delays in naming construction contractors, procurement of long-lead equipment items, getting construction approvals from government agencies, and getting approvals for environmental impact assessment (EIA) reports. Delays in project completion could compromise PTT's financial and operating performance.

The Company pays close attention to critical path management, thus, accelerated hiring of construction contractors; close monitoring of the procurement of construction materials; development of measures to alleviate environmental impacts; monitoring and analysis of impacts on project management; appointment of a community relations task group to develop plans for public participation; and preparation of plans and measures to minimize the potential impacts of project delays, to minimize the possible effect of project's delay.



Activity for Bond Holder

4. Operation Risks

4.1. Risks associated with operations

Hazards are inherent to the exploration for production, transportation, and storage of natural gas, crude oil, petroleum and petrochemical products, and refined products; they include fires, explosions, oil spills, well blowouts, gas pipeline leaks, dispersion of hazardous gases, terrorist activities, natural disasters, actions of external parties, and other unforeseeable events. These could prove detrimental to PTT's personnel, assets, environment, business operation, reputation, financial standing, and business opportunities.

The Company therefore takes risk management seriously by adopting preventive maintenance measures for its production facilities and instituting emergency and crisis response preparedness measures, together with the formulation of strategic and operating plans to support business continuity management. Like other companies in the petroleum and petrochemical industries, it has taken out insurance policies to protect its major operating assets against risks and business interruption.

4.2. Environmental and safety regulations

PTT's business operations must comply with relevant laws and regulations concerning impacts on the environment and safety, which are bound to get increasingly tough. If such new laws are promulgated or if changes are made to the policy on their enforcement, they may limit the Company's operation or significantly raise operating costs. Besides, approval delays for EIAs and HIAs (Health Impact Assessments), and that for community participation, in any operation could harm its future business.

To address these risks, PTT monitors and analyzes the impacts of changes in environmental and safety laws and regulations on its operation. It also closely coordinates with government agencies, applies available information to develop work plans and response measures, and ensures ongoing community relations activities in operating areas with a constant focus on community participation.

5. Financial Risks

5.1. Fluctuation of the Baht

Since PTT and its affiliates have outstanding foreign loans, changes in the exchange rate between the Baht and the US dollar directly and indirectly affect the majority of PTT's revenue, consequently affecting its bottom line. Therefore, the fluctuation of the Baht and the government's economic, financial, and treasury policies affect its consolidated financial and operating performance.

To alleviate this, PTT has balanced its foreign loans in proportion to its revenue from foreign currencies (in short, taking a natural hedge) and leveraged financial derivatives in converting foreign-currency loans, while managing its foreign-currency deposits and purchasing foreign currencies forward to match the quantity of foreign currencies required for foreign-loan repayment and for commercial transactions. PTT has also developed a treasury and credit policy for use as a common guideline for PTT Group.

5.2. Financial support to affiliated companies

In the past and during the recent Asian economic crisis, the Company provided financial support to its affiliates under a shareholder support agreement and coordinated with their executives, creditors, and other major shareholders on debt restructuring. It is the Company's policy not to incur new financial burdens unless necessary or for its benefit. In the long term, it will consider extending financial support in the form of



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loans or commercial credit, or both, to individual affiliates in the belief that such a policy and action would foster sustainable strength for members of PTT Group.

In extending such financial support to these affiliates, whether in the form of subordinated loans, capital, or commercial credit, PTT cannot guarantee that these companies will repay such loans or credit, or that they will not need financial support from PTT again - all these could harm PTT's performance and financial status. Besides, if PTT or any member of PTT Group becomes a default party under any agreement on shareholder support, some creditors may accelerate debt repayment. Therefore, we cannot guarantee that PTT will not raise its shareholding, raise its shareholding to more than half, or take over such a company if such action is considered more beneficial. If this should happen, the Thai accounting standards require that PTT consolidate the financial statements of the company in question with those of PTT, effective from the date of such control onward; such consolidation may affect PTT's overall financial status.

5.3. Acquisition of funds for plan execution

The businesses of PTT - in particular, petroleum exploration and production, natural gas transmission, and the petrochemical business - require huge capital investments that are paid in advance. Although the Company closely monitors and manages business risks, the actual investment capital required may deviate from project plans due to factors beyond its control, thus potentially affecting the success and project capital costs.

Thanks to PTT's business conduct that focuses on fostering long-term growth and good corporate governance, the Company has continuously grown and plans to invest in prudent business expansion, with consideration for sources of capital, particularly capital structuring that will enable it to maintain essential financial ratios at suitable levels comparable to companies in the same industry. Continuous monitoring of factors concerning the sourcing of investment capital has assured PTT that it can secure sufficient and suitable funds for future business expansion.