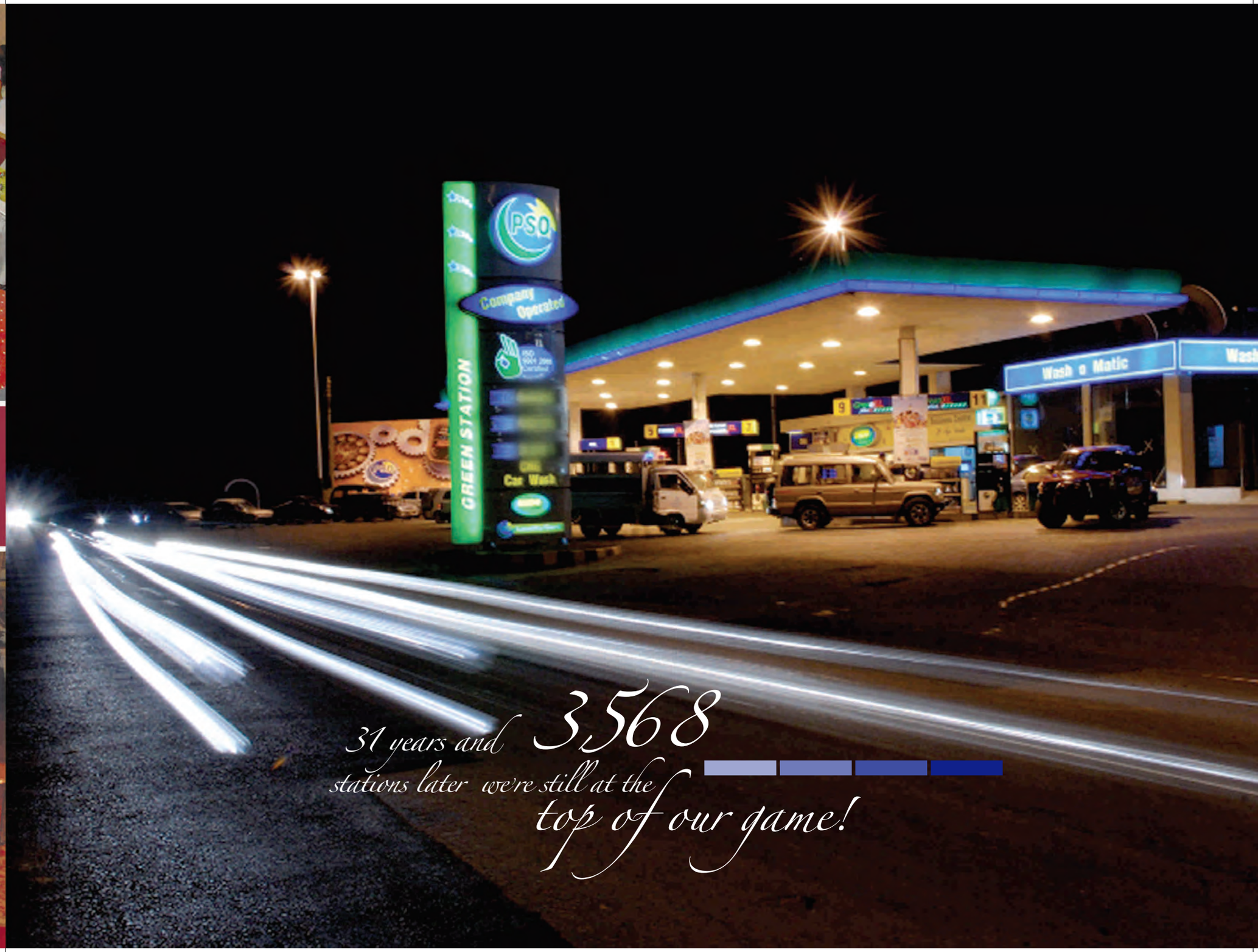
PSO: Report to Shareholders



31 years and 3568 stations later we're still at the top of our game!

Report to Shareholders

The Board of Management of PSO is pleased to present the thirty-second annual report and the audited financial accounts of the Company, for the year ended June 30, 2008. This Report presents the financial, operating and corporate responsibility performance of the Company, and highlights the key business challenges faced by us during the year.

Your Company continued its journey of success and marked its 31st anniversary with a record profit after tax of Rs. 14.05 billion and has emerged with a more progressive and dynamic outlook.

Overall, during 2007-08 PSO performed exceptionally well, established new milestones and reinforced market leadership in major products of its business portfolio i.e. Motor Gasoline (Mogas), Hi-speed Diesel (HSD) and Fuel Oil (FO), despite competitive challenges posed by existing players and supply constraints.

GLOBAL AND DOMESTIC BUSINESS ENVIRONMENT

Global as well as domestic business environments faced numerous challenges relating to rising crude oil prices, devaluation of USD against major currencies, food and commodity crisis and consequent inflationary pressure.

The Pakistan economy nevertheless showed resilience against global externalities and domestic shocks, and grew by 5.8%

PETROLEUM INDUSTRY OVERVIEW

FY2008 witnessed an unprecedented rise in crude oil prices. US WTI crude oil price hit USD139.9 a barrel on June 30, 2008. A major reason underlying soaring oil prices has been the weakening of the USD due to which, it is assumed that certain investors used oil as a hedge against USD devaluation.

Despite a relatively balanced supply-demand position, and in the absence of major supply disruptions, insufficient refining capacity in major consumer nations also contributed to rising crude oil prices. Besides, the geo-political instability in certain key oil supplying countries (i.e. Iraq, Iran, Nigeria and Venezuela) had an upward impact on oil prices.

During FY-08, petroleum consumption in the country crossed over 18 millions tons – an all time high level – consequent to a robust 8% growth over the previous year. This unusual high growth was the result of increased consumption of Mogas, High Speed Diesel (HSD), Superior Kerosene Oil (SKO) and Furnace Oil (FO). High growth in Mogas and HSD was due to control over smuggling of the products from Iran, increase in the population of vehicles and extraordinary increase in the use of generators for electricity supply backup.

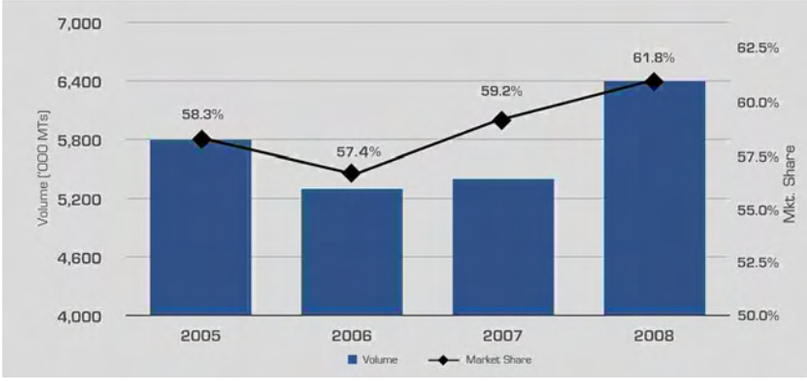
Consumption of Black Oil (Fuel Oil) and Light Diesel Oil (LDO) grew to 7.7 million tons – an increase of 1% over the preceding year. It is to be noted that since 2005 Black Oil demand has shown growth owing to supply constraints of natural gas. Reduced hydro-electric power also contributed to the rise in Fuel Oil consumption. This growing Fuel Oil consumption is expected to continue in the coming years.

During FY-08, local refineries produced 9.6 million tons, while the deficit requirement of around 9.2 million tons was imported. The major chunk of the demand was in FO and HSD, for which 4.2 million and 4.5 million tons were imported respectively.

PSO PERFORMANCE

During FY-08, PSO sold over 13 million tons of POL products, showing an 11% growth, substantially surpassing the 8% industry growth.

White Oil



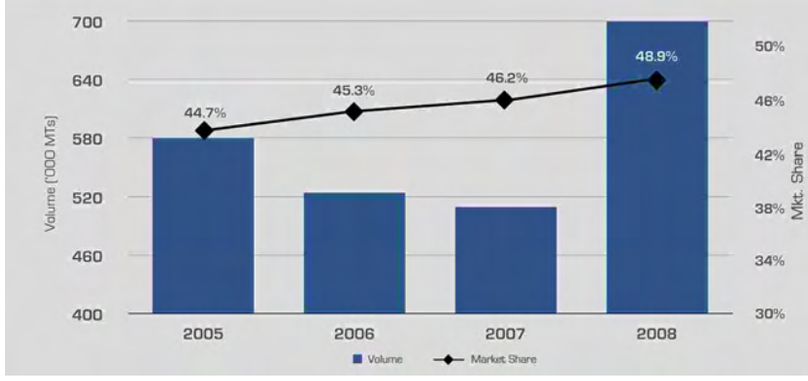
In White Oil, PSO enhanced its market share appreciably from 59.2 % in FY 2007 to 61.8%. Similarly in Black Oil, PSO's share increased to 82.3%.

PSO's increased White Oil market share was possible due to continued aggressive marketing initiatives, including the expansion of the New Vision retail network and enhanced contribution of its fuel cards, which substantially contributed towards sales volume growth.

PSO enhanced its Mogas market share to 48.9% Vs. 46.2% of last year. This shows our Mogas sales volume increased by 34% outperforming industry growth of 26%.

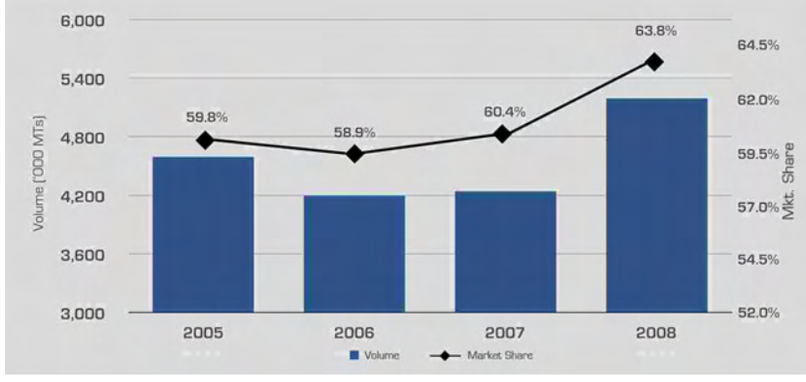
Our HSD sales recorded an impressive 20% growth, outperforming the industry that increased over 13%. As a result, the Company's market share increased to 63.8% Vs. 60.4% during the preceding year.

MOGAS



PSO achieved an impressive HSD sales volume of 5.3 million tons and 0.72 million tons for Mogas against the previous year's sales of 4.4 million tons and 0.54 million tons respectively.

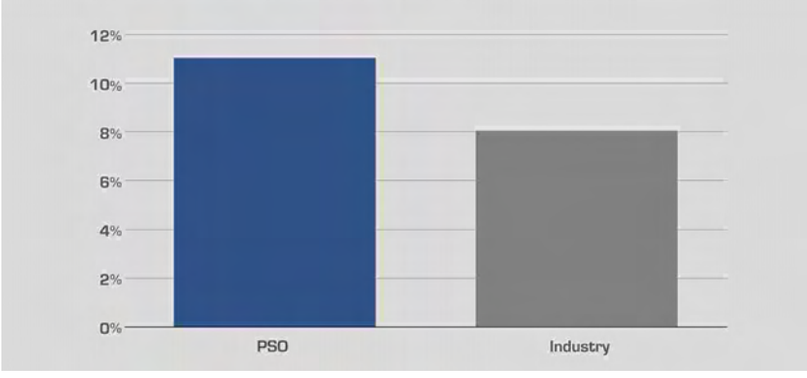
HSD



Report to Shareholders

You will be pleased to note that against the overall industry increase of 0.96 million tons of HSD during the year under review, PSO successfully captured almost 90% of the total increase.

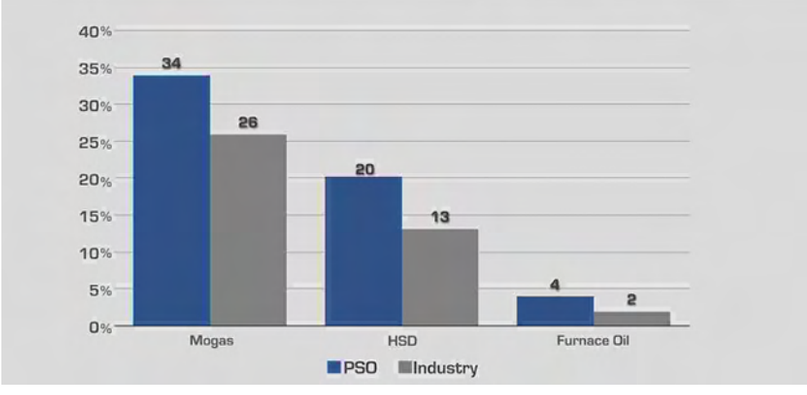
Overall Sales Volume Growth



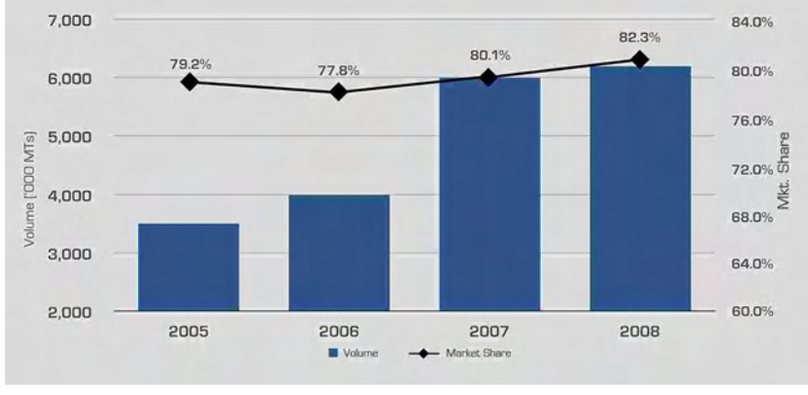
In FY-08, PSO's market share in Jet fuel (excluding exports) stood at 63.9%. In order to maintain its leadership position in the aviation industry, PSO developed an exclusive aviation, consumer and retail facilities at the newly developed Sialkot International Airport (SIAL). PSO's refueling facility at SIAL is fully capable of providing services to larger body aircrafts as per international Aviation Quality Control and Safety Standards.

In Black Oil, PSO sales grew by over 4% in Fuel-Oil (FO) mainly due to an increased demand by the power generation sector. Throughout FY-08 the Company actively pursued new business of up coming IPPs and successfully signed Fuel Supply Agreement/ Memorandum of Understanding with Atlas Power

Volumetric Growth of Different Products



Black Oil




Providing fuelling
facilities at 9 airports
nationwide
PSO
Pakistan State Oil
S28
S.28

Company Limited, Halmore Power Company Limited and KAPCO – II to fulfill their future fuel requirements for power generation.

In addition, the Company continued its dominating streak in winning tender businesses of major Government entities like Defence, Director General (Agri), Pakistan Steel, National Logistics Corporation (NLC), Heavy Industries Taxila (HIT), Pakistan Ordnance Factory (POF) WAH etc despite exogenous market constraints.

In Light Diesel Oil (LDO), our market share stood at 37.6%. In this product, PSO experienced a decline of 29% mainly due to the advent of new market players who have refinery backup. LDO is only 1.6% of the country's Black Oil sales.

During the year, PSO added 24 New Vision retail outlets, bringing the total number of such outlets to over 1,633. PSO's "Green Station" concept, launched last year, is also being implemented gradually at strategically located outlets. Moreover during the year, the Company closed down 81 non-performing retail outlets under the "Retail Rationalization Program". Throughout the year, the Company has maintained its strong focus on the CNG business and added another 30 stations bringing the total to 240, which is the highest number of stations developed by an OMC in the country.

Cards

Besides serving the customers with the existing fuel-based cards, PSO introduced a new member in the family of cards i.e. PSO Commercial Card. This card was launched to meet customers' commercial fueling requirements for the purchase of Premier XL or Green XL Plus Diesel.

PSO Lubricants

During FY-08, the Company sold 35,000 MTs of lubricants translating into a market share of around 26.6%. Since March 2008, PSO is selling its own "DEO" and "Carient" brands. PSO and BP Castrol mutually terminated their 40 years business alliance on the Castrol brand lube marketing in February 2008, as BP had decided to launch its own operation in Pakistan. Based on the changed environment your management has put in place aggressive marketing and distribution plans to grow its lubricant market share.

Non Fuel Business

PSO is also promoting growth of its Non Fuel business and has launched a few initiatives new to the local oil marketing sector. For the convenience of its customers ATM's were installed in collaboration with leading banks at selected retail outlets. The Company also established a food outlet as part of its Quick Service Restaurant (QSR) network plan, in collaboration with a foreign fast food chain at one of its retail outlet. The most recent introduction to the forecourt is the establishment of the 'FedEx' Courier Service facility. Besides this PSO customers can now experience the state-of-the-art car cleaning solution 'Wash Express' which has been introduced at selected outlets.

OPERATIONS

PSO handled over 13 million tons of fuel, including 6.4 million tons of Black Oil, mainly to cater to the growing needs of PEPCO, HUBCO and other IPPs.

Throughout the year, emphasis was placed on making operational activities more economical, efficient and customer-oriented. The Company successfully met with the stiff challenges in terms of the highest ever POL demand, specifically the huge

Catering to national demands with our state of the art lubricant manufacturing terminal

Fuel Oil demand of the power sector. With relentless efforts by the PSO team at operating locations, un-interrupted supplies were made round-the-clock to meet the customers' fuel oil demand.

Your management continued Company's policy of continuous improvement, operational cost containment and total customer satisfaction throughout the year, keeping critical operating parameters (i.e. quality, quantity and timeliness) under control. This helped the Company to attract new customers, especially the hospitality customers while retaining the existing customers in a changing competitive environment.

The management of operational activities at the Joint Installation at MehmoodKot (JIMCO), working with Shell and Chevron as partners, were also effectively managed.

SUPPLY

During FY-08, PSO arranged 40% of the products for its retail and industrial consumers from local refineries, whereas the remaining 60% were imported. The Company has more than 80% share in the import of deficit products in the country, for which 144 import vessels were handled - the highest number in the last five years. Out of these 144 vessels, 62 carried Black Oil and the remaining 82 carried White Oil products.

PSO maintained its leadership in Diesel and Furnace Oil imports at competitive rates and imported more than 3.4 million tons of Diesel and 4.1 million tons of Furnace Oil during the year. In addition to these, 493,000 tons of LSFO was imported to meet the Kot Addu Power Co. Ltd. (KAPCO) requirement which was in addition to the acquisition of locally produced 390,000 tons.

To optimize storage utilization, PSO provided hospitality to refineries and OMC's which resulted in a sizeable earnings growth.

LOGISTICS

The Company successfully managed to maintain an uninterrupted flow of POL supplies to all customers, especially to the large power generation sector. The period under review saw the tragic event of 27th December 2007, that severely damaged the logistical network (rail and road). In addition to this, the emergency shut-down of PARCO that coincided with scheduled turnaround of Bosicor and Attock Refinery, also posed serious challenges to the product movement. However, the Company managed to overcome all these challenges and met the customers demand with total satisfaction.

Through well-coordinated and integrated efforts of all components of the supply chain and with the support of PSO's carriage contractors and Pakistan Railways, the Company moved 7.3 million MTs of products from its different locations. PSO handled the Fuel Oil volume of 225,000 MTs in February 2008 - the highest volume transported during a month in the last three years and also the highest ever volume of 46,600 MTs of LSFO during January 2008.

HUMAN RESOURCE DEVELOPMENT

PSO management has been making a sizeable investment in the Human Resource Development of the Company. Extra emphasis is placed on the training aspect of existing employees. The average training man-hours per employee have been increased from 2.5 days to 4 days. During the year 215 training sessions were held which benefited 2,220 employees. These training sessions were organized on marketing and sales,

teamwork, general management, leadership, communication, realizing potential, quality management, achieving excellence, supply chain management and quality and quantity control of cargo and tank systems.

Moreover, the PSO internship program worked effectively during FY-08 from which 225 students of various universities benefited.

Engage Human Resources and Pakistan Society of Human Resources Management (PSHRM) conducted a preference study in 2007, interviewing 550 graduating MBA's. As a result of this survey PSO was bestowed with the 'Most Preferred Local Company Award'.

Throughout the year the relationship between management and the bargainable employees remained cordial.

Corporate Social Responsibility

During FY-08, the Company fully carried out its social responsibility to the society by focusing on three major platforms. They are education, health care and community building, which entails activities for women empowerment, children welfare and relief efforts during and after natural calamities.

Being a conscientious corporate citizen, the Company played a key helping role during the 2007 flood in Turbat and Pasni, in Balochistan, by sending relief goods as well as refueling relief flights to the area.

Your Company also played a leading role in making people aware of the need for energy conservation. A public service media campaign was run in the leading print and electronic media of the country, making people aware of the ways and means through which energy can be saved for the country.

During FY-08, the Company financially supported several institutions enabling education to reach to the under privileged nationwide. With the help of the Heritage Foundation, PSO helped in the building two schools in the earthquake affected areas of Mansehra, whereas five more schools are in the pipeline in collaboration with The Citizens Foundation.

In FY-08, the Company supported many institutions through donations, prominent among which are Child Aid Association (Jinnah Hospital), Burns Center (Civil Hospital), Loralai District Headquarter Hospital, Frontier Foundation, Dowites Operation Theatre Society (Civil Hospital) and Marie Adelaide Leprosy Center in Gawadar.

Total Quality Management

In its pursuit to bring significant operating efficiencies and achieve the highest level of customer satisfaction, the Company has already implemented ISO Certification of its major functions and facilities. During FY-08, ISO 9001: 2000 Quality Management System Certification was earned by several departments making approximately 70% of the Company ISO compliant.

Health Safety and Environment

Overall the Company maintained and improved its safety record and achieved 5.476 Million Safe Operational Man hours during FY-08 without any Lost Work Day (LWD) injury.

PSO's commitment to health, safety and environment was further endorsed when the Company won the Royal Society of the Prevention of Accidents (RoSPA) Gold Award 2008. PSO is the first OMC in Pakistan that has achieved this recognition. In addition to this the Company also managed to win the Environment Excellence Award 2007 and Health and Environment National Excellence Award 2007.

Report to Shareholders

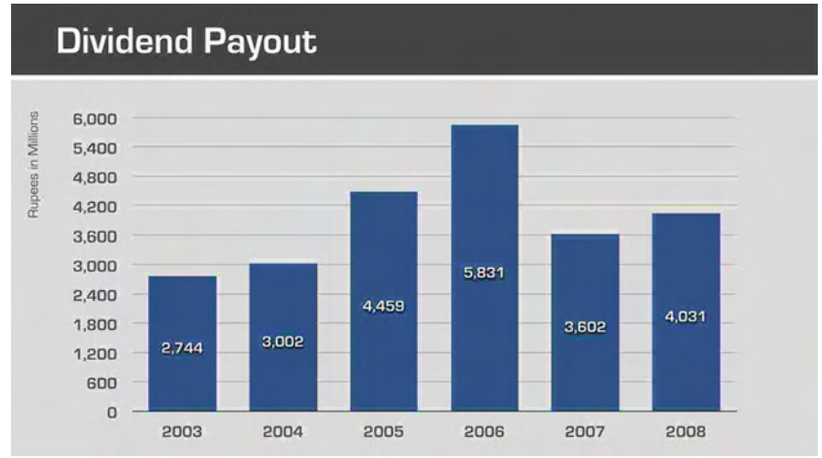
FINANCIAL RESULTS

For the year ended 30 June 2008, the Company achieved impressive performance with a turnover touching Rs. 583 billion (US$ 9.4 billion) showing an increase of 42%. PSO is the largest corporate entity in Pakistan based on turnover. Profit before tax at Rs. 21.4 billion and profit after tax at Rs. 14.1 billion were the highest ever earned by the Company. The earning per share at Rs. 81.94 was also at record level showing a 200% increase over Rs. 27.24 last year.

Profit Appropriation	2008	2007
	(Rs.in million)	
Total profit available for appropriation	14,057	4,705
Transfer to general reserve	10,000	1,100
Interim dividend @ 110% already paid	1,887	1,715
Proposed final dividend @ 125% i.e Rs 12.5/- per share of Rs.10/-	2,144	1,887
Total dividend for the year	4,031	3,602
	14,031	4,702
Unappropriated profit carried forward	26	3

Based on ever increasing oil prices, especially during Jan-June 2008, PSO made record earnings during 2008 mainly due to one time inventory gains. Last year the Company had an inventory loss. Subsequent to the year end 2008, the international oil prices have shown a downward trend which, if it maintains a similar trend may cause corresponding inventory loss for the period.

Excluding the one time large inventory gain, the 2008 operating profit increased by about 40% in line with the massive growth in both regulated and non-regulated business delivered by the Company during the year.

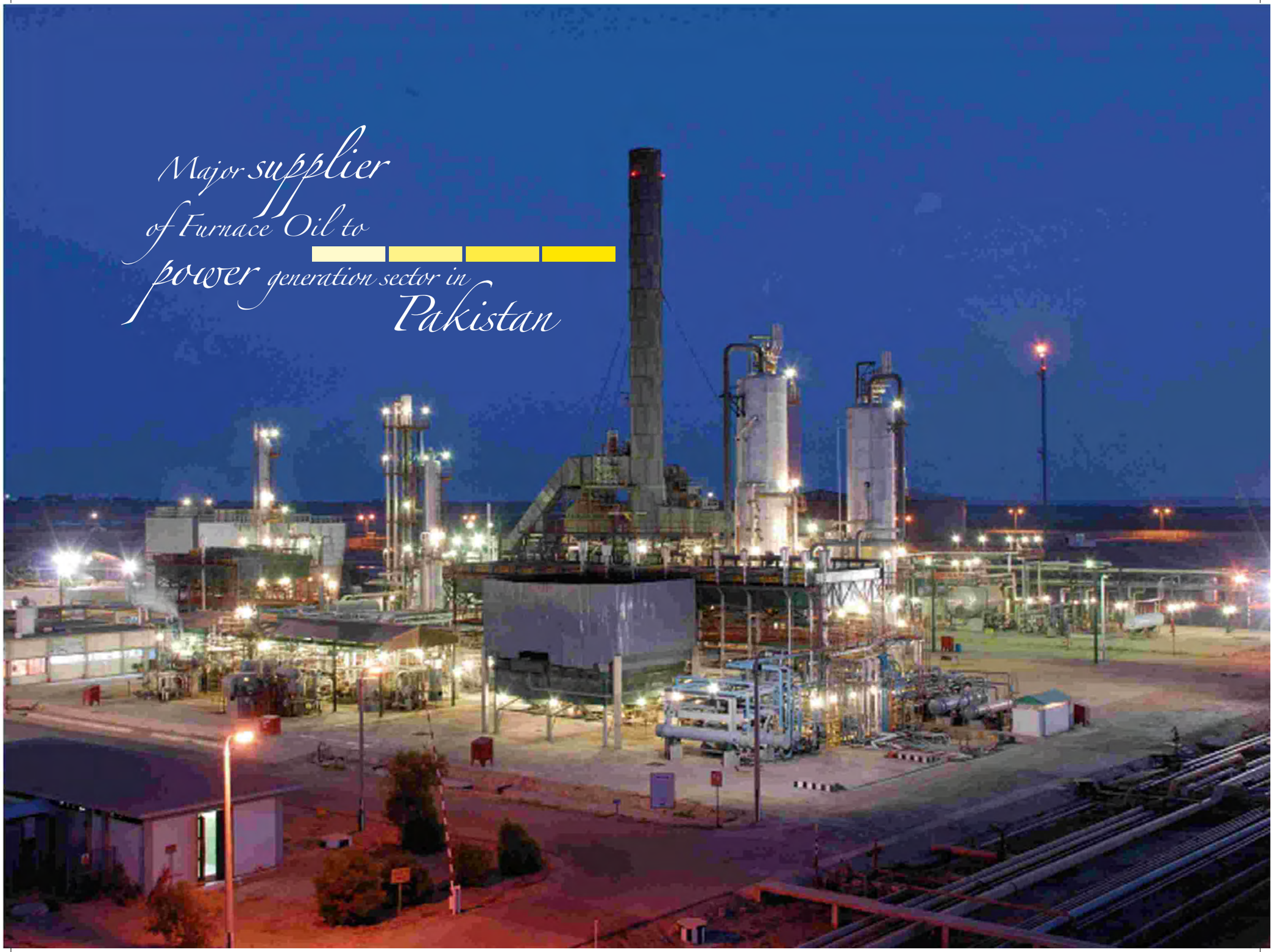


Company's income tax payments during 2008 at Rs.7.3 billion Vs Rs.2.4 billion last year showed an increase of 200% mainly due to 35% tax on inventory gain recorded in 2008 accounts.

Based on these results, the board announced a dividend of Rs. 12.5 per share. Combined with the earlier interim dividends aggregating Rs. 11 per share, the total dividend for the year stood at Rs. 23.5 per share translating into a total payout of Rs. 4 billion to the shareholders.

Cash Flow Constraints

Despite being profitable, PSO faced serious liquidity problems due to ever-increasing receivables from the government resulting in galloping financial cost. Due to rising international prices,


Major supplier
of Furnace Oil to
power generation sector in
Pakistan

government continued to provide a very high level of subsidy to the consumers in Pakistan. The subsidy on diesel touched the highest ever level at Rs. 37.07 per litre in June 2008.

The subsidy accumulation on account of Price Differential Claims (PDC) of your Company reached a record level of Rs. 43 billion in April, 2008. However, a reimbursement of Rs. 20 billion was received from GOP on June 30, 2008, thus mitigating the cash flow crunch to some extent at the year end.

In addition to PDC, large fuel consumers like PEPCO, HUBCO and PIA also defaulted on payments to PSO, thereby further aggravating the liquidity position. As on June 30, 2008 receivables from these entities stood at Rs. 27 billion adding to Company's cash flow problems.

Subsequent to the year end, total receivables on account of PDC and IPP dues have again accumulated to Rs. 75 billion in end August 2008.

CORPORATE AND FINANCIAL REPORTING FRAMEWORK

PSO Board of Management is fully cognizant of its responsibility as recognized by the Code of Corporate Governance issued by the Securities and Exchange Commission of Pakistan (SECP). The following are the comments on acknowledgement of PSO's commitment towards high standards of Corporate Governance and continuous improvement:

- The financial statements, prepared by the management of the Company, present fairly its state of affairs, the result of its operations, cash flows and changes in equity.
- Proper books of the accounts of the Company have been maintained.
- Appropriate accounting policies have been consistently applied in the preparation of financial statements and accounting estimates are based on reasonable and prudent judgment.
- International Accounting Standards, as applicable in Pakistan, have been followed in preparation of financial statements and departure, if any, has been adequately disclosed.
- The system of internal control is sound in design and has been effectively implemented and monitored.
- There are no significant doubts upon the Company's ability to continue as a going concern.
- There has been no material departure from the best practices of corporate governance, as detailed in the listing regulations.
- Key operating and financial data of the last ten years in summarized form is annexed.
- The following is the value of investment of provident and pension funds based on their respective un-audited accounts as on 30 June 2008.

	Rs. Million
PSOCL Management Emp. Pension Fund	1,259
PSOCL Workers' Staff Pension Fund	867
State Oil Co. Ltd. Staff Provident Fund	869
State Oil Co. Ltd. Employees Provident Fund	629
PSOCL Employees Gratuity Fund	296

- During the year, six meetings of the Board of Management were held and the attendance by each member is given on page no.139.
- The pattern of shareholding is annexed.

CHANGES IN BOARD OF MANAGEMENT

During FY-08, certain changes took place in the constitution of PSO's Board of Management (BOM), resulting in replacement of the Chairman and certain members of BOM. Besides, the new Managing Director of PSO was appointed during the year. Accordingly, Sardar Muhammad Yasin Malik replaced Mr. Pervaiz Kausar as Chairman while Mr. Mohammad Abdul Aleem replaced Mr. Jalees Ahmed Siddiqi as Managing Director.

In addition, Mr. Muhammed Yousaf Qamar Hussain Siddiqui, Haji Amin Pardessi, Mr. Iskander Mohammed Khan and Mr. Iftikhar Asghar became the members of BOM, whereas Mr. Tariq Kirmani, Mr. Tariq Iqbal Khan and Mr. Kamran Mirza ceased to be members of BOM. Mr. Iftikhar Asghar, however, later on resigned from the membership of BOM. PSO wishes to take this opportunity to welcome the new chairman and members of BOM, and place on record its appreciation for participation and contributions by the outgoing BOM members.

OUTLOOK AND CHALLENGES

As 80% of the Country's energy demand is met by import, the abnormal surge in international crude oil prices in the past one year has adversely affected the economy and the business. This increase in international prices has led the Government to the decision of adjusting and reducing the profit margins of Oil Marketing Companies and refineries. With the reduction in OMC's margin, PSO's future performance would be dependent on cost savings, increased sales and high operating efficiencies. Your Company has already embarked upon various initiatives aiming at sustainable earnings including focusing on the growth of Non Fuel Retail business and further expanding CNG network and introducing LPG auto gas filling facilities at retail outlets.

To increase operational efficiency, reduced depot model (12+1) recently announced by the government will ensure higher operational efficiencies. The Company has proactively aligned its resources in view of the new supply regime and would further rationalize its resources to the optimal level.

Your management is fully aware of the need and is working on plans to boost its lubricant sales performance. Plans are in place to further enhance PSO brand equity with aggressive marketing efforts supported by print and electronic media. PSO also would aggressively pursue market development and selective penetration strategy in the years to come. The Company would continue to maintain focus on its cards business to provide better service to its customers. PSO believes that the future growth lies in innovation, highest level of customer service and diversification into new business areas.

Being fully aware of the global trend in the development of alternative and renewable energy resources, the Company has already initiated research and development work on bio-diesel and tests are in advance stages to blend it with conventional diesel.

However, the most critical success factor for PSO and the oil and energy sector will be the earliest resolution of, current circular debt issue. PSO management will continue to stress upon the authorities that timely payment of PSO debts by GOP and IPPs is critical to ensure timely, sustained and sufficient supply of fuel in the country.

We would like to take this opportunity to thank our business partners including dealers and cartage contractors, employees, and the shareholders for their support in making all our efforts successful and taking the Company to the next performance level. We would also like to thank Government of Pakistan especially Ministry of Petroleum & Natural Resources for their continued support during the year. We look forward to another year of achievements as we continue to create value for all our stakeholders while working to meet the country's growing demand for energy.

Muhammad Abdul Aleem
Managing Director

Sardar M. Yasin Malik
Chairman

Karachi: September 5, 2008