

Industry Flash

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Indian Oil & Gas

Oil Bonds – No Surprises, but Provides Visibility

- Oil bonds of Rs235bn for FY08** — The government today announced oil bonds of Rs234.6bn for FY08, marginally lower than FY07 but in-line with our calculations. Overall subsidy burden of Rs549bn is also in-line with our estimates.
- Sentiment boost for upstream** — This provides visibility to the upstream portion of subsidy sharing, which we believe now has a likelihood of reverting to 33% levels (we assume 35%) in FY08E as against 40% in FY07. This should improve sentiment for upstream companies, viz. ONGC (ONGC.BO - Rs1,066.45; 1M) and GAIL (GAIL.BO - Rs400.10; 1L).
- Downstream – Refining will be savior** — With the contours of subsidy sharing in FY08 becoming clearer, it is evident that downstream R&M (BPCL (BPCL.BO - Rs375.00; 3M), HPCL (HPCL.BO - Rs264.45; 3M), IOC (IOC.BO - Rs472.30; 3M)) will end up bearing much more “net” under-recovery; we estimate Rs110bn in FY08E as against Rs48bn in FY07. This will, thus, be similar to FY05 net under-recovery and the original FY07 proposal. However, we expect the FY08E earnings of downstream R&M companies to only partially reflect the increase in net losses due to robust refining margins. It remains difficult to be constructive on these stocks, however, given the political uncertainty and reluctance to increase prices.
- Pure refiners – certain to be excluded** — Exclusion of pure refiners from the subsidy sharing becomes a certainty. CPCL (CHPC.BO - Rs292.55; 1L), with its inexpensive valuations (PER of 6.3x FY08E), stands out.

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Figure 1. Subsidy Sharing Mechanism

| Rs bn | FY06 | FY07 | | FY08E | FY09E |
|-------------------------------------|------|----------|--------|-------|-------|
| | | Proposed | Actual | | |
| Gross under-recoveries | 400 | 735 | 495 | 542 | 441 |
| less: Bonds | 115 | 280 | 241 | 242 | 177 |
| less: Upstream contribution | 140 | 240 | 205 | 190 | 154 |
| less: Refineries sharing | 30 | 15 | | | |
| less: Price hike & Duty Cuts | | 90 | | | |
| Net under-recovery | 115 | 110 | 49 | 110 | 110 |
| Upstream as a % of under-recoveries | 35% | 33% | 41% | 35% | 35% |

Source: Citi Investment Research

See Appendix A-1 for Analyst Certification and important disclosures.

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Appendix A-1

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performance and risk.

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