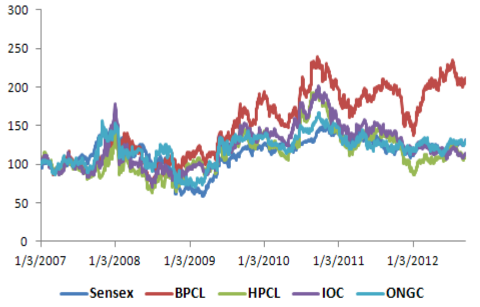
Event update

Industry	Oil & Gas

(Price Performance (BB: HPCL IN, IOCL IN, BPCL IN, ONGC IN)



Sector Update

September 14, 2012

A drop in the bucket now; future agility key to sustainability

Yesterday's fuel price was a long welcome initiative on the part of the government to take its first steps towards fiscal consolidation. Although the near-term annualized impact on inflation could be ~85-90bps direct impact (indirect impact could be much higher at 120-160bps, assuming 50-100% pass through of diesel prices), this would be much better than the impact of suppressed inflation on inaction on fuel price hike – something which even the RBI is comfortable with. However, the key is whether this is enough and how nimble-footed is the government to take such uneasy steps in the future as well? We believe any meaningful reforms is likely only in a scenario of sustainably lower oil prices. Till then, any measures such as price hikes, duty cuts would be temporary pain relievers at best

Diesel prices hiked by 13%; Subsidized LPG allocation cut by one-third

The government hiked the prices of diesel by ₹5/litre (13%) to ₹52.45/litre (ex-pump, Mumbai) late yesterday evening. However, the effective price increase to PSU R&M companies is only ₹3.5/litre with the balance ₹1.5/litre being in the form of a hike in specific excise duty. The hike in excise duty has essentially meant that 58% of the earlier cut in excise duty in June 2011 (excise duties on diesel were cut by ₹2.6/litre in June 2011) has been rolled back. With respect to cooking fuels, while there was no hike in kerosene prices, the allocations of domestic LPG per family per annum was cut to 6 cylinders – cylinders beyond the approved limit would be available at market rate. The cut in LPG allocations implies 1/3rd cut in volumes of domestic LPG cylinders, which in price terms implies an effective cut in subsidy of ~₹115/cylinder.

FY13E under-recoveries down by ₹203bn; higher oil prices, weak rupee a threat

The oil ministry's press release indicates an effective reduction in subsidy by ₹203bn for the remaining part of FY13E. This broadly comprises of i) ₹150bn cut in subsidy due to hike in diesel prices by ₹3.5/litre; and ii) ₹53bn cut in subsidy due to cut in LPG allocations. Despite the above cut, the full year under-recoveries, as per the oil ministry's calculations, stand at ₹1.67trillion, 21% higher YoY.

We had modelled a modest increase in diesel prices in FY13E and the above hike is pretty much in line with our expectations. In case of LPG, the effective hike of ₹115/cylinder is much higher than our expectations of ₹25/cylinder. Further, we note that the step taken towards cut in allocations of subsidized LPG is a far more sustainable and effective step in cutting subsidies than ad-hoc price increases. In case of kerosene though, there was a negative suprisewhile we had modelled a hike of ₹2/litre, NIL hike has meant a negative surprise. However, overall, the move on the part of the government to hike fuel prices has been a bold move, albeit a bit delayed.

We model FY13E under-recoveries at ₹1.05 trillion, assuming US$105/bbl and exchange rate at ₹54/USD. However, currently oil prices are higher at US$116/bbl. Thus, assuming higher average oil price at US$110-115/bbl for FY13E and exchange rate at ₹55-56/USD, the under-recoveries for the full year could be ₹ 1.3-1.55 trillion. This could negate the impact of the fuel price hike.

Agility to take uneasy/ tough decisions key thing to watch for

With the noise behind the fuel price hike behind us (atleast for now), the future outlook would depend upon the government's ability to be nimble footed in taking tough decisions. This looks tough in the near-term given the likely upward push to oil prices led by the ongoing US QE/ ECB bond buying program. A sustainable decline in oil prices is key to any landmark pricing reforms in the oil sector. In this regard, some initiatives by the government such as online tracking of LPG cylinders are useful but execution bottlenecks may delay sustainable benefits therefrom. Till the time the sustainable benefits of subsidy channelization (through Aadhar for kerosene subsidy, online tracking of LPG cylinders) manifest themselves, government is unlikely to take bold steps in the future.

R&M to remain trading plays; Upstream earnings contingent upon subsidy sharing formula

Against this backdrop, we believe R&M companies would remain trading plays at best – buy on extreme pessimism and sell on rallies due to fuel price hike, subsidy support etc. Upstream companies such as ONGC, Oil India and GAIL enjoy a relatively better earnings outlook compared to PSU R&M companies. However, any significant change in upstream subsidy sharing formula could pose downside risk to earnings estimates.

Table 1: Marketing margins post price hike

	Marketing Margin (in ₹)	
	Pre Hike	Post Hike
Diesel	-16.8/L	-11.9/L

Source: Systematix Institutional Research

Table 2: Under recoveries – Govt. estimates

FY13 Under recoveries (₹ Bn)	Pre Hike	Post Hike
LPG/kerosene	693	640
Auto fuels	1,180	1,030
Total subsidy	**1,873**	**1,670**

Source: Systematix Institutional Research

Table 3: Implicit Brent price post hike

	Brent Price ($/bbl)
Diesel	84
Kerosene	26.4
LPG	35
Petrol	117

Source: Systematix Institutional Research

Sudarshan Narasimhan
sudarshan@systematixshares.com
(+91 22 3029 8293)

Harshil Shah
harshilshah@systematixshares.com
(+91 22 3029 8257)

For any queries contact us at: Institutional Team

N. Subramaniam	Sr. VP & Head – Sales & Sales Trading	+91- 22-3029 8285	nsubramaniam@systematixshares.com
Equity Sales			
Mamta Singh	AVP– Sales	+91-22-3029 8092	mamtasingh@systematixshares.com
Ridhim Thapar	AVP– Sales	+91-22-3029 8265	ridhimt@systematixshares.com
Sales Trading / Dealing			
Jigar Kamdar	AVP - Sales Trading	+ 91-22-3029 8181	jigarkamdar@systematixshares.com
Dipesh Upadhyay	Sr. Manager - Sales Trading & Dealing	+ 91-22-3029 8091	dipeshu@systematixshares.com
Sachin Parekh	Sr. Manager - Sales Trading	+ 91-22-3029 8291	sachinp@systematixshares.com
Vinod Bhuwad	Sales Trader	+ 91-22-3029 8267	vinodbhuwad@systematixshares.com
Nayan Narnoli	Dealer – Cash & Derivatives Segment	+ 91-22-3029 8180	nayan@systematixshares.com
Monish Lotia	Dealer – Cash Segment	+ 91-22-3029 8252	monishlotia@systematixshares.com
Equity Research			**Telephone: + 91-22- 3029 8000**
RESEARCH ANALYST	**SECTOR ALLOCATION**	**DIRECT Nos.**	**E-mail**
Sudarshan Narasimhan	Sr. VP & Head of Research –Oil & Gas, Petrochemicals	+ 91-22-3029 8293	sudarshan@systematixshares.com
Vinod Chari	VP - Capital Goods	+ 91-22-3029 8263	vinodchari@systematixshares.com
Surya Narayan Patra	AVP - Pharma	+ 91-22-3029 8186	suryapatra@systematixshares.com
Eric Martins	AVP – Metals & Mining, Pipes	+ 91-22-3029 8253	eric@systematixshares.com
Jyoti Khatri	AVP – Banking	+ 91-22-3029 8296	jyotikhatri@systematixshares.com
Anurag Purohit	AVP – IT	+ 91-22-3029 8258	anuragp@systematixshares.com
Binod Modi	Sr. Analyst – Cement & Construction	+ 91-22-3029 8264	binodmodi@systematixshares.com
Rohit Jain	Analyst - Real Estate	+ 91-22-3029 8269	rohitj@systematixshares.com
Rahul Agarwal	Analyst	+ 91-22-3029 8260	rahulagarwal@systematixshares.com
Subodh Gupta	Technical Analyst	+ 91-22-3029 8261	subodhgupta@systematixshares.com
Prateek Khandelwal	Associate	+ 91-22-3029 8259	prateekk@systematixshares.com
Harshil Shah	Associate	+ 91-22-3029 8257	harshilshah@systematixshares.com
Rudra Sahoo	Research Editor	+ 91-22-3029 8199	rudrasahoo@systematixshares.com
Mrunali Pagdhare	DTP/Designer Associate	+ 91-22-3029 8188	mrunali@systematixshares.com
Mandar Puri	DTP/Designer Associate	+ 91-22-3029 8250	mandarpuri@systematixshares.com

Stock Ratings

BUY (B)	The stock's total return is expected to exceed 20% over the next 12 months.
ACCUMULATE (A)	The stock's total return is expected to be within 10-20% over the next 12 months.
HOLD (H)	The stock's total return is expected to be within0-10% over the next 12 months.
SELL (S)	The stock's is expected to give negative returns over the next 12 months.
NOT RATED (NR)	The analyst has no recommendation on the stock under review.

Industry Views

ATTRACTIVE (AT)	Fundamentals /Valuations of the sector is expected to be attractive over the next 12-18 months.
NEUTRAL (NL)	Fundamentals /Valuations of the sector are expected to neither improve nor deteriorate over the next 12-18 months.
CAUTIOUS (CS)	Fundamentals /Valuations of the sector is expected to deteriorate over the next 12-18 months.

SYSTEMATIX SHARES & STOCKS (I) LTD.

Head Office J. K. Somani Building, 2nd Floor, British Hotel Lane,
Fort, Mumbai, Pin: 400001, Tel: +91 22 66198000, Fax: +91 22 66198029

Registered Office EGA Trade Center, 4th Floor, 809-, Poonamalle High Road,
Kilpauk, Chennai, Pin: 600010Tel: +91 44 26612184/ 87/ 88Fax: +91 44 26612190