

Fuel prices raised...finally

Quick Note

September 14, 2012

Finally, government raises price; but impact only minor

Long awaited, the government today announced diesel price increases. It also cut the excise duty on petrol and sought to limit the number of subsidised cylinders per consumer. In our view, however, the government's actions are only minor, compared with the gravity of India's oil subsidy problem.

Moreover, this price action comes nearly 15 months after the previous price hike in June 2011. Already, several political parties have voiced opposition to the today's price hike. In our view, if the time gap between this hike and the previous one is any indication, this may well be the last major hike, before the general elections in 2014.

On our estimates, today's actions will reduce overall under-recoveries by INR203bn to INR1.67trn in FY13F. This implies an 11% reduction from earlier estimates of INR1.87trn. At INR1.67trn, under-recovery size is still 21% higher than the INR1.38trn in FY12.

Positive on sentiment; but bottom lines may not change much

Any price increase is a positive move, in our view, and the shares of public sector oil companies should react positively. But we highlight that these price actions may not lead to changes in the bottom lines of oil PSUs, as each company's profitability will ultimately depend on how the INR1.67trn in under-recoveries is shared. On such sharing, there remains no clarity.

What has been done?

- **Diesel price increased by INR5/litre (13% in Delhi).** Of this increase INR1.5/L is due to excise duty increase and OMCs' under-recovery would decrease by INR3.5/L. Diesel under-recoveries would come down by INR150bn for FY13F to INR1.03trn. The annualised impact is INR275bn, on our estimates.
- **Petrol excise duty cut by INR5.3/L.** There is no change in retail price. Losses of OMCs on petrol would decline by INR64bn for the remainder of FY13F, on our estimates. We note the duty cut on petrol is largely offset by the duty increase on diesel, so the move is overall excise duty neutral.

We also highlight that officially, petrol has been de-regulated since June 2010. Over the past year, even as the government tacitly controlled petrol prices, it repeatedly stated that OMCs decide the price. Now with government formally saying that petrol prices will not change, in our view it seems that petrol is also a controlled product!

- **LPG limit of 6 cylinders per customer.** For the remainder of FY13, each LPG customer will be eligible for only three subsidised cylinders, as per the government's announcement. For any additional cylinders, customers would have to pay a non-subsidised price, which will be notified separately by oil market companies. The government expects this arrangement to reduce under-recoveries by INR53bn for FY13F (annualised impact INR97bn). A positive decision, but if not properly

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implemented, a wide pricing gap between subsidised and non-subsidised cylinders could lead to the emergence of a black market, in our view.

- **Kerosene – no price change.** There is a 230% price increase required for this perceived politically sensitive fuel. The current price is INR14.8/L and a required hike for no under-recoveries at the retail level is INR34.3/L, on our estimates; however, the government has shied away from even a notional increase. The government estimate on kerosene under-recoveries for FY13F is INR320bn.
- **Branded diesel to have market pricing.** This implies that branded diesel will be sold at a premium of nearly 30% to unbranded subsidised diesel, based on our estimates. The share of branded diesel has come down sharply in recent years and is less than 1% currently. With such a sharp difference between pricing in the premium and non-premium segments, we think the market share of premium diesel will decline further.

Fig. 1: Key price changes – No price changes for Kerosene and LPG

Sharp hikes still required

	Current (before Today's action)			13th Sep hikes		Reduction in U/Rs		Further price hike reqd	
	Prices (Delhi)	Under-recoveries	Reqd. price hikes	Excise duty	Base price	Amount	%	Amount	%
Diesel (INR/ltr)	41.3	17.1	19.2	1.5	3.5	3.5	21%	13.6	32%
PDS Kerosene (INR/ltr)	14.8	32.7	34.3	-	-			34.3	232%
Domestic LPG (INR/cyl)	399.3	347.0	347.0	-	-			347.0	87%

Source: Ministry of Petroleum & Natural Gas, Nomura estimates

Fig. 2: Impact on under-recoveries – only an 11% reduction

Fuel under-recoveries remain elevated and are likely to increase by 21% y-y in FY13F

INR Bn	FY12	FY13E			%change	Y-Y
		Before	Reduction	Revised		
Diesel	812	1180	150	1030	-13%	27%
Kerosene	274	320	0	320	0%	17%
LPG	300	373	53	320	-14%	7%
Total	1,385	1873	203	1670	-11%	21%

Source: Ministry of Petroleum & Natural Gas, Nomura estimates

Appendix A-1

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