

## Price hike to reduce under recovery

The fuel price increases announced by the government last night are likely to result in under recovery reducing by Rs238bn (diesel) and Rs130bn (LPG) for the remainder of FY13. The government also reduced excise duty on petrol by Rs5.3/litre, which will result in revenue loss of Rs64bn. At current prices, ONGC and OIL's (after price hikes) realisations are likely to be US\$51/bbl and US\$57/bbl assuming a 39% upstream share of under recovery. While policy uncertainty prevails, the fuel price increase will provide some relief to PSU oil companies' finances.

### Diesel under recovery falls; LPG rationing to result in savings

We estimate current under recovery for diesel, kerosene, petrol and LPG at Rs11.6/litre, Rs34/litre, Rs0.4/litre and Rs316/cylinder. We have assumed 10 cylinders are used per family per year to estimate LPG under recovery. Even after the excise duty cut on petrol Oil Marketing Companies' (OMC's) will lose Rs0.4/litre. We estimate that the government will have to forgo Rs64bn in revenue due to excise duty cut. Fuel price increases and limiting of subsidised LPG cylinders to six per family per year should reduce gross under recovery by Rs433bn. Assuming that the government bears 50-60% of the gross under recovery, its share will reduce by Rs216bn- Rs259bn. Estimated gross under recovery for FY13 assuming current crude oil and fuel prices is Rs1.67tn.

### Estimated FY13 gross under recovery (Rs mn)

Fuel	BPCL	HPCL	IOC	Total
SKO	86,559	86,893	160,753	334,205
LPG	96,650	87,429	157,440	341,518
MS	7,547	6,413	17,106	31,067
HSD	158,536	181,596	620,694	960,827
<b>Total</b>	<b>349,292</b>	<b>362,332</b>	<b>955,993</b>	<b>1,667,617</b>

Source: BRICS Research

### Reduction in expected gross under recovery for remainder of FY13

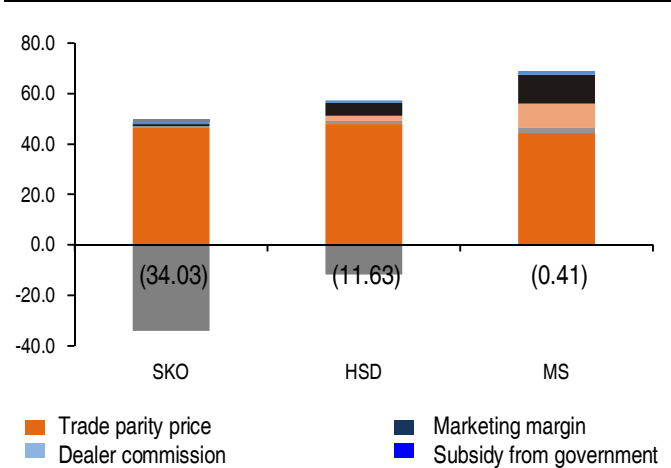
Product	Current	Earlier	Reduction
Petrol	4,973	69,295	64,323
Diesel	526,264	764,462	238,198
LPG*	194,740	325,393	130,652
<b>Total</b>	<b>725,977</b>	<b>1,159,150</b>	<b>433,173</b>

Source: BRICS Research; \*Assume use of 10 cylinder per family per annum

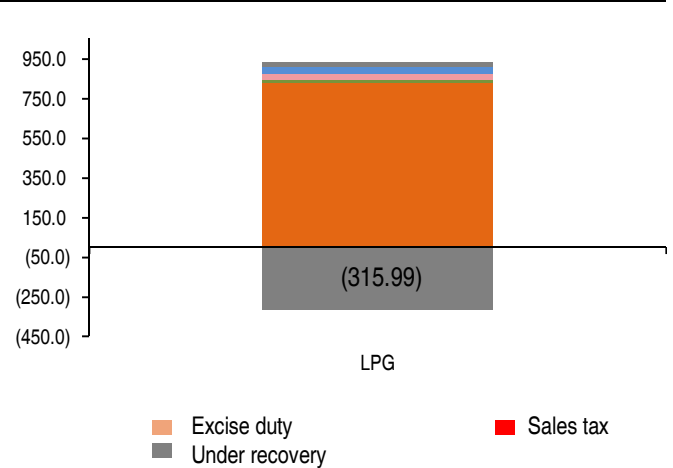
### Peer valuation

Company	(Rs mn)							
	CMP (Rs)	Net Sales FY13E	EBITDA FY13E	Net Profit FY13E	EPS (Rs) FY13E	ROE (%) FY13E	P/E (x) FY13E	Rating
Oil & Natural Gas Corp	283	1,274,683	440,826	174,597	20.4	15.5	13.9	ADD
Oil India	481	105,403	40,307	30,943	51.5	17.5	9.3	REDUCE
GAIL India	370	419,220	69,950	41,234	32.5	22.5	11.4	BUY

Source: BRICS Research

**Exhibit 1: Price build up for Kerosene, HSD and MS (Rs/lit.)**

Source: Bloomberg, BRICS Research \*At today's price

**Exhibit 2: Price build up for LPG (Rs/cylinder)**

Source: Bloomberg, BRICS Research \*At today's price

**ONGC,OIL net oil price realisation to be US\$51/bbl and US\$57/bbl**

Net oil price realisations for ONGC and OIL (after price hikes) are expected to be US\$51/bbl and US\$57/bbl (we have assumed 39% upstream share in under recovery) on a run-rate basis. ONGC's net oil price realisation is up by US\$4.4/bbl and OIL's by US\$3/bbl as a result of the price increase. We believe that our long-term assumptions of US\$53/bbl and US\$57/bbl, respectively, are reasonable given the possibility of further increases in domestic fuel prices and stabilisation of international oil prices and rupee-dollar exchange rate.

**Maintain Add on ONGC, BUY on GAIL and Reduce on OIL**

Given the ad hoc nature of the fuel price increase and lack of a clear policy roadmap regarding distribution of under recoveries among stakeholders, we believe that the structural uncertainty in the sector is still present. We maintain our Add rating for ONGC with a target of Rs306 (upside of 8.5%) and our Reduce rating on OIL (downside of 6.6%) with a target of Rs451. We maintain BUY rating on GAIL with 15.2% upside to our target of Rs423.

**Exhibit 3: ONGC: Sensitivity of target price to net oil price realisation and exchange rate**

Exchange rate(Rs/US\$)	Net crude oil realisation(US\$/bbl)			
	45	49	53	
49	252	279	306	306
52	285	313	341	341
55	317	347	377	377

Source: BRICS Research

**Exhibit 4: OIL: Sensitivity of target price to net oil price realisation and exchange rate**

Exchange Rate (Rs/US\$)	Net crude oil realisation (US\$/bbl)			
	49	52	57	
	371	371	451	531
	444	444	531	618
	517	517	611	704

Source: BRICS Research

**Exhibit 5: DCF calculation for GAIL (Rs mn)**

	FY13E	FY14E	FY15E	FY16E
PAT	41,234	48,914	56,645	55,392
Depreciation	10,281	11,955	13,810	15,587
Cash Profit	51,515	60,869	70,455	70,979
Change in Working Capital	17,359	9,075	13,999	8,717
Capex	(48,241)	(42,235)	(47,658)	(33,712)
Free Cash Flow	20,633	27,709	36,797	45,984
Cost of Capital	12.5%			
Terminal Growth Rate	3.0%			
Terminal Cash Flow	45,984			
Terminal Value	484,039			
PV, Explicit Forecast Period	104,163			
PV, Terminal Value	350,579			
Less: Net Debt	(8,093)			
Value of Equity	462,836			
<b>Value/share</b>	<b>365</b>			

Source: Company, BRICS Research

**Exhibit 6: Sensitivity of GAIL's operating business NAV to cost to cost of capital and terminal growth rate**

Terminal growth rate	Cost of capital			
	10.0%	12.5%	15.0%	
1%	393	330	289	
2%	422	346	299	
3%	458	365	311	

Source: BRICS Research

**Exhibit 7: SoTP based target price of Gail (Rs mn)**

Particulars	Valuation (Rs mn)	Per share (Rs)
GAIL standalone	462,836	365
<b>Investments</b>		
ONGC	42,559	34
Petronet LNG	10,266	8
GIPCL	27	0
IGL	5,576	4
Other	14,975	12
<b>Total</b>	<b>536,238</b>	<b>423</b>

Source: BRICS Research

#### BRICS RECOMMENDATION SCALE

<b>BUY:</b>	More than 15% upside
<b>ADD:</b>	Upside up to 15% (between 0% and 15%)
<b>REDUCE:</b>	Downside up to 15% (between 0% and -15%)
<b>SELL:</b>	More than 15% downside

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