

OIL AND GAS

Diesel price hike a bold step

India Equity Research | Oil, Gas and Services



In response to burgeoning fuel under-recovery and threat of a sovereign downgrade, the government has finally (a) hiked prices of diesel by INR 5/lt (12%) which includes an excise duty hike of INR 1.5/lt, (b) capped LPG cylinders to 6 per household, and (c) cut excise duty on petrol by INR 5.3/lt. At current prices of crude and USDINR, we see this leading to a reduction in under-recovery by INR224bn to INR1.67tn in FY13 and by INR431bn to INR1.75tn in FY14. We estimate GOI finances to improve by INR257bn. We believe that under-recoveries still remain high and govt. may share only 55% and upstream 40%. Maintain 'BUY' on ONGC and all three OMCs, noting that HPCL is the most levered to lower subsidies.

Under-recovery in FY13/14 to be INR1.7tn, GOI benefit INR257bn

Diesel: Diesel prices have been hiked by INR 5/lt (12.1%), of which excise duty hike is INR 1.5/lt. Thus, under-recovery run-rate will fall by only INR 3.1/lt to INR 13.1/lt.

Petrol: While petrol prices have not been hiked, excise duty has been cut by INR 5.3/lt, almost removing the current under-recovery on petrol of INR 6/lt.

LPG: LPG consumption has been capped at 6 per household. For the rest of FY13, consumers can get only 3 more cylinders at subsidised rates, and any additional cylinder will have to be procured at market rates (currently at INR747/cyl, and to be notified monthly). This will bring down under-recovery from INR380/cyl to INR253/cyl.

Total under-recovery in FY13 will come down from INR1.89tn to INR1.67tn at current prices (INR1.38tn in FY12), while in FY14 it will come down from INR2.18tn to INR1.75tn.

Government finances will improve due to a) hike in excise duty on diesel by INR132bn, b) lower government subsidy sharing to the extent of INR237bn (at current crude prices and USDINR, and assuming 55% govt. sharing). This will be partly offset by a cut in excise duty on petrol by INR112bn, leading to a net benefit of INR257bn.

Fuel price hike expectation plays out; Wait for a correction in crude

Rise in crude prices, recent surge in diesel cracks (due to US hurricane and Venezuelan refinery fire), and rising diesel consumption growth at ~10% YoY (vs. 8% earlier) due to petrol-diesel price distortion and poor power supplies meant a price hike was imminent. Diesel prices are now pegged at Brent crude of USD80-85/bbl while petrol prices are pegged at Brent crude of USD115/bbl. Our 'BUY' rating on ONGC, IOCL, BPCL and HPCL was based on expectation of a) increase in fuel prices, and b) correction in crude prices. While the former has played out today, we still expect crude prices to correct (despite today's QE3) as demand growth remains weak and non-OPEC supplies increase. A fall in diesel cracks to more normal levels can also bring down under-recoveries. We maintain our earnings estimates for ONGC and OMCs, while noting that ONGC's EPS may see a marginal increase if crude corrects or INR appreciates. Maintain 'BUY' on ONGC and all three OMCs, noting that HPCL is the most levered to lower subsidies.

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Table 1: Fuel-wise under-recovery: Diesel under-recovery run-rate after hike still remains high at INR 13/lt

	FY13 YTD	Runrate before hike	Runrate after hike	FY13 old avg	FY13 new avg
MS under-recovery (INR/lt)	3.1	5.3	0.0	4.3	1.4
HSD under-recovery (INR/lt)	11.8	16.1	13.0	14.2	12.5
SKO under-recovery (INR/lt)	29.6	32.5	32.5	31.2	31.2
LPG under-recovery (INR/cyl)	316	380	253	351	282

Source: Edelweiss research

Table 2: Under-recovery down by INR 224bn in FY13 and INR 431bn in FY14 (at current levels of crude and USDINR)

	FY12	FY13E old	FY13E new	Reduction in FY13 u/r	FY14 old	FY14 new	Reduction in FY14 u/r
MS consumption (bn lt)	20.3	21.1	21.1		22.1	22.1	
HSD consumption (bn lt)	76.8	85.2	85.2		89.4	89.4	
SKO consumption (bn lt)	10.4	9.2	9.2		8.7	8.7	
LPG consumption (bn cyl)	1.1	1.1	1.1		1.2	1.2	
MS under-recovery (INR/lt)	NA	4.3	1.4	2.9	5.3	0.0	5.3
HSD under-recovery (INR/lt)	10.6	14.2	12.5	1.7	16.1	13.0	3.1
SKO under-recovery (INR/lt)	26.4	31.2	31.2	0.0	32.5	32.5	0.0
LPG under-recovery (INR/cyl)	277	351	282	69	380	253	127
MS under-recovery (INR bn)	NA	NA	NA		NA	NA	
HSD under-recovery (INR bn)	812	1,206	1,061	144	1,443	1,165	278
SKO under-recovery (INR bn)	274	286	286	0	283	283	0
LPG under-recovery (INR bn)	300	403	324	79	458	306	153
Total Under-recovery (INR bn) *	1,385	1,895	1,671	224	2,185	1,754	431

* Total under-recovery excludes MS (petrol)

Source: Edelweiss research

Table 3: Government finances to improve by INR257bn for the full year

Measure	Full year impact (INR bn)
Reduction in excise on Petrol by INR 5.3/lt	(112)
Increase in excise on Diesel by INR 1.5/lt	132
55% share of under-recovery reduction	237
TOTAL impact on GOI finances (INR bn)	257

Source: Edelweiss research



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Recent Research

Date	Company	Title	Price (INR)	Recos
11-Sep-12	Gujarat State Petronet	Tariff cut in line with our expectations; <i>EdelFlash</i>		
05-Sep-12	Oil & Gas	Tight supply fuels GRM surge; <i>Monthly Update</i>		
17-Aug-12	Reliance Industries	Refining: Positive longer-term view; <i>Company Update</i>	816	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	104	60	18	183
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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