3QFY06 Results Update
SECTOR: OIL & GAS

BPCL

STOCK INFO.	BLOOMBERG
BSE Sensex: 9,920	BPCL IN
	REUTERS CODE
S&P CNX: 3,001	BPCL.BO

Equity Shares (m)	300.0
52-Week Range (Rs)	470/340
1,6,12 Rel. Perf. (%)	-10/-17/-54
M.Cap. (Rs b)	124.3
M.Cap. (US$ b)	2.8

31 January 2006

Buy

Previous Recommendation:Buy

Rs414

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/05A	644,268	15,411	51.4	-24.2	8.1	1.6	21.6	29.2	0.4	4.6
03/06E	796,928	14,270	47.6	-7.4	8.7	1.4	17.5	25.1	0.3	4.5
03/07E	584,276	19,298	64.3	35.2	6.4	1.3	21.3	32.4	0.4	3.3

**Consolidated Nos*

- BPCL reported net losses of Rs10.2b as against a Rs1.5b profits last year. Results disappointed primarily on account of non-payment of Government share of fuel marketing losses, despite Parliament approval for the same. Mounting fuel marketing losses, lower than expected refining margins and inventory losses were the drivers of poor performance, despite higher crude thruput.
- Fuel marketing (gross) losses were up 20.1% YoY Rs21.8b. Net losses (post upstream share of Rs7.25b and refinery discount of Rs0.7b) at Rs13.8b was up 38.6% YoY. Inventory losses (on crude and products) were Rs4b as against Rs1b last year.
- Refining margin at US$0.66/bbl disappointed as the new hydrocracker facility (commissioned in 2QFY06) could not stabilise operations and pulled down distillate yield by over 5%, impacting GRM significantly.
- While crude thruput at 2.9m tons was up 31.8% YoY on the back of capacity expansion, market sales at 5.5m tons was up just 1.7% YoY, thanks to YoY decline in diesel demand as well as falling market share.
- We believe hydrocracker stabilisation would improve GRM significantly over the next two quarters. We expect payment of Government share of fuel marketing losses (of Rs115b for the industry) in 4QFY06, would allow OMCs to report profits close to FY05 levels. Stock trades at a P/E of 6.4x and P/BV of 1.3x FY07 estimates. We maintain **Buy.**

QUARTERLY PERFORMANCE (STANDALONE) (Rs Million)

Y/E MARCH	FY05				FY06				FY05	FY06E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Gross Sales	**145,639**	**147,764**	**173,795**	**171,372**	**171,185**	**172,651**	**201,569**	**242,413**	**638,570**	**787,818**
Change (%)	*18.2*	*22.7*	*26.3*	*11.8*	*-1.5*	*0.7*	*-58.4*	*-54.6*	*19.5*	*23.4*
Raw Material Consumed	27,493	34,732	36,964	38,339	35,794	39,334	55,486	55,779	137,528	186,393
Staff Cost	1,871	1,601	1,443	2,632	1,818	1,655	1,687	2,417	7,932	7,577
Fininshed Goods Purchase	90,886	95,663	108,623	112,255	109,992	126,484	125,867	127,092	407,427	489,435
Other Exp (incl Stock Adj)	21,540	11,062	23,461	13,283	21,245	22,060	22,733	24,090	69,346	90,128
EBITDA	**3,849**	**4,706**	**3,304**	**4,863**	**-3,203**	**-1,590**	**-9,105**	**28,182**	**16,337**	**14,284**
Change (%)	*-29.9*	*-37.1*	*-60.5*	*-30.7*	*-183.2*	*-133.8*	*-375.6*	*479.5*	*-42.4*	*-12.6*
% of Net Sales	*2.6*	*3.2*	*1.9*	*2.8*	*-1.9*	*-0.9*	*-4.5*	*11.6*	*2.6*	*1.8*
Depreciation	1,536	1,625	1,387	1,412	1,525	1,483	1,433	1,521	5,960	5,962
Interest	226	377	379	416	404	378	585	366	1,398	1,733
Other Income	548	2,007	602	1,427	826	1,458	907	793	4,584	3,984
PBT	**2,635**	**4,711**	**2,140**	**4,462**	**-4,306**	**-1,993**	**-10,216**	**27,087**	**13,563**	**10,572**
Tax	777	1,497	683	948	7	37	27	3,230	3,905	3,301
Rate (%)	*29.5*	*31.8*	*31.9*	*21.2*	*-0.2*	*-1.9*	*-0.3*	*11.9*	*28.8*	*31.2*
PAT	**1,858**	**3,214**	**1,457**	**3,514**	**-4,313**	**-2,030**	**-10,243**	**23,858**	**9,658**	**7,271**
Change (%)	*-41.8*	*-32.6*	*-69.9*	*-15.1*	*-332.1*	*-163.2*	*-803.1*	*578.9*	*-43.0*	*-24.7*

E: MOSt Estimates

Varatharajan S (Varatharajan@MotilalOswal.com); Tel: +91 22 3982 5413

BPCL reported net losses of Rs10.2b as against a Rs1.5b profits last year. Results disappointed primarily on account of non-payment of Government share of fuel marketing losses, despite Parliament approval for the same. Mounting fuel-marketing losses, lower than expected refining margins and inventory losses were the drivers of poor performance, despite higher crude thruput.

Fuel marketing losses continue to hurt

Fuel marketing losses were up 20.1% YoY at Rs21.8b for the quarter, thanks to higher crude prices and addition of petrol /diesel to loss making fuel list. However, 1/3rd sharing by upstream players and product price discounts from standalone refiners cushioned losses.

Upstream players paid Rs7.25b towards their share of losses, product price discounts from standalone (external) refiners was Rs0.7b. Adjusting for these contributions, BPCL's burden was Rs13.8b, up 38.6% YoY.

Going forward, we expect Government's sharing of 1/3rd losses to provide a huge relief. Crude prices continue to be a critical factor and possible weakness could turn marketing margins positive.

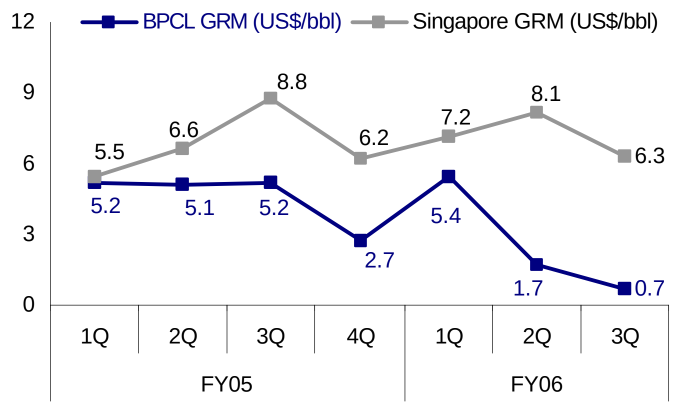
BPCL recorded an inventory loss of Rs4b in 3QFY05, adding to the large fuel marketing losses, thanks to the sequential drop in crude prices.

Refining margins suffer

Refining margins were down sharply at just US$0.66/bbl compared to US$5.2/bbl last year, as the new hydrocracker commissioned in 2QFY06 could not stabilize, pulling down yield by over 5%, seriously denting the refining margins. Drop in regional refining margins too were a key factor, apart from the product price discounts. Singapore refining margins were down at US$6.3/bbl as compared to US$8.8/bbl last year. BPCL refinery gave a discount of about US$1.8/bbl. Also, YoY comparison with 3QFY05 would also be impacted by the tariff cuts effected over the last one year, though impact would be minimal. We expect hydrocracker stabilization over the next few months to lead to GRMs better than pre-2QFY06 levels (adjusting for discounts!).

We expect Asian refining margins to bounce back as Global refining fundamentals continue to remain robust, with limited capacity additions and strong demand growth. With the new secondary processing units allowing it to process heavier and sour crudes, BPCL is in a good position to leverage the expected regional refining margin strength. Expansion of capacity from 9 to 12m ton too would contribute to refining earnings growth.

QUARTERLY REFINERY-WISE MARGIN TREND (US$/BBL)



Source: Company/Motilal Oswal Securities

Crude thruput up on the back of expansion

Crude thruput was up YoY at 2.1m ton as against 2.3m ton in 2QFY06, due to shutdown for expansion. This is set to further rise to about 3m tons per quarter. However, market sales at 5.5m tons was up just 1.7% YoY, thanks to YoY decline in diesel demand as well as falling market share. Reliance has emerged as a key competitor, with 10-11% market share.

QUARTERLY REFINERY THRUPUT (M TON)

Source: Company/Motilal Oswal Securities

REVISED ESTIMATES (RS M)

	FY06E			FY07E		
	OLD	NEW	CH.(%)	OLD	NEW	CH.(%)
EBITDA	37,202	35,117	-5.9	42,804	42,708	-0.2
Net Profit	15,652	14,270	-9.7	19,362	19,298	-0.3
Change (%)	*52.2*	*47.6*		*64.5*	*64.3*	

Source: Company/Motilal Oswal Securities

Key takeaways from conference call

BPCL-KRL merger now requires only court and DCA approvals, which are just procedural requirements. Merger has been approved by shareholders of both companies and no hiccups are likely. BPCL's shares in KRL would not be cancelled and would be held as treasury stock. The merger would be effective April 2004.

Capex over the next 3 years include Kochi refinery modernization/expansion (by 2m tons) and SBM totalling Rs.30b, extension of pipeline from Indore to Delhi and Bina refinery, which awaits financial closure.

Refinery discount was US$1.8/bbl in 3QFY06.

BPCL has tied up with GAIL for city gas distribution in Maharashtra ex-Mumbai and Lucknow. It is also in the process of expanding its JV with GSPC in Gujarat outside Ahmedabad.

The recent discussions on export-parity pricing for surplus petroleum products is unlikely to materialize as it is unviable, given the overwhelming import dependence for crude oil.

Downgrading FY06 estimate

We are downgrading FY06 estimate by 9% to reflect the poor refining performance in 3QFY06 and continuing poor marketing margins in 4QFY06.

Government sharing of losses a huge positive

Parliament approval for Rs57.5b of additional grant towards compensation for fuel marketing losses is already in place, though delay in working out the structure of the oil bonds led to non-payment of the same in 3QFY06. Oil companies expect payment of Rs115b, in 4QFY06, which would enable them to return profits close to last year reported numbers.

Policy initiatives could address fuel marketing losses

A committee headed by C.Rangarajan, is currently studying the pricing and tariff structure in the oil sector, whose recommendations are expected to address the fuel marketing loss issue comprehensively. We expect a combination of pricing and tariff restructuring initiatives would bring substantial benefit for oil marketing companies and could possibly remove fuel marketing losses from the books of oil companies, though the timing and implementation of the policies is fraught with political pitfalls.

Valuation and view

The stock is trading at 6.4x FY07E earnings and 1.3x FY07E book value. We believe negatives are already in the price, while cheap asset valuation would provide downside support. Policy initiatives to address fuel-marketing losses would drive both earnings growth and re-rating of the stock, delivering large upside. We maintain **Buy**.

BPCL: an investment profile

Company description

Fortune 500 company, it is the second largest oil marketing company in India, with a refining capacity of 9m ton at Mumbai and a product sale of over 20.5m ton. It is in the process of merging its refining subsidiary Kochi Refineries with itself. Kochi Refineries owns 7.5m ton of refining capacity. BPCL also has a majority stake (63%) in Numaligarh Refineries, a 3m ton refinery in the North East

Key investment arguments

- Government has announced that it would bear 1/3rd of fuel marketing losses along with standalone refiners. This loss sharing would enable oil marketing companies to turn profitable.
- Policy risk more than priced in. Valuations continue to reflect highly pessimistic earnings expectation.

Key investment risks

- Continued increase in crude prices, along with non-revision of retail prices of controlled products.
- Loss of market share to private players.

Recent developments

- Parliament approval for Rs57.5b of additional grant towards compensation for fuel marketing losses has already been granted.
- Standalone refiners are sharing a part of the loss burden.

Valuation and view

- Valuations at 6.4x FY07E EPS are moderate.
- We maintain **Buy.**

Sector view

- Refining margins are on an upswing due to improved fundamentals, globally. We expect the upcycle to continue, at least over the next 18 months.

COMPARATIVE VALUATIONS

		BPCL	HPCL	IOC
P/E (x)	FY06E	8.7	11.3	10.5
	FY07E	6.4	6.1	7.1
P/BV (x)	FY06E	1.4	1.2	1.7
	FY07E	1.3	1.1	1.4
EV/Sales (x)	FY06E	0.3	0.2	0.3
	FY07E	0.4	0.1	0.4
EV/EBITDA (x)	FY06E	4.5	6.1	6.7
	FY07E	3.3	3.1	4.5

EPS: INQUIRE FORECAST VS CONSENSUS (RS)

	INQUIRE FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY06	47.6	30.3	57.0
FY07	64.3	42.8	50.2

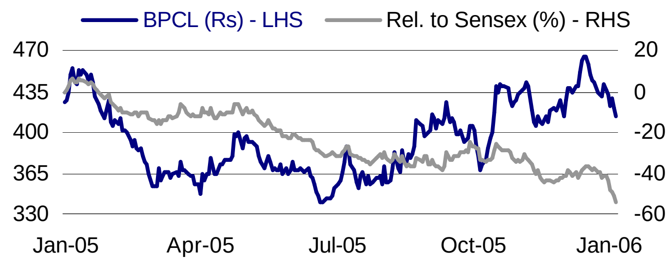
TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
414	-	-	Buy

SHAREHOLDING PATTERN (%)

	DEC.05	SEP.05	DEC.04
Promoters	66.2	66.2	66.2
Domestic Institutions	14.1	13.4	16.2
FIIs/FDIs	16.8	17.3	14.1
Others	2.9	3.1	3.5

STOCK PERFORMANCE (1 YEAR)



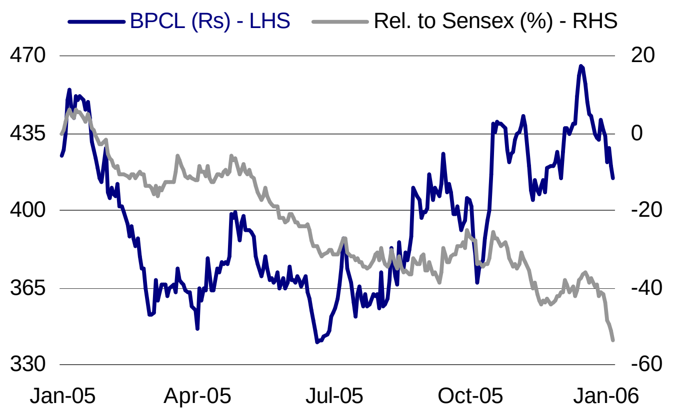
INCOME STATEMENT					(Rs Million)
Y/E MARCH	**2003**	**2004**	**2005**	**2006E**	**2007E**
Net Sales	**499,517**	**549,957**	**644,268**	**796,928**	**584,276**
Change (%)	*21.8*	*10.2*	*19.5*	*23.4*	*-31.7*
Total Income	**499,519**	**549,960**	**644,272**	**796,933**	**584,281**
Finished Gds Purchase	243,562	267,525	286,850	399,838	255,087
Raw Materials Cons	183,127	201,812	286,956	304,453	243,015
Duties, Taxes, etc	34,510	35,430	33,009	57,520	43,466
EBITDA	**38,319**	**45,190**	**37,453**	**35,117**	**42,708**
% of Net Sales	*7.7*	*8.2*	*5.8*	*4.4*	*7.3*
Depreciation	7,362	8,245	8,806	8,819	7,582
Interest	4,911	2,577	2,495	2,885	1,785
Other Income	3,517	4,264	3,578	4,467	2,383
Extraordinary Items (net)	0	1,009	0	0	0
PBT	**29,410**	**37,624**	**29,730**	**27,880**	**35,723**
Tax	11,186	13,980	8,998	9,353	11,862
Rate (%)	*38.0*	*37.2*	*30.3*	*33.5*	*33.2*
Minority Interest	2,697	3,305	5,321	4,256	4,563
PAT	15,527	20,339	15,411	14,270	19,298
Adjusted PAT	**15,527**	**21,348**	**15,411**	**14,270**	**19,298**
Change (%)	*66.8*	*37.5*	*-27.8*	*-7.4*	*35.2*

BALANCE SHEET					(Rs Million)
Y/E MARCH	**2003**	**2004**	**2005**	**2006E**	**2007E**
Share Capital	3,000	3,000	3,000	3,000	3,000
Reserves	48,153	62,577	74,308	82,946	92,552
Net Worth	**51,153**	**65,577**	**77,308**	**85,946**	**95,552**
Equity	3,350	3,350	3,350	2,725	2,725
Reserves	6,816	9,013	12,198	16,860	20,784
Minority interest	**10,166**	**12,363**	**15,548**	**19,584**	**23,509**
Loans	58,187	47,023	67,325	57,681	44,958
Deferred Tax	12,268	14,442	17,257	20,216	23,590
Capital Employed	**131,774**	**139,404**	**177,437**	**183,428**	**187,609**
Gross Fixed Assets	149,879	161,542	172,966	206,346	220,293
Less: Depreciation	57,549	65,572	73,950	82,630	89,945
Net Fixed Assets	**92,330**	**95,970**	**99,016**	**123,717**	**130,349**
Capital WIP	13,504	19,067	28,587	12,994	11,994
Investments	700	662	4,348	7,041	2,315
Curr. Assets, L & Adv.					
Inventory	54,894	57,423	63,109	56,836	52,120
Debtors	14,443	14,711	20,667	21,277	15,988
Cash & Bank Balance	19,514	16,180	20,190	22,618	30,213
Loans & Advances	27,956	28,957	31,452	32,713	32,149
Current Liab. & Prov.					
Liabilities	81,165	80,449	80,937	86,223	76,966
Provisions	10,403	13,117	8,994	7,546	10,554
Net Current Assets	**25,241**	**23,705**	**45,487**	**39,676**	**42,951**
Application of Funds	**131,774**	**139,404**	**177,437**	**183,428**	**187,609**

E: MOSt Estimates

RATIOS					
Y/E MARCH	**2003**	**2004**	**2005**	**2006E**	**2007E**
Basic (Rs)					
EPS	**51.8**	**67.8**	**51.4**	**47.6**	**64.3**
Cash EPS	76.3	98.6	80.7	77.0	89.6
Book Value	170.5	218.6	257.7	286.5	318.5
Dividend	15.0	17.5	12.0	14.0	22.0
Valuation (x)					
P/E		6.1	8.1	8.7	6.4
Cash P/E		4.2	5.1	5.4	4.6
EV/EBITDA		3.4	4.6	4.5	3.3
EV/Sales		0.3	0.3	0.2	0.2
Price/Book Value		1.9	1.6	1.4	1.3
Dividend Yield (%)		4.2	2.9	3.4	5.3
Profitability Ratios (%)					
RoE	33.7	34.8	21.6	17.5	21.3
RoCE	38.4	44.3	29.2	25.1	32.4
Turnover Ratios					
Debtors (No. of Days)	8	6	6	7	7
Asset Turnover (x)	2.8	2.7	3.1	3.7	2.6
Leverage Ratio					
Debt/Equity (x)	1.1	0.7	0.9	0.7	0.5

STOCK PERFORMANCE (1 YEAR)



For more copies or other information, contact
Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari
Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

Disclosure of Interest Statement	BPCL
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

MOSt is not engaged in providing investment-banking services.