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UPDATE

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Surprise, surprise. The recent Government action on (1) increasing prices and (2) reducing taxes on certain fuels will result in lower gross under-recoveries of ₹420 bn for FY2012E. Upstream companies would stand to benefit the most from the lower subsidy burden; we have revised our FY2012E and FY2013E EPS for upstream companies by 16-33% and 19-30%. The downstream companies will benefit moderately from higher tariff protection (5-11% EPS increase for both FY2012E and FY2013E); their net under-recoveries on fuels are unchanged in our models resulting in more muted impact on their earnings. However, investment sentiment will improve markedly.

Lower gross under-recoveries is a large positive for the sector

We are pleasantly surprised by the Government's decision to (1) increase retail prices of diesel (₹3/liter), LPG (₹50/cylinder) and kerosene (₹2/liter), (2) reduce import tariffs on crude oil (to 0% from 5.15%), diesel and gasoline (to 2.6% from 7.7% previously) and other petroleum products (to 5.2% from 10.3%) and (3) reduce excise duty on diesel by ₹2.6/liter. We see the announced changes as positive for the sector as the move will result in lower gross under-recoveries and more important, it shows the government's willingness to take tough decisions on fuel reforms. We now estimate FY2012E gross under-recoveries at ₹910 bn from versus ₹1.33 tn previously; please see our related report of June 25, 2011 titled *A bold and generous move*.

Upstream companies to benefit significantly from lower gross under-recoveries

We have revised our FY2012E and FY2013E EPS estimates by 16-33% and 19-30% for the upstream companies (ONGC, OIL and GAIL) due to lower subsidies resulting from lower overall gross under-recoveries, which would more than offset lower import tariffs on crude oil (0% versus 5.15% previously). Also, we see large upside risks to our earnings estimates if the Government was to revert to 33.33% share for the upstream companies; we assume 39% for FY2012-14E.

Downstream companies to benefit too from higher tariff protection and sentiment

We have revised our FY2012E and FY2013E EPS estimates by 5-11% for the downstream companies (BPCL, HPCL and IOCL) due to higher refining margins from higher tariff protection. We continue to assume that they will bear net under-recoveries of ₹74 bn for FY2012-13E and thus, there is no net impact of the aforementioned changes that result in lower gross under-recoveries. More important, we expect investment sentiment to improve due to enhanced earnings visibility.

Large potential upside to revised 12-month target prices on higher earnings

We maintain our BUY rating on ONGC and upgrade OIL to BUY from ADD previously. We maintain our ADD rating on BPCL, HPCL, IOCL and GAIL. We highlight 36-37% potential upside to our revised 12-month target prices of ONGC (₹370; ₹340 previously) and OIL (₹1,760; ₹1,515 previously), 27% upside in case of GAIL (₹570; ₹525 previously) and 26-29% potential upside in the case of the downstream companies. Exhibit 1 gives our earnings revisions for FY2012-14E.

Standalone refiners to benefit modestly from high tariff protection

We see a modest positive impact on refining margins given higher tariff protection (see Exhibit 2) from the announced changes in customs duty on crude oil and products. We note that there is no import tariff on kerosene and LPG currently while the import tariffs on other products and crude oil have been cut by 5%, which will result in higher tariff protection for the refiners.

QUICK NUMBERS

- ₹910 bn of gross under-recoveries for FY2012E, down ₹420 bn versus previous estimates
- 36-37% potential upside for ONGC and OIL from current levels
- 26-29% potential upside for BPCL, HPCL and IOCL from current levels

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Upstream companies to benefit significantly from likely lower subsidy burden
Revision in EPS estimates, March fiscal year-ends, 2012-14E (Rs)

	2012E			2013E			2014E		
	Old EPS	New EPS	Change (%)	Old EPS	New EPS	Change (%)	Old EPS	New EPS	Change (%)
Downstream companies									
BPCL	42	46	10	54	60	11	62	68	9
HPCL	29	33	11	39	44	11	37	43	16
IOCL	30	32	5	35	37	5	38	40	3
Upstream companies									
GAIL India	34	40	16	35	41	19	46	48	3
Oil India	141	187	33	148	191	30	180	188	4
ONGC	31	40	28	31	40	27	40	40	1

Source: Kotak Institutional Equities estimates

Tariff protection has increased from the removal of import duties on crude oil
Import tariffs on oil products, March fiscal year-ends, 2005-2012E (%)

	2005	2006	2007	2008	2009	2010	2011	Jun-11	2012E
LPG	6.6	—	—	—	—	—	—	—	—
Gasoline	16.7	10.2	8.1	7.7	3.4	3.0	7.7	2.6	3.8
Naphtha	7.6	4.7	—	—	—	—	—	—	—
Kerosene	6.6	—	—	—	—	—	—	—	—
ATF	19.4	10.2	10.2	10.3	3.9	—	—	—	—
Diesel	16.7	10.2	8.1	7.7	3.4	3.0	7.7	2.6	3.8
FO	19.4	10.2	10.2	10.3	6.0	5.6	10.3	5.2	6.3
Bitumen	19.4	10.2	10.2	10.3	6.0	5.6	10.3	5.2	6.3
Weighted average import duty	14.5	7.9	6.2	6.1	2.9	2.5	5.7	2.2	3.0
Duty on crude	10.2	5.1	5.1	5.2	—	0.4	5.2	—	1.2
Tariff differential	4.4	2.8	1.1	0.9	2.9	2.1	0.5	2.2	1.8

Source: Kotak Institutional Equities estimates

Key assumption behind earnings estimates

- ▶ **Gross under-recoveries.** We estimate gross under-recoveries at ₹910 bn for FY2012E and ₹485 bn for FY2013E assuming (1) crude oil price assumption of US\$105/bbl for FY2012E and US\$95/bbl for FY2013E and (2) no change in retail prices from current levels (post the June 24, 2011 changes). The lower gross under-recovery for FY2013E versus in FY2012E reflects our lower crude oil price assumption of US\$95/bbl for FY2013E versus US\$105/bbl for FY2012E.
- ▶ **Net under-recoveries for downstream companies.** We continue to assume the net under-recoveries for downstream companies at ₹74 bn for FY2012E and FY2013E versus ₹69 bn in FY2011 and ₹56 bn in FY2010. We assume that the government will provide sufficient compensation to protect the earnings of the downstream companies. Exhibit 3 gives our assumed breakdown of subsidies for FY2012-13E.

Share of under-recoveries of various participants, March fiscal year-ends, 2007-13E (₹ bn)							
	2007	2008	2009	2010	2011	2012E	2013E
Dated Brent crude oil price (US\$/bbl)	65	79	89	67	84	105	95
Gross under-recoveries	521	798	1,061	490	814	910	485
Payment by government (direct budgetary support)	27	27	29	30	32	31	31
Payment by government (oil bonds/cash)	241	353	713	260	410	462	229
Share of BPCL	53	86	162	53	94	105	52
Share of HPCL	49	77	147	56	90	101	50
Share of IOCL	138	190	404	152	227	256	127
Receipt from upstream companies	205	257	329	144	303	343	152
Share of ONGC	170	220	282	116	249	287	125
Share of GAIL	15	14	18	13	21	19	10
Share of Oil India	20	23	29	15	33	37	16
Net under-recovery of OMCs	48	161	(10)	56	69	74	74

Source: Company, Kotak Institutional Equities estimates

- **Share of upstream companies.** We assume upstream companies will bear 39% of the gross under-recoveries for FY2012-14E. This is in line with the subsidy borne by upstream companies in FY2011. We expect net crude oil price realization of ONGC and OIL to increase sharply in FY2012E versus FY2011 levels due to significantly higher global crude oil prices (US\$105/bbl versus US\$84/bbl in FY2011) and similar subsidy amounts in these two years. Exhibits 4 and 5 give our key assumptions behind the earnings model of ONGC and OIL.

Key assumptions for ONGC, March fiscal year-ends, 2007-2014E

	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Macro assumptions								
Rs/US\$ rate	45.3	40.3	45.8	47.4	45.6	45.5	44.0	44.0
Subsidy share scheme loss (Rs bn)	170.2	220.0	282.3	115.5	248.9	286.9	146.4	119.9
Import tariff on crude oil (%)	5.1	5.2	0.9	0.4	5.2	1.2	—	—
Pricing and volumes assumptions								
Crude price								
Crude price, Bonny Light (US\$/bbl)	64.8	78.9	83.0	67.1	84.0	105.0	95.0	90.0
Net crude price, ONGC-India (US\$/bbl)	46.1	52.9	47.7	55.9	53.8	62.9	72.6	72.0
Natural gas price								
Ceiling natural gas price, India (Rs/cu m)	3.20	3.20	3.20	3.20	6.78	7.50	7.50	7.50
Ceiling natural gas price, India (US\$/mn BTU)	1.89	2.12	1.87	1.80	3.98	4.41	4.56	4.56
International operations								
Net natural gas price, OVL-Vietnam (Rs/cu m)	3.2	2.8	3.2	3.3	3.2	3.2	3.1	3.1
Net crude price, OVL-Sudan (Rs/ton)	9,384	10,142	12,136	10,173	12,223	18,730	16,401	15,545
Net crude price, OVL-Russia (Rs/ton)	14,985	16,231	19,433	16,253	19,573	24,413	21,360	20,236
Sales volumes—Domestic fields								
Crude oil - own fields (mn tons)	22.6	22.3	21.2	20.5	20.4	20.2	20.6	21.0
Crude oil - JV (mn tons)	1.8	1.8	1.7	1.8	2.6	3.8	4.6	4.6
Natural gas - own fields (bcm)	17.9	17.8	17.7	18.1	18.2	18.5	18.8	18.8
Natural gas - JV (bcm)	2.4	2.7	2.8	2.5	2.0	2.2	2.0	1.9
Sales volumes—Overseas fields								
Crude oil (mn tons)	5.8	6.8	6.6	6.5	6.8	7.7	8.3	8.8
Natural gas (bcm)	2.1	2.0	2.2	2.4	2.7	2.7	2.9	3.0
Total sales								
Crude oil (mn tons)	30.2	30.9	29.4	28.8	29.7	31.6	33.5	34.4
Natural gas (bcm)	22.5	22.4	22.8	23.0	22.9	23.4	23.7	23.6
Total sales (mn toe)	50.3	50.9	49.8	49.3	50.1	52.5	54.6	55.5
Total sales (mn boe)	367	372	363	360	366	384	399	405
Crude oil (%)	60	61	59	58	59	60	61	62
Natural gas (%)	40	39	41	42	41	40	39	38

Source: Company, Kotak Institutional Equities estimates

Key assumptions for OIL, March fiscal year-ends, 2007-2014E

	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Rs/US\$ rate	45.3	40.3	45.8	47.4	45.6	45.5	44.0	44.0
Subsidy share scheme loss (Rs mn)	19,938	23,051	30,233	15,488	32,931	37,023	19,122	15,753
Import tariff on crude oil (%)	5.1	5.2	0.9	0.4	5.2	1.2	—	—
Crude/natural gas prices								
Crude price								
Crude price, Bonny Light (US\$/bbl)	64.8	78.9	83.0	67.1	84.0	105.0	95.0	90.0
Net crude price, OIL-India (US\$/bbl)	47.0	59.8	55.6	56.2	58.5	76.2	79.9	77.9
Natural gas price								
Ceiling natural gas price, India (Rs/cu m)	3.20	3.20	3.20	3.20	6.78	7.50	7.50	7.50
Ceiling natural gas price, India (US\$/mn BTU)	1.89	2.12	1.87	1.80	3.98	4.41	4.56	4.56
Net natural gas price, OIL-India (Rs/cu m)	2.88	2.88	2.88	2.88	5.49	6.07	6.07	6.07
Net natural gas price, OIL-India (US\$/mn BTU)	1.70	1.91	1.68	1.62	3.22	3.56	3.69	3.69
Sales volumes—Domestic fields								
Crude oil (mn tons)	3.0	3.0	3.4	3.5	3.6	3.7	3.8	3.8
Natural gas (bcm)	1.8	1.8	1.7	1.9	1.8	2.0	2.4	2.7
Total sales (mn toe)	4.6	4.7	4.9	5.2	5.2	5.5	5.9	6.3
Total sales (mn boe)	34	35	37	39	39	41	44	47
Crude oil (%)	66	65	68	68	69	67	64	61
Natural gas (%)	34	35	32	32	31	33	36	39

Source: Company, Kotak Institutional Equities estimates

- **Exchange rate assumption.** We model the exchange rates for FY2012E, FY2013E and FY2014E at ₹45.5/US\$, ₹44/US\$ and ₹44/US\$.

Fair valuation of OMCs (₹)

BPCL		HPCL		IOCL	
Profit after tax (Rs mn)	21,692	Profit after tax (Rs mn)	14,761	Profit after tax (Rs mn)	88,201
Less: income from investments valued separately (Rs mn)	1,458	Less: income from investment valued separately (Rs mn)	454	Less: income from investment valued separately (Rs mn)	9,513
Adjusted profit after tax (Rs mn)	20,234	Adjusted profit after tax (Rs mn)	14,307	Adjusted profit after tax (Rs mn)	78,688
Adjusted EPS	56	Adjusted EPS	42	Adjusted EPS	32
P/E multiple (X)	10	P/E multiple (X)	9	P/E multiple (X)	10
Fair value on P/E (without value of investments) (A)	560	Fair value on P/E (without value of investments) (A)	380	Fair value on P/E (without value of investments) (A)	324
Add: Value of investments (Rs mn)	87,941	Add: Value of investments (Rs mn)	39,524	Add: Value of investments (Rs mn)	271,463
<i>KRL treasury shares</i>	26,983	<i>MRPL (Rs50/share)</i>	14,858	<i>Oil and Natural Gas Corp.</i>	197,377
<i>Numaligarh</i>	13,606	<i>HPCL-Mittal Energy (Book value)</i>	12,265	<i>Chennai Petroleum Corp.</i>	16,998
<i>Indraprastha Gas</i>	8,442	<i>Oil India</i>	9,363	<i>Gas Authority of India</i>	13,967
<i>Oil India Ltd</i>	9,363	<i>Other unquoted investments</i>	3,039	<i>Oil India Ltd.</i>	14,980
<i>Petronet LNG</i>	7,875	Value of investments (Rs) (B)	117	<i>IOC treasury shares (IBP Co.)</i>	13,450
<i>Other equity</i>	21,672	Total equity value (A) + (B)	496	<i>Petronet LNG Ltd.</i>	7,875
Value of investments (Rs) (B)	243			<i>Other equity</i>	6,815
Total equity value (A) + (B)	803			Value of investments (Rs) (B)	112
				Total equity value (A) + (B)	436
Current stock price	635	Current stock price	393	Current stock price	337
KIE target price	800	KIE target price	500	KIE target price	435
Potential upside (%)	26	Potential upside (%)	27	Potential upside (%)	29
KIE rating	ADD	KIE rating	ADD	KIE rating	ADD

Source: Kotak Institutional Equities estimates

Fair value of ONGC (₹/share)

FY2013E EPS	40
Less: income from investments valued separately	0
Adjusted EPS for FY2013E	40
P/E (X)	9
Valuation	356
Investments	16
Indian Oil Corp.	11
GAIL	4
Petronet LNG	1
Fair value	372

Source: Kotak Institutional Equities estimates

Fair value of OIL (₹/share)

FY2013E EPS	191
P/E (X)	9
Valuation	1,723
Investments	39
Numaligarh Refinery Limited	24
Other investments	16
Fair value	1,762

Source: Kotak Institutional Equities estimates

Sum-of-the-parts valuation of GAIL, FY2013E basis (₹)

	Valuation base (Rs bn)		Multiples (X)		EV (Rs bn)		EV (Rs/share)
	Other	EBITDA	Other	EV/EBITDA	Other	EBITDA basis	
Natural gas transportation							
HVJ pipeline	60				60		47
DV pipeline	49				49		38
DUPD pipeline	32				32		26
DBN pipeline	37				37		29
CGJH pipeline	21				21		17
DV GREP pipeline	203				203		160
DB pipeline	33				33		26
KBM pipeline	24				24		19
Short distance pipelines		6.2		7.0		43	34
Total natural gas transportation							396
Other businesses							
LPG transportation		3.8		6.0		23	18
LPG production		19.3		5.0		96	76
Petrochemicals		12.3		6.5		80	63
Oil and gas upstream	20		1.0		20		16
Total other business segments							173
Investments							
ONGC shares	77		0.8		62		49
Others	40		0.8		32		25
Investments	117		0.8		94		74
Total						242	643
Net debt/(cash)					92	92	72
Implied value of share (Rs/share)							570

Source: Kotak Institutional Equities estimates

Consolidated profit model, balance sheet, cash model of BPCL, March fiscal year-ends, 2007-2014E (₹ mn)

	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Profit model (Rs mn)								
Net sales	965,569	1,102,081	1,340,734	1,202,170	1,516,252	1,809,632	1,680,182	1,678,957
EBITDA	35,362	28,472	27,507	32,635	34,940	37,724	44,544	47,211
Other income	7,332	13,954	15,087	22,402	16,748	14,835	13,086	11,419
Interest	(4,774)	(6,725)	(22,699)	(10,110)	(11,008)	(10,073)	(7,428)	(4,711)
Depreciation	(9,041)	(10,982)	(10,755)	(12,423)	(16,554)	(17,880)	(18,091)	(17,690)
Pretax profits	28,879	24,719	9,141	32,505	24,126	24,606	32,111	36,228
Extraordinary items	(68)	—	—	(8,290)	—	—	—	—
Tax	(9,286)	(9,059)	(5,103)	(11,317)	(6,127)	(7,698)	(9,850)	(11,517)
Deferred taxation	(268)	(1,108)	2,421	3,033	(1,482)	(285)	(568)	(237)
Adjusted net profits	18,100	15,806	6,324	20,830	16,517	16,623	21,692	24,474
Earnings per share (Rs)	50.1	43.7	17.5	57.6	45.7	46.0	60.0	67.7
Balance sheet (Rs mn)								
Total equity	102,735	116,768	121,281	130,867	140,432	150,732	164,174	179,339
Deferred taxation liability	13,826	14,814	12,392	8,593	10,075	10,360	10,929	11,166
Total borrowings	108,292	150,224	211,714	221,952	189,719	146,719	97,505	53,005
Current liabilities	112,767	145,803	128,313	171,312	219,583	246,905	240,755	243,921
Total liabilities and equity	337,620	427,608	473,701	532,724	559,809	554,716	513,363	487,432
Cash	8,640	9,616	4,416	3,424	3,655	3,253	3,540	3,174
Current assets	127,698	187,457	148,469	232,416	272,259	286,183	270,116	268,338
Goodwill	—	—	—	—	—	—	—	—
Total fixed assets	118,334	127,354	140,033	161,871	170,116	176,501	175,928	175,377
Investments	82,949	103,182	180,784	135,013	113,780	88,780	63,780	40,543
Total assets	337,621	427,608	473,701	532,724	559,809	554,716	513,363	487,432
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	29,920	22,988	19,717	22,972	16,583	18,834	26,619	30,735
Working capital	11,451	(25,161)	20,585	(48,542)	8,119	13,397	9,917	4,944
Capital expenditure	(17,908)	(20,665)	(23,323)	(33,698)	(24,627)	(23,146)	(16,872)	(16,892)
Investments	(45,481)	(21,684)	(82,456)	35,270	21,234	25,000	25,000	23,237
Other income	4,337	6,434	6,655	13,694	17,058	14,835	13,086	11,419
Free cash flow	(17,682)	(38,088)	(58,822)	(10,304)	38,367	48,920	57,751	53,443
Ratios (%)								
Debt/equity	105.4	128.7	174.6	169.6	135.1	97.3	59.4	29.6
Net debt/equity	97.0	120.4	170.9	167.0	132.5	95.2	57.2	27.8
RoAE	16.3	12.7	4.8	11.3	10.7	10.7	12.9	13.4
RoACE	10.9	7.3	7.2	7.9	6.9	7.2	9.2	10.7
Key assumptions (standalone until FY2005)								
Crude throughput (mn tons)	19.8	20.9	20.0	20.4	21.8	22.4	22.6	22.6
Effective tariff protection (%)	1.6	1.4	2.4	2.2	0.7	1.9	2.3	2.3
Net refining margin (US\$/bbl)	3.2	5.6	5.2	2.9	4.5	4.3	4.6	4.8
Sales volume (mn tons)	24.5	26.7	27.8	29.3	30.9	32.4	34.0	35.7
Marketing margin (Rs/ton)	(1,140)	(3,010)	(5,944)	511	(2,111)	(1,772)	1,319	1,652
Subsidy under-recoveries (Rs mn)	(10,400)	(33,354)	2,728	(12,375)	(15,841)	(17,003)	(16,342)	(15,976)

Source: Company, Kotak Institutional Equities estimates

Profit model, balance sheet, cash model of HPCL, March fiscal year-ends, 2007-2014E (₹ mn)

	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Profit model (Rs mn)								
Net sales	889,959	1,043,130	1,249,348	1,073,004	1,341,199	1,655,318	1,534,578	1,522,519
EBITDA	24,036	15,757	28,707	32,469	39,298	35,398	43,159	45,033
Other income	6,845	11,980	9,057	16,462	7,226	7,600	5,907	4,163
Interest	(4,230)	(7,925)	(20,828)	(9,038)	(8,840)	(11,048)	(9,555)	(7,772)
Depreciation	(7,040)	(8,508)	(9,813)	(11,644)	(14,070)	(15,626)	(17,661)	(19,698)
Pretax profits	19,611	11,303	7,122	28,249	23,614	16,324	21,850	21,726
Extraordinary items	3,030	—	—	(6,999)	(152)	—	—	—
Tax	(6,625)	(1,799)	(2,416)	(5,616)	(8,071)	(3,266)	(4,372)	(4,347)
Deferred taxation	(365)	(2,025)	(343)	(2,046)	—	(2,030)	(2,718)	(2,702)
Prior period adjustment	61	3,870	1,387	(575)	—	—	—	—
Adjusted net profits	13,617	11,349	5,750	17,489	15,490	11,028	14,761	14,677
Earnings per share (Rs)	40.2	33.5	17.0	51.6	45.7	32.5	43.5	43.3
Balance sheet (Rs mn)								
Total equity	95,987	105,633	107,306	115,580	125,435	132,511	141,981	151,398
Deferred tax liability	14,209	15,960	16,034	18,080	31,956	33,987	36,704	39,406
Total borrowings	105,175	167,867	227,552	213,024	250,212	192,212	164,453	121,473
Current liabilities	101,195	124,337	117,558	165,551	196,066	245,402	243,849	243,327
Total liabilities and equity	316,566	413,797	468,450	512,234	603,670	604,111	586,987	555,604
Cash	868	2,940	6,083	2,432	800	2,176	2,528	2,400
Current assets	113,779	190,034	153,844	203,988	265,110	270,132	256,740	252,900
Total fixed assets	130,644	152,452	166,558	191,943	224,410	238,454	264,370	256,953
Investments	71,275	68,371	141,965	113,872	113,350	93,350	63,350	43,350
Total assets	316,566	413,796	468,450	512,234	603,670	604,111	586,988	555,604
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	23,966	(18,679)	(12,139)	28,120	31,107	17,114	27,217	31,782
Working capital changes	8,936	(6,504)	48,461	(6,530)	(29,107)	44,314	11,839	3,317
Capital expenditure	(38,510)	(31,638)	(19,275)	(36,180)	(41,533)	(25,699)	(41,561)	(11,149)
Investments	(31,704)	(1,851)	(70,386)	16,521	522	20,000	30,000	20,000
Other income	2,067	4,692	3,187	8,037	5,726	7,600	5,907	4,163
Free cash flow	(35,246)	(53,980)	(50,151)	9,968	(33,286)	63,329	33,402	48,113
Ratios (%)								
Debt/equity	95.4	138.1	184.5	159.4	159.0	115.4	92.0	63.7
Net debt/equity	94.7	135.6	179.6	157.6	158.5	114.1	90.6	62.4
RoAE	14.9	9.8	4.7	10.1	10.6	6.8	8.6	7.9
RoACE	8.6	5.0	5.3	6.8	5.6	4.8	6.0	6.1
Key assumptions								
Crude throughput (mn tons)	16.7	16.8	15.8	15.8	14.8	17.2	18.8	18.8
Effective tariff protection (%)	1.4	1.3	2.4	2.5	1.3	2.2	2.5	2.5
Net refining margin (US\$/bbl)	4.3	6.6	4.0	2.7	5.3	4.3	4.6	4.6
Sales volume (mn tons)	23.4	26.2	27.0	27.7	28.3	29.6	31.0	32.5
Marketing margin (Rs/ton)	(710)	(2,345)	(5,021)	627	(2,089)	(1,543)	1,309	1,615
Subsidy under-recoveries (Rs mn)	(7,685)	(31,191)	5,587	(12,297)	(15,042)	(16,689)	(16,986)	(16,858)

Source: Company, Kotak Institutional Equities estimates

Consolidated profit model, balance sheet, cash model of IOCL, March fiscal year-ends, 2007-2014E (₹ mn)

	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Profit model (Rs mn)								
Net sales	2,149,428	2,444,378	3,041,265	2,660,338	3,288,532	4,788,488	4,458,985	4,490,114
EBITDA	110,451	120,872	61,445	146,723	144,882	163,317	183,695	189,295
Other income	27,451	43,748	45,155	68,588	31,566	38,909	36,280	32,402
Interest	(17,058)	(17,556)	(41,758)	(16,638)	(29,243)	(34,963)	(30,800)	(21,559)
Depreciation	(28,686)	(29,918)	(31,389)	(34,943)	(48,611)	(50,435)	(54,605)	(55,630)
Pretax profits	92,157	117,145	33,453	163,729	98,594	116,828	134,570	144,508
Extraordinary items	24,757	5,374	—	(14,995)	—	—	—	—
Tax	(25,834)	(38,293)	(13,316)	(47,193)	(18,739)	(30,841)	(39,796)	(45,303)
Deferred taxation	(8,040)	(473)	1,435	5,556	(285)	(7,063)	(3,865)	(1,582)
Net profits	82,729	83,430	25,523	108,238	79,570	78,923	90,909	97,622
Net profits after minority interests	62,702	74,517	27,437	116,128	77,105	77,259	89,604	96,045
Earnings per share (Rs)	26.3	31.2	11.5	47.9	31.8	31.8	36.9	39.6
Balance sheet (Rs mn)								
Total equity	378,117	450,449	470,654	547,804	585,645	635,993	694,045	756,367
Deferred tax liability	59,859	60,331	58,876	54,072	69,411	76,474	80,339	81,921
Total borrowings	290,215	382,818	465,250	497,522	569,564	611,734	462,502	354,260
Current liabilities	330,791	386,724	376,107	472,991	629,775	729,786	704,346	707,983
Total liabilities and equity	1,058,981	1,280,322	1,370,888	1,572,389	1,854,395	2,053,986	1,941,232	1,900,531
Cash	9,385	8,413	8,076	13,501	12,824	13,212	15,394	12,916
Current assets	437,178	599,256	473,965	648,895	896,572	1,124,605	1,048,237	1,039,173
Total fixed assets	415,014	460,307	565,545	690,165	754,268	751,339	732,771	723,612
Investments	197,403	212,345	323,301	219,828	190,731	164,830	144,830	124,830
Total assets	1,058,981	1,280,322	1,370,888	1,572,389	1,854,395	2,053,986	1,941,232	1,900,531
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	(44,660)	(107,263)	(345,677)	138,838	110,255	94,402	119,018	107,484
Working capital changes	2,237	(1,414)	76,881	(163,423)	(92,804)	(126,851)	29,343	30,933
Capital expenditure	(50,969)	(79,586)	(135,923)	(128,974)	(124,042)	(31,991)	(27,010)	(29,214)
Investments	99,768	92,665	299,410	147,320	27,328	25,916	20,014	20,849
Other Income	13,582	18,253	16,413	24,515	22,227	38,254	35,605	31,634
Free cash flow	19,958	(77,346)	(88,896)	18,276	(57,038)	(270)	176,969	161,686
Ratios (%)								
Debt/equity	66.3	74.9	87.9	82.7	86.9	85.9	59.7	42.3
Net debt/equity	64.1	73.3	86.3	80.4	85.0	84.0	57.7	40.7
RoAE	16.1	16.3	5.5	21.2	12.7	11.6	12.4	12.2
RoACE	11.2	11.4	5.1	12.4	8.9	8.0	8.7	9.2
Key assumptions (IOC standalone)								
Crude throughput (mn tons)	44.0	47.4	51.3	50.7	53.0	55.4	55.9	55.9
Effective tariff protection (%)	1.6	1.3	2.8	2.2	0.8	1.9	2.3	2.3
Net refining margin (US\$/bbl)	4.2	8.2	3.7	4.5	6.0	6.4	6.6	6.6
Sales volume (mn tons)	53.4	57.4	61.0	64.0	67.1	70.1	73.4	76.9
Marketing margin (Rs/ton)	(633)	(2,203)	(5,253)	874	(1,466)	(1,310)	1,468	1,774
Subsidy under-recoveries (Rs mn)	(21,900)	(97,738)	—	(31,588)	(38,032)	(40,395)	(40,862)	(40,628)

Source: Company, Kotak Institutional Equities estimates

Profit model, balance sheet, cash model of GAIL, March fiscal year-ends, 2007-2014E (₹ mn)

	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Profit model (Rs mn)								
Net sales	160,472	180,082	237,760	249,964	325,365	421,622	503,793	635,372
EBITDA	30,649	39,275	40,647	46,688	55,324	77,137	83,668	95,760
Other income	5,450	5,564	7,966	5,411	4,407	5,670	5,483	5,293
Interest	(1,071)	(796)	(870)	(700)	(829)	(1,966)	(3,693)	(4,955)
Depreciation	(5,754)	(5,710)	(5,599)	(5,618)	(6,503)	(10,233)	(12,367)	(14,499)
Pretax profits	29,274	38,333	42,144	45,781	52,400	70,607	73,090	81,598
Tax	(7,941)	(12,525)	(13,941)	(13,750)	(14,352)	(13,092)	(13,749)	(15,374)
Deferred taxation	(190)	(10)	(62)	(636)	(2,437)	(6,881)	(6,724)	(5,780)
Net profits	24,619	26,015	28,037	31,398	35,611	50,634	52,617	60,444
Earnings per share (Rs)	19.4	20.5	22.1	24.8	28.1	39.9	41.5	47.7
Balance sheet (Rs mn)								
Total equity	113,929	130,049	147,696	167,990	192,508	226,925	262,589	303,130
Deferred taxation liability	13,187	13,197	13,259	13,896	16,332	23,213	29,937	35,718
Total borrowings	13,379	12,659	12,001	14,804	23,100	97,900	99,500	34,500
Current liabilities	45,512	60,604	81,548	103,784	88,149	76,546	85,906	100,753
Total liabilities and equity	186,007	216,509	254,505	300,473	320,089	424,585	477,932	474,101
Cash	26,604	44,730	34,562	41,715	21,266	19,247	19,126	19,430
Other current assets	50,851	59,370	87,804	95,412	90,148	101,911	109,010	115,915
Total fixed assets	93,913	97,500	114,767	142,616	182,849	277,601	323,971	312,930
Investments	14,638	14,909	17,373	20,730	25,825	25,825	25,825	25,825
Total assets	186,007	216,509	254,505	300,473	320,089	424,584	477,932	474,101
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	23,920	33,692	30,456	33,480	39,606	58,453	60,322	73,872
Working capital changes	(10,151)	(388)	(5,573)	12,454	(10,372)	(23,365)	2,261	7,942
Capital expenditure	(20,449)	(12,419)	(25,535)	(35,702)	(46,198)	(101,360)	(52,833)	(1,900)
Investments	(205)	(270)	(2,464)	(3,358)	(5,095)	—	—	—
Other income	3,884	4,042	5,243	4,705	4,407	5,670	5,483	5,293
Free cash flow	(3,002)	24,658	2,127	11,580	(17,652)	(60,601)	15,232	85,207
Ratios (%)								
Debt/equity	10.5	8.8	7.5	8.1	11.1	39.1	34.0	10.2
Net debt/equity	(10.4)	(22.4)	(14.0)	(14.8)	0.9	31.4	27.5	4.4
ROAE (%)	20.5	19.2	18.4	18.3	18.2	22.1	19.4	19.1
ROACE (%)	16.1	17.8	17.5	17.2	16.9	17.9	14.9	16.8
Key assumptions								
Gas transmission volumes (mcm/d)	77	82	83	107	118	124	134	154
Petrochemical sales volumes (000 tons)	347	391	423	410	420	450	460	480
LPG sales volumes (000 tons)	1,037	1,039	1,092	1,101	1,073	1,100	1,100	1,100
LPG transmission volumes (000 tons)	2,490	2,754	2,744	3,160	3,337	3,350	3,350	3,350
Subsidy losses (Rs mn)	14,880	13,137	17,812	13,267	21,112	18,855	11,509	10,210

Source: Company, Kotak Institutional Equities estimates

Profit model, balance sheet, cash model of OIL, March fiscal year-ends, 2007-2014E (₹ mn)

	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Profit model (Rs mn)								
Net sales	53,892	60,819	72,414	79,056	86,115	112,930	118,727	120,569
EBITDA	22,280	23,812	28,400	34,486	43,371	64,280	67,900	68,155
Other income	5,335	6,770	9,372	9,371	9,377	14,150	13,950	14,090
Interest	(140)	(344)	(87)	(37)	(139)	(68)	—	—
Depreciation and depletion	(2,595)	(3,093)	(3,768)	(4,811)	(9,477)	(11,763)	(13,724)	(15,422)
Pretax profits	24,881	27,145	33,916	39,010	43,132	66,599	68,126	66,823
Tax	(7,406)	(8,538)	(11,910)	(11,598)	(12,973)	(21,663)	(22,137)	(21,711)
Deferred tax	(1,020)	(707)	(343)	(1,211)	(1,282)	55	34	30
Net profits	16,454	17,901	21,663	26,201	28,877	44,991	46,022	45,142
Earnings per share (Rs)	76.9	83.6	101.2	115.3	120.1	187.1	191.4	187.7
Balance sheet (Rs mn)								
Total equity	68,491	79,330	93,310	137,638	156,001	184,782	214,316	242,970
Deferred tax liability	8,033	8,655	8,998	10,209	11,491	11,436	11,402	11,372
Liability for abandonment cost	11	11	15	19	1,645	1,645	1,645	1,645
Total borrowings	8,140	1,749	565	375	10,268	—	—	—
Current liabilities	10,320	17,541	30,914	32,693	33,216	35,655	35,935	36,099
Total liabilities and equity	94,995	107,286	133,801	180,934	212,620	233,518	263,298	292,086
Cash	32,757	42,808	60,700	85,429	117,675	121,215	139,511	156,495
Current assets	22,350	18,957	22,853	37,266	30,318	32,315	33,023	33,248
Total fixed assets	35,813	40,633	45,361	49,460	55,723	71,084	81,860	93,438
Investments	4,075	4,887	4,887	8,594	8,904	8,904	8,904	8,904
Deferred expenditure	—	—	—	184	—	—	—	—
Total assets	94,995	107,286	133,801	180,934	212,620	233,518	263,298	292,086
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	18,357	20,104	27,246	23,621	27,373	36,299	39,263	39,444
Working capital changes	(8,696)	7,435	2,368	(9,113)	7,472	442	(429)	(61)
Capital expenditure	(9,370)	(9,492)	(8,496)	(11,485)	(11,045)	(20,874)	(18,000)	(20,000)
Investments	226	(811)	—	(3,201)	(310)	—	—	—
Other income	2,892	4,214	5,470	7,268	9,377	14,150	13,950	14,090
Free cash flow	3,409	21,450	26,587	7,091	32,867	30,017	34,784	33,473
Ratios (%)								
Debt/equity	11.9	2.2	0.6	0.3	6.6	—	—	—
Net debt/equity	(32.8)	(31.9)	(31.9)	(38.3)	(54.1)	(46.3)	(48.3)	(49.6)
RoAE	23.2	21.8	22.8	20.9	18.3	24.7	21.8	18.8
RoACE	23.0	21.5	22.7	20.9	18.2	24.5	21.6	18.7
Key assumptions								
Rs/dollar rate	45.3	40.3	45.8	47.4	45.6	45.5	44.0	44.0
Crude fob price (US\$/bbl)	64.8	78.9	83.0	67.1	84.0	105.0	95.0	90.0
Ceiling/actual natural gas price (Rs/'000 cm)	3,200	3,200	3,200	3,200	6,783	7,500	7,500	7,500
Subsidy loss (Rs bn)	19.9	23.1	30.2	15.5	32.9	37.0	19.1	15.8

Source: Company, Kotak Institutional Equities estimates

Consolidated profit model, balance sheet, cash model of ONGC, March fiscal year-ends, 2007-2014E (₹ mn)

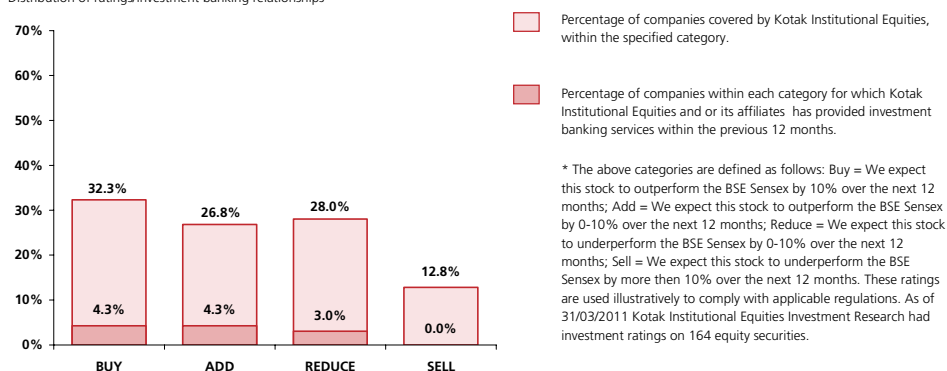
	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Profit model (Rs mn)								
Net sales	966,542	1,091,644	1,200,176	1,070,520	1,247,463	1,600,991	1,621,885	1,623,807
EBITDA	357,906	408,423	419,955	445,845	510,110	675,047	687,667	674,397
Other income	45,378	53,565	50,721	50,409	30,130	53,996	64,828	76,571
Interest	394	(12,027)	(5,966)	(3,019)	(4,826)	(3,681)	(2,943)	(4,400)
Depreciation and depletion	(119,550)	(138,624)	(153,985)	(186,838)	(206,027)	(227,479)	(253,758)	(249,666)
Pretax profits	284,127	311,338	310,725	306,397	329,387	497,883	495,794	496,902
Tax	(88,986)	(102,908)	(111,333)	(95,580)	(107,997)	(144,870)	(143,042)	(140,681)
Deferred tax	(9,264)	(6,471)	(3,495)	(11,457)	(7,191)	(9,594)	(8,475)	(10,594)
Net profits	178,318	203,710	201,719	199,951	228,375	343,419	344,277	345,627
Adjusted net profits after minority interests	181,772	198,963	194,664	196,409	215,817	340,495	341,913	343,663
Earnings per share (Rs)	21.2	23.3	22.8	23.0	25.2	39.8	40.0	40.2
Balance sheet (Rs mn)								
Total equity	670,137	786,657	929,353	1,024,615	1,162,780	1,379,719	1,592,954	1,807,879
Deferred tax liability	80,976	87,227	92,076	102,669	109,860	119,454	127,929	138,523
Liability for abandonment cost	151,857	129,325	171,451	174,590	186,226	186,226	186,226	186,226
Total borrowings	21,826	22,039	73,633	61,274	71,396	114,296	88,796	61,870
Current liabilities	187,051	251,797	293,499	306,532	389,100	379,376	387,993	395,684
Total liabilities and equity	1,111,847	1,277,045	1,560,013	1,669,680	1,919,361	2,179,070	2,383,899	2,590,182
Cash	206,262	249,807	224,671	222,348	285,774	364,241	546,386	773,965
Current assets	192,652	257,384	309,514	306,619	369,995	443,593	449,906	455,833
Total fixed assets	643,219	695,227	871,287	986,293	1,129,307	1,236,951	1,253,321	1,226,098
Goodwill	27,686	22,847	111,108	92,455	92,455	92,455	92,455	92,455
Investments	36,888	45,041	36,926	53,551	33,871	33,871	33,871	33,871
Deferred expenditure	5,141	6,739	6,506	8,413	7,960	7,960	7,960	7,960
Total assets	1,111,848	1,277,045	1,560,013	1,669,680	1,919,362	2,179,071	2,383,899	2,590,183
Free cash flow (Rs mn)								
Operating cash flow, excl. working capital	252,772	284,517	274,321	302,059	322,511	411,424	425,265	412,311
Working capital changes	(4,990)	(24,929)	(109,306)	(29,693)	84,192	(33,322)	50,027	1,764
Capital expenditure	(135,049)	(166,427)	(208,137)	(207,849)	(248,463)	(220,052)	(153,711)	(105,438)
Investments	53,822	(7,348)	(92,159)	(11,021)	15,288	—	—	—
Other income	20,422	22,822	31,612	22,154	30,130	53,996	64,828	76,571
Free cash flow	186,976	108,636	(103,668)	75,650	203,659	212,046	386,409	385,207
Ratios (%)								
Debt/equity	3.3	2.8	7.9	6.0	6.1	8.3	5.6	3.4
Net debt/equity	(27.5)	(29.0)	(16.3)	(15.7)	(18.4)	(18.1)	(28.7)	(39.4)
RoAE	25.5	24.9	21.2	18.6	19.0	24.9	21.5	19.0
RoACE	22.1	22.0	18.2	16.1	15.7	22.0	19.3	17.3
Key assumptions								
Rs/dollar rate	45.3	40.3	45.8	47.4	45.6	45.5	44.0	44.0
Crude fob price (US\$/bbl)	64.8	78.9	83.0	67.1	84.0	105.0	95.0	90.0
Ceiling/actual natural gas price (Rs/'000 cm)	3,200	3,200	3,200	3,200	6,783	7,500	7,500	7,500
Subsidy loss (Rs bn)	170.2	220.0	282.3	115.5	248.9	286.9	146.4	119.9

Source: Company, Kotak Institutional Equities estimates

"I, Sanjeev Prasad, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Source: Kotak Institutional Equities

As of March 31, 2011

Ratings and other definitions/identifiers

Definitions of ratings

BUY. We expect this stock to outperform the BSE Sensex by 10% over the next 12 months.

ADD. We expect this stock to outperform the BSE Sensex by 0-10% over the next 12 months.

REDUCE. We expect this stock to underperform the BSE Sensex by 0-10% over the next 12 months.

SELL. We expect this stock to underperform the BSE Sensex by more than 10% over the next 12 months.

Our target price are also on 12-month horizon basis.

Other definitions

Coverage view. The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: **Attractive, Neutral, Cautious.**

Other ratings/identifiers

NR = Not Rated. The investment rating and target price, if any, have been suspended temporarily. Such suspension is in compliance with applicable regulation(s) and/or Kotak Securities policies in circumstances when Kotak Securities or its affiliates is acting in an advisory capacity in a merger or strategic transaction involving this company and in certain other circumstances.

CS = Coverage Suspended. Kotak Securities has suspended coverage of this company.

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RS = Rating Suspended. Kotak Securities Research has suspended the investment rating and price target, if any, for this stock, because there is not a sufficient fundamental basis for determining an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.

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