INDIA

Bharat Petroleum Corp

18 June 2008

BPCL IN		Outperform
Stock price as of 17Jun 08	Rs	280.20
12-month target	Rs	470.00
Upside/downside	%	+67.7
Valuation	Rs	470.00
- RNAV		
GICS sector		energy
Market cap	Rs m	101,292
30-day avg turnover	US$m	7.2
Market cap	US$m	2,362
Number shares on issue	m	361.5

Investment fundamentals

Year end 31 Mar		2008A	2009E	2010E	2011E
Total revenue	bn	1,112.4	1,024.4	1,046.4	1,109.1
EBITDA	bn	37.0	31.8	37.6	37.3
EBITDA growth	%	-18.1	-14.2	18.5	-1.0
EBIT	bn	24.1	17.4	22.8	21.9
EBIT Growth	%	-29.4	-27.9	30.9	-3.8
Reported profit	bn	17.7	11.4	16.6	16.4
Adjusted profit	bn	16.1	11.4	16.6	16.4
EPS rep	Rs	48.95	31.54	45.81	45.46
EPS adj	Rs	44.63	31.54	45.81	45.46
EPS adj growth	%	-31.1	-29.3	45.2	-0.8
PE adj	x	6.3	8.9	6.1	6.2
Total DPS	Rs	17.64	11.37	16.51	16.39
Total div yield	%	6.3	4.1	5.9	5.8
ROE	%	13.2	8.3	11.0	9.8
EV/EBITDA	x	5.0	5.9	4.9	5.0
Net debt/equity	%	60.4	51.6	33.9	15.5
Price/book	x	0.8	0.7	0.6	0.6

BPCL IN rel SENSEX performance, & rec history

Source: Datastream, Macquarie Research, June 2008 (all figures in INR unless noted)

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Defensive, deep value

Event

- Bharat Petroleum (BPCL) reported recurring PAT of Rs584mn in 4Q FY3/08 (vs PAT of Rs6.7bn in 4Q FY3/07), which was below our expectations of a profit of Rs1.2bn. The difference is primarily on account of higher net interest burden due to the pending issuance of Rs40bn oil bonds by the government.

Impact

- **Volume driven sales growth.** Sales volume grew 11% YoY to 7.0MMT in 4Q FY3/08, as a result of 8.5% YoY growth in domestic sales and 77% YoY growth in exports. The refinery throughput declined 5.1% YoY and 4.2% QoQ to 5.0MMT (Figure 2). This coupled with Rs1-2/l increase in Petrol and Diesel prices in February 2008, resulted in 35%YoY and 13% QoQ growth in net sales.
- **Gross refining margins (GRM) increased two-fold.** BPCL reported GRM of US$6.65/bbl in 4Q FY3/08 (vs US$5.83/bbl in 4QFY3/07 and US$5.28/bbl in 3Q FY3/08) in line with sharp increase in GRMs globally. BPCL's GRMs were 14% higher YoY, driven by 2.0% higher GRM of US$5.20/bbl for the Mumbai refinery and 28% higher GRM of US$8.98/bbl for the Kochi refinery (Figure 2).
- **Retail margins remain significantly negative.** Petrol and diesel retail margins remained significantly negative during 4Q FY3/08 as the rise in global crude prices could not be passed through (Figure 3). LPG and kerosene margins (Figure 4) were significantly negative.
- **Losses shared by the upstream companies.** Upstream companies – mainly ONGC (ONGC IN, Rs883, Neutral, TP: Rs991) shouldered the partial burden by providing a discount of Rs23.7bn in 4Q FY3/08 (2.0x of Rs11.8bn in 4Q FY3/07) on purchases of crude oil, LPG and kerosene. In addition, BPCL received oil bonds worth Rs39.7bn (vs Rs9.0bn in 4Q FY3/07 and Rs20.8bn in 3QFY3/08) from the government as compensation for under-recoveries.
- **FY09E subsidy sharing stays unclear.** The initial ad hoc announcement by the government for subsidy sharing in FY09E suggests that oil marketing companies, such as BPCL would be significantly disadvantaged (Refer annexure 1). We re-iterate that this is not tenable and shall get changed as it typically does many times during the course of the year. The government's primary intent is to keep BPCL's earnings largely between Rs10–15bn.

Earnings revision

- No change.

Price catalyst

- 12-month price target: Rs470.00 based on a RNAV methodology.
- Catalyst: Rebalance of subsidy equation in favour of oil marketing companies.

Action and recommendation

- **Defensive, deep value play.** Since early-2008, BPCL had started outperforming given its defensive, deep value (0.6x PBV, 6.1x FY10E PER) nature. We believe the recent enhanced subsidy scare shall be short-lived and feel the outperformance shall recommence.

Fig 1 BPCL: Snapshot of 4Q FY3/08 results

Rs m	4Q FY3/08	4Q FY3/07	% change YoY	3Q FY3/08	% change QoQ
Net sales	325,786	241,265	35.0	289,284	12.6
Expenditure	(317,186)	(228,527)	38.8	(283,634)	11.8
EBITDA	8,600	12,738	-32.5	5,650	52.2
Depreciation	(3,319)	(2,778)	19.5	(3,065)	8.3
Other income	1,343	2,547	-47.3	1,904	-29.5
EBIT	6,624	12,507	-47.0	4,489	47.6
Interest	(2,156)	(1,648)	30.8	(1,620)	33.1
PBT	4,468	10,859	-58.9	2,869	55.7
PBT (excl. exceptional items)	4,468	10,859	-58.9	1,590	181.0
Tax	(3,884)	(4,159)	-6.6	44	NM
PAT (recurring)	584	6,700	-91.3	1,634	-64.3
PAT (reported)	584	6,700	-91.3	2,913	-80.0

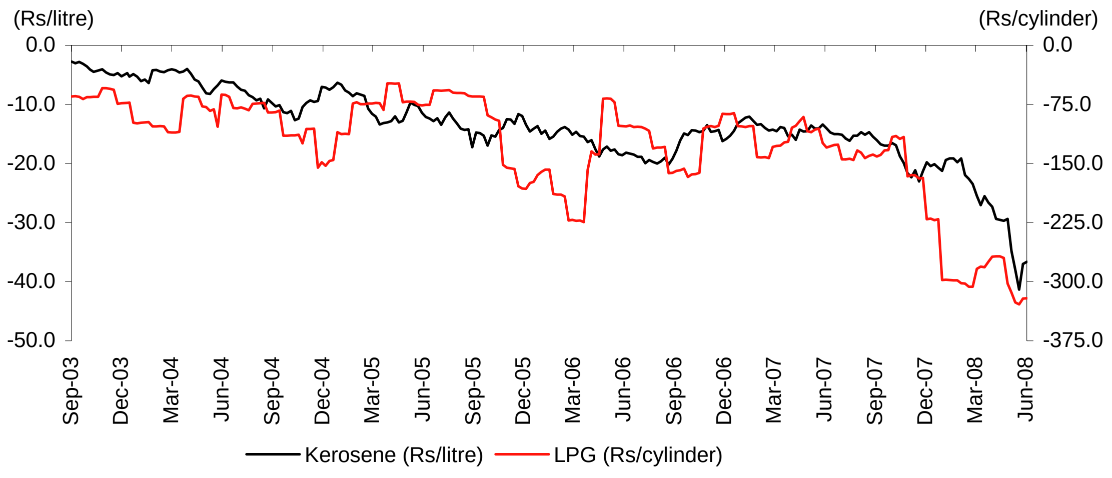
Source: Company data, Macquarie Research, June 2008

Fig 2 BPCL: Snapshot of 3Q FY3/08 key operating parameters

	4Q FY3/08	4Q FY3/07	% change YoY	3Q FY3/08	% change QoQ
Refinery Throughput (MMT)	5.00	5.27	-5.1	5.22	-4.2
Market Sales (MMT)	**6.97**	**6.31**	**10.5**	**6.72**	**3.7**
Domestic	6.67	6.14	8.6	6.05	10.2
Exports	0.30	0.17	76.5	0.67	-55.2
GRMs (US$/bbl)	**6.65**	**5.83**	**14.1**	**5.28**	**25.9**
Mumbai	5.20	5.10	2.0	4.15	25.3
Kochi	8.98	7.00	28.3	7.10	26.5
Recovery from Upstream	23,692	11,845	100.0	16,229	46.0
Oil Bonds	39,715	9,009	340.8	20,789	91.0

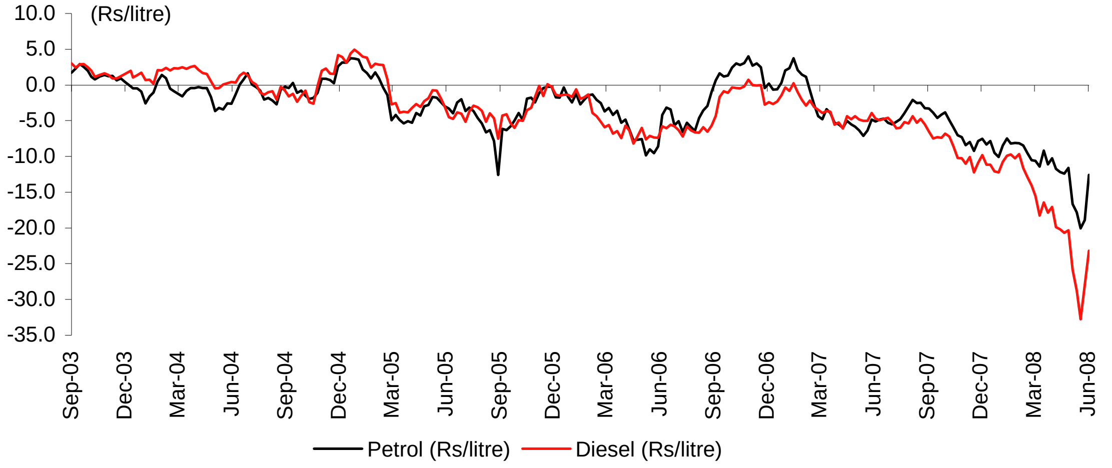
Source: Company data, Macquarie Research, June 2008

Fig 3 Petrol and diesel margins: Margins continued to be in deep red



Source: Bloomberg, Macquarie Research, June 2008

Fig 4　Kerosene and LPG margins: Remain significantly negative



Source: Bloomberg, Macquarie Research, June 2008

Annexure 1: Proposed subsidy sharing lacks clarity

US$10bn of under-recoveries is still not accounted

The Petroleum Ministry has said that the FY09E subsidy burden for oil marketing companies will be US$4.8bn and upstream companies will be US$10.7bn. However, this leaves US$32.5bn to be funded by oil bonds.

While the petroleum ministry said that the balance US$32.5bn will be funded by oil bonds, the finance ministry said US$22.5bn of oil bonds will be issued. Thus the funding of US$10bn of under-recovery is still unclear and we believe the subsidy sharing could change from here.

Fig 5 Proposed subsidy share leaves US$10bn unaccounted

	Amount (Rs bn)	Amount (US$ bn)
Custom duty cuts	162	3.9
Excise duty cuts	67	1.6
Price Increase	211	5.0
Upstream	450	11
Oil Marketing Companies	200	4.8
Oil Bonds	946	23
Unaccounted	**417**	**10**
Total	2,453	58

Source: Macquarie Research, June 2008

Proposed subsidy sharing untenable, expect rollbacks

We believe the upstream share of the subsidies is likely to be revised, especially if the oil prices continue to remain at current high levels. This is not uncommon as we have seen in the past that the subsidy share gets revised several times during the year.

Constitution of high powered committee re-affirms our expectation

The Prime Minister has constituted a high-powered committee to examine the financial position of oil companies. The committee will examine the impact of the increase in oil prices between FY2005 and FY2008 on the financial position of oil companies, including upstream exploration companies, refiners and downstream oil marketing companies. It will also examine the available options for burden sharing by all stakeholders, including upstream exploration companies, refiners, OMCs and standalone refiners.

It will also analyse the cashflows and the profitability of all three groups of companies so as to get a clear picture of the changes taking place in their operating positions, particularly the impact on access to credit and cash availability for their operations.

The constitution of this committee re-affirms our view that a revision in subsidy share will happen after the committee submits it report.

Fig 6 In the proposed scenario, upstream subsidy share will fall to 22% (33% earlier)

	Amount (Rs bn)	Amount (US$ bn)	Subsidy share (%)
Upstream	**450**	**11**	**22.4**
Oil Marketing Companies	200	4.8	9.9
Oil Bonds	946	23	47.0
Unaccounted	417	10	20.7
Total	2,013	48	100

Source: Macquarie Research, June 2008

Mixed impact on oil companies

The proposed subsidy share favours upstream companies

The government's under-recovery estimates are based on the current market price of crude oil. The government estimates for the total under-recoveries for FY09E are Rs2,453bn or US$58bn, of which Rs440bn or US$10.5bn will reduce after price hike and duty changes. The Petroleum Ministry has announced that the upstream companies will bear Rs450bn or US$10.7bn of the subsidies and oil marketing companies will bear Rs200bn or US$4.8bn of subsidies.

Compared to our estimates at US$130/bbl of crude, the upstream companies will benefit to the extent of Rs280bn or US$6.7bn from the change in the subsidy share and petroleum price hike. On the other hand, oil marketing companies burden rises by Rs44bn or US$1.0bn despite the fall in under-recoveries due to rise in fuel prices.

Fig 7 Government estimates upstream burden to be Rs450bn at US$130/bbl crude

Rs bn	**Pre-price hike Macq Estimate @US$130/bbl**	**Government Estimates @US$130/bbl**
Government	1,314	946
Upstream	730	450
ONGC	625	385
GAIL	40	25
Others	65	40
Refineries	0	0
Oil Marketing Companies	156	200
Price Hike and Duty Cut	0	440
Unaccounted	**0**	**417**
Total	**2,200**	**2,453**

Source: Macquarie Research, June 2008

The public sector upstream companies are likely to benefit significantly, if the crude prices for the year averages above US$130/bbl and the actual subsidy share remains as proposed by the Petroleum Ministry. ONGC and Cairn India (CAIR IN, Rs277.65, UP, TP: Rs227) will be negatively impacted due to 5% cut in custom duty.

The oil marketing companies Hindustan Petroleum (HPCL IN, Rs194.20, OP, TP: Rs368) and BPCL will be impacted due to the higher-than-expected subsidy burden on them.

Bharat Petroleum Corporation Ltd (BPCL IN, Outperform, Target price: Rs470.00)

Profit & Loss		**2004A**	**2005A**	**2006A**	**2007A**
Revenue	**m**	**553,603**	**644,268**	**775,161**	**984,192**
Gross Profit	**m**	**83,920**	**68,730**	**66,433**	**104,294**
Cost of Goods Sold	m	469,684	575,538	708,728	879,898
EBITDA	**m**	**45,191**	**37,781**	**17,039**	**45,196**
Depreciation	m	8,245	8,810	9,458	11,021
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**36,946**	**28,971**	**7,581**	**34,175**
Net Interest Income	m	-2,577	-2,469	-3,052	-5,204
Associates	m	0	0	0	0
Exceptionals	m	-1,009	835	201	-1,974
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	4,264	3,505	3,994	6,698
Pre-Tax Profit	**m**	**37,624**	**30,842**	**8,724**	**33,695**
Tax Expense	m	-13,980	-10,080	-1,691	-10,136
Net Profit	**m**	**23,644**	**20,763**	**7,034**	**23,559**
Minority Interests	m	3,305	5,321	1,663	-2,107
Reported Earnings	**m**	**20,339**	**15,442**	**5,371**	**21,452**
Adjusted Earnings	**m**	**21,348**	**14,606**	**5,169**	**23,426**
EPS (rep)		68	51	18	59.33
EPS (adj)		71	49	17	64.80
EPS Growth YoY (adj)	%	37	-32	-65	276.0
DPS	%	0	18	6	21.39
Yield	%	0	5	2	7.7
Weighted Average Shares	%	300	300	300	362
Period End Shares	%	300	300	300	362

Profit & Loss		**2008A**	**2009E**	**2010E**	**2011E**
Revenue	**m**	**1,112,431**	**1,024,388**	**1,046,391**	**1,109,118**
Gross Profit	**m**	**96,436**	**94,113**	**101,330**	**104,779**
Cost of Goods Sold	m	1,015,995	930,275	945,062	1,004,339
EBITDA	**m**	**37,037**	**31,771**	**37,649**	**37,281**
Depreciation	m	12,921	14,382	14,882	15,382
Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0
EBIT	**m**	**24,116**	**17,389**	**22,767**	**21,899**
Net Interest Income	m	-7,149	-8,293	-6,693	-5,893
Associates	m	0	0	0	0
Exceptionals	m	1,560	0	0	0
Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	11,673	6,972	7,122	7,122
Pre-Tax Profit	**m**	**30,200**	**16,067**	**23,195**	**23,128**
Tax Expense	m	-11,075	-4,566	-6,591	-6,572
Net Profit	**m**	**19,125**	**11,501**	**16,603**	**16,555**
Minority Interests	m	-1,429	-98	-41	-119
Reported Earnings	**m**	**17,696**	**11,404**	**16,562**	**16,436**
Adjusted Earnings	**m**	**16,136**	**11,404**	**16,562**	**16,436**
EPS (rep)		48.95	31.54	45.81	45.46
EPS (adj)		44.63	31.54	45.81	45.46
EPS Growth (adj)	%	-31.1	-29.3	45.2	-0.8
PE (rep)	x	5.7	8.9	6.1	6.2
PE (adj)	x	6.3	8.9	6.1	6.2
Total DPS		17.64	11.37	16.51	16.39
Total Div Yield	%	6.3	4.1	5.9	5.8
Weighted Average Shares	m	362	362	362	362
Period End Shares	m	362	362	362	362

Profit and Loss Ratios		**2008A**	**2009E**	**2010E**	**2011E**
Revenue Growth	%	13.0	-7.9	2.1	6.0
EBITDA Growth	%	-18.1	-14.2	18.5	-1.0
EBIT Growth	%	-29.4	-27.9	30.9	-3.8
Gross Profit Margin	%	8.7	9.2	9.7	9.4
EBITDA Margin	%	3.3	3.1	3.6	3.4
EBIT Margin	%	2.2	1.7	2.2	2.0
Net Profit Margin	%	1.7	1.1	1.6	1.5
Payout Ratio	%	39.5	36.0	36.0	36.0
EV/EBITDA	x	5.0	5.9	4.9	5.0
EV/EBIT	x	7.7	10.7	8.2	8.5
Balance Sheet Ratios					
ROE	%	13.2	8.3	11.0	9.8
ROA	%	6.0	4.1	5.5	5.1
ROIC	%	7.0	5.5	7.1	6.9
Net Debt/Equity	%	60.4	51.6	33.9	15.5
Interest Cover	x	3.4	2.1	3.4	3.7
Price/Book	x	0.8	0.7	0.6	0.6
Book Value per Share		363.4	395.0	440.8	486.2

Cashflow Analysis		**2008A**	**2009E**	**2010E**	**2011E**
EBITDA	**m**	**37,037**	**31,771**	**37,649**	**37,281**
Tax Paid	m	-11,075	-4,566	-6,591	-6,572
Chgs in Working Cap	m	11,190	-1,377	-343	1,602
Net Interest Paid	m	-7,149	-8,293	-6,693	-5,893
Other	m	-842	-94	-36	-114
Operating Cashflow	**m**	**29,161**	**17,440**	**23,984**	**26,304**
Acquisitions	m	0	0	0	0
Capex	m	-31,250	-18,000	-10,000	-5,000
Asset Sales	m	0	0	0	0
Other	m	11,673	6,972	7,122	7,122
Investing Cashflow	**m**	**-19,577**	**-11,028**	**-2,878**	**2,122**
Dividend (Ordinary)	m	-6,379	-4,111	-5,970	-5,925
Equity Raised	m	0	0	0	0
Debt Movements	m	0	-20,000	-20,000	0
Other	m	7,808	4,209	6,012	6,060
Financing Cashflow	**m**	**1,429**	**-19,902**	**-19,959**	**135**
Net Chg in Cash/Debt	**m**	**12,573**	**-13,490**	**1,147**	**28,561**

Balance Sheet		**2008A**	**2009E**	**2010E**	**2011E**
Cash	m	28,814	15,323	16,471	45,031
Receivables	m	21,334	19,646	20,068	21,271
Inventories	m	118,862	109,455	111,806	118,509
Investments	m	72,341	72,341	72,341	72,341
Fixed Assets	m	165,608	169,225	164,343	153,961
Intangibles	m	0	0	0	0
Other Assets	m	27,365	27,365	27,365	27,365
Total Assets	**m**	**434,324**	**413,356**	**412,394**	**438,478**
Payables	m	148,968	136,495	138,925	148,432
Short Term Debt	m	69,630	49,630	29,630	29,630
Long Term Debt	m	44,036	44,036	44,036	44,036
Provisions	m	11,977	11,977	11,977	11,977
Other Liabilities	m	19,313	19,316	19,321	19,326
Total Liabilities	**m**	**293,924**	**261,454**	**243,889**	**253,401**
Shareholders' Funds	m	131,405	142,809	159,371	175,808
Minority Interests	m	9,003	9,101	9,142	9,261
Other	m	-8	-8	-8	-8
Total S/H Equity	**m**	**140,401**	**151,902**	**168,505**	**185,061**
Total Liab & S/H Funds	**m**	**434,325**	**413,356**	**412,395**	**438,462**

All figures in INR unless noted.
Source: Macquarie Research, June 2008

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand
Outperform – return >5% in excess of benchmark return (>2.5% in excess for listed property trusts)
Neutral – return within 5% of benchmark return (within 2.5% for listed property trusts)
Underperform – return >5% below benchmark return (>2.5% below for listed property trusts)

Macquarie - Asia
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie First South - South Africa
Outperform – expected return >+10%
Neutral – expected return from -10% to +10%
Underperform – expected return <-10%

Macquarie - Canada
Outperform – return >5% in excess of benchmark return
Neutral – return within 5% of benchmark return
Underperform – return >5% below benchmark return

Macquarie - USA
Outperform (Buy) – return >5% in excess of benchmark return
Neutral (Hold) – return within 5% of benchmark return
Underperform (Sell)– return >5% below benchmark return

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Volatility index definition*

This is calculated from the volatility of historic price movements.

Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low–medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.
* Applicable to Australian/NZ stocks only

Financial definitions

All "Adjusted" data items have had the following adjustments made:
Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / efpowa*
ROA = adjusted ebit / average total assets
ROA Banks/Insurance = adjusted net profit /average total assets
ROE = adjusted net profit / average shareholders funds
Gross cashflow = adjusted net profit + depreciation
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 31 March 2008

	AU/NZ	Asia	RSA	USA	CA
Outperform	38.95%	70.56%	64.52%	50.00%	69.72%
Neutral	47.37%	16.32%	27.42%	39.47%	26.06%
Underperform	13.68%	13.12%	8.06%	10.53%	4.22%

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