Oil & Gas/Chemicals | India

Bharat Petroleum Corporation BPCL IN

NEUTRAL

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RESULTS FIRST LOOK

BPCL reported a net loss of INR32.3bn (est of PAT of INR3.7bn) in 2Q, mainly owing to no government compensation (est of 50% or INR25.7bn) and large forex losses (INR8bn). While gross under-recoveries declined sharply by 53% in 2Q, BPCL did not benefit much as its net under-recoveries were lower by only 4%. Refining margins at US$1.6/bbl (down 42% y-y, 45% q-q) also disappointed. We still believe that for oil marketing companies to emerge as long-term investment ideas, clarity is needed on deregulation and sharing mechanism. We maintain our Neutral rating.

Price target: 620.0 INR

Price (28 Oct 2011): 637.1 INR

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2QFY12 results – Another disappointing quarter owing to no government support and poor refining margins

- **Earnings vs. our Forecast:** **BELOW**

Likely Impact:

- **Earnings Estimates:** **NO CHANGE**
- **Dividend Estimates:** **NO CHANGE**
- **Price Target:** **NO CHANGE**
- **Long-term View:** **CONFIRMED**

Key highlights of 2QFY12 results:

- More than operating performance, under-recoveries and the sharing mechanism continue to be the key determinants of profit (or loss) for the BPCL, in our view.
- BPCL reported another disappointing quarterly result in 2Q (net losses of INR32.3bn) mainly owing to no government compensation and large foreign exchange fluctuation losses. It had reported net loss of INR25.6bn in 1Q FY12.
- While gross under-recoveries declined sharply by 53% in 2Q (owing to price hikes and duty cuts announced in June 2011), BPCL did not benefit much as its net under-recoveries were lower by only 4% owing to nil government compensation. It was made to absorb higher under-recoveries (~66% vs 33% in 1QFY12 and 9% in FY11) in 2Q.
- Similar to 1QFY12, upstream support continues at one-third of gross under-recoveries.
- While it is likely that the govt/upstream will make good some of the losses in subsequent quarters, the entire sharing mechanism remains ad-hoc and non transparent (reported loss of INR57.9bn in 1HFY12 vs net profit of 4.2bn in 1HFY11 and INR15.5bn in FY11).
- 2Q results were also affected by foreign exchange fluctuation losses of ~8bn owing to sharp rupee depreciation (~10%) towards the end of the quarter.
- Lower refining margins at US$1.6/bbl in 2Q (down 42% y-y, 45% q-q) also disappointed.Lower refining margins in 2Q were in part attributable to refinery shutdown (in Sept. 2011) and higher octroi charges in Mumbai refinery. The regional benchmark Singapore complex margins in 2Q were at US$9/bbl.
- Refining throughput at 5.6MMT (up 7% q-q).
- Marketing sales (incl exports) at 8.0MMT (down 6% q-q).

We still believe that lower under-recoveries may not result in any improved bottom-lines for oil marketing companies (OMCs).

Profitability of OMCs remain at the mercy of government dictated sharing mechanism. We still believe that for these companies to emerge as long-term investment ideas, further clarity is needed on future steps towards deregulation, as well as sharing mechanism. We maintain our Neutral rating on BPCL.

Exhibit 1: BPCL – 2QFY12 results

INR bn	2QFY11	1QFY12	2QFY12F	2QFY12A	y-y	q-q	Comments
Revenue	380.1	491.7	504.6	444.3	17%	-10%	
Excise Duty	26.0	30.5	31.3	21.5	-17%	-30%	
Net Sales	**354.2**	**461.2**	**473.3**	**422.8**	**19%**	**-8%**	No compensation from Govt.
(Inc)/dec in stock	(21.2)	(6.3)	0.0	(5.4)			
RM cons	156.6	192.4	204.3	204.0	30%	6%	Post INR16.4bn upstream discount
Staff cost	4.5	6.6	5.5	4.4	-3%	-33%	
Purchases	166.1	276.3	232.6	220.0	32%	-20%	
Other expenditure	23.4	14.0	23.7	27.0	15%	93%	Include FE fluctuation loss of INR 8bn
Total Expenses	**329.5**	**483.0**	**466.1**	**450.0**	**37%**	**-7%**	
EBITDA	**24.7**	**(21.9)**	**7.3**	**(27.1)**			Higher net under-recoveries of INR32.3bn
Depreciation	4.0	4.9	5.0	4.6	14%	-6%	
EBIT	**20.7**	**(26.8)**	**2.3**	**(31.7)**			
Interest	2.8	3.3	3.6	4.5	63%	35%	Sharp 35% q-q increase in interest costs
Other income	5.5	4.5	5.0	4.0	-28%	-11%	Below estimates
Profit before tax	**23.4**	**(25.6)**	**3.7**	**(32.3)**			
Tax expense	2.0	0.0	0.0	0.0			
Tax rate %	8%	0%	0%	0%			
Net Profit	**21.4**	**(25.6)**	**3.7**	**(32.3)**			1HFY12 losses of INR57.9bn (vs PAT of 4.2 bn in 1HFY11 / 15.5bn in FY11)
EPS (reported)	59.3	(70.9)	10.1	(89.3)			

Source: Company data, Nomura estimates

Exhibit 2: BPCL – Key operating matrix

	2QFY11	1QFY12	2QFY12F	2QFY12A	y-y	q-q
Refining Throughput (MMT)	5.6	5.2	5.6	5.6	0%	7%
Market Sales incl exports(MMT)	7.5	8.5	8.1	8.0	7%	-6%
Brent (US$/bbl)	76.3	117.1	112.5	112.5	47%	-4%
Exchange Rate (INR/US$)	46.5	44.7	45.8	45.8	-2%	2%
Refining Margin (US$/bbl)						
Singapore Complex	4.3	8.6	9.0	9.0	109%	5%
Premium/Discount	(1.5)	(5.6)	(1.0)	(7.4)		
BPCL GRM	**2.8**	**3.0**	**8.0**	**1.6**	**-42%**	**-45%**
Subsidy sharing (INR bn)						
Gross U/R	24.6	102.9	51.4	48.7	98%	-53%
Less: Upstream	8.2	34.1	17.1	16.4	100%	-52%
Less: Govt compensation	29.5	35.2	25.7	0.0		
Net U/R	-13.1	33.6	8.6	32.3		-4%

Source: Company data, Nomura estimates

Valuation Methodology and Investment Risks: Valuation Methodology - Our 12-month target price of INR620 is based on 1.25x P/B FY13F book value per share of INR497.Risks - Key upside risks: Significant change in government policy on fixing retail prices. Complete deregulation Would be a significant positive in the long term and could lead to a re-rating. Even partial deregulation, but with a clear policy on sharing of any under-recoveries, would also be positive for BPCL. A significant and sustained decline in global oil prices would also be positive, as losses on retail fuels decline sharply at low oil prices. Refining margins that are higher than our estimates would be a positive for

BPCL. Key downside risks: Higher oil prices, lower-than-expected refining margins and higher net under-recoveries are key downside risks.

Note: Ratings and Price Targets are as of the date of the most recently published report (http://go.nomuranow.com/research/globalresearchportal) rather than the date of this email.

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Mentioned companies

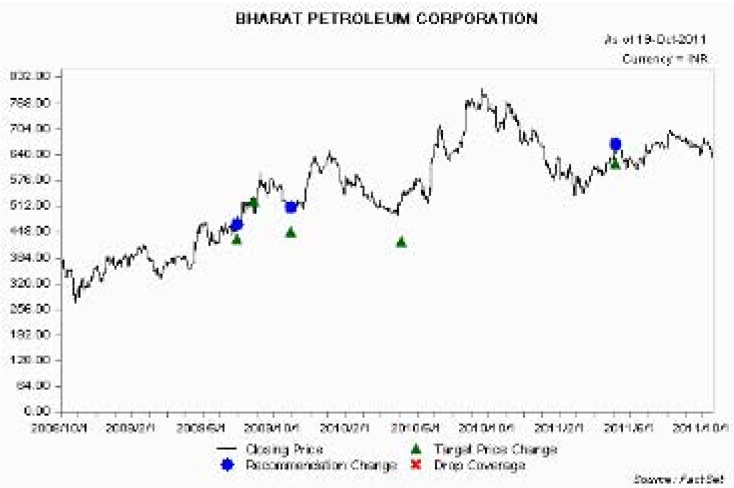
Issuer name	Ticker	Price	Price date	Stock rating	Disclosures
Bharat Petroleum Corporation	BPCL IN	637.1 INR	28 Oct 2011	Neutral	

Previous Rating

Issuer name	Previous Rating	Date of change
Bharat Petroleum Corporation	Buy	12 May 2011

Bharat Petroleum Corporation (BPCL IN) **637.1 INR (28 Oct 2011)** Neutral

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
06-May-2011		620.00	665.50
06-May-2011	Neutral		665.50
05-May-2010		425.00	526.45
30-Oct-2009		450.00	509.25
30-Oct-2009	Reduce		509.25
27-Aug-2009		525.00	495.35
29-Jul-2009		430.00	468.15
29-Jul-2009	Neutral		468.15

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our 12-month target price of INR620 is based on 1.25x P/B FY13F book value per share of INR497.

Risks that may impede the achievement of the target price Key upside risks - Significant change in government policy on fixing retail prices. Complete deregulation would be a significant positive in the long term and could lead to a re-rating. Even partial deregulation, but with a clear policy on sharing of any under-recoveries, would also be positive for BPCL. A significant and sustained decline in global oil prices would also be positive, since losses on retail fuels decline sharply at low oil prices. Refining margins that are higher than our estimates would be a positive for BPCL.Key downside risks – Higher oil prices, lower-than-expected refining margins and higher net under-recoveries are key downside risks.

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