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Oil Prices Cut Impact

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Auto fuel price cut – An impact analysis

The UPA government has cut prices of petrol and diesel by Rs2/ltr and Rs1/ltr respectively, to check the soaring inflation that stood at 6.73% for WPI index for the week ending 15th February 2007. The government had last reduced prices on November 29, 2006, by the same amount. The current move is in line with the commitment given by Ms Sonia Gandhi to align the domestic auto fuel prices with the fall in price of Indian crude basket; this commitment was given in June 2006 when retail prices of auto fuels were last hiked. Crude prices have fallen considerably from an average of $66.7/bbl in June 2006, to an average of $ 57.4/bbl in November 2006, before falling further to an average of $52.9/bbl in January 2007. The oil marketing will be duly compensated with oil bonds and excise & customs duly adjustment. The announcements and their impact analysis is given below.

1) Announcement:

Reduction in retail fuel price of petrol by Rs 2/ltr and diesel by Rs 1/ltr

Impact:

Due to the reduction in retail prices, PSU oil marketing companies are estimated to suffer an increase in net under recovery on diesel from Rs1.30/ltr as per 2nd fortnight prices for the month of February to Rs2.30/ltr, on the other hand Rs2/ltr profit on petrol is likely to be neutralised completely, with the price cut.

Negative: IOC, HPCL and BPCL

Table 1. Retail selling prices of petrol and diesel in 4 major cities

Rs / litre	DELHI	KOLKATA	MUMBAI	CHENNAI
Petrol				
Old	44.85	48.99	50.58	49.67
New	42.85	46.91	48.45	47.51
Diesel				
Old	31.25	33.92	36.11	34.41
New	30.25	32.88	34.97	33.32

Source: IISL research, company

2) Announcement:

Government will issue oil bonds to compensate for losses borne by oil marketing companies.

Impact:

Of the Rs283 bn of oil bonds approved in June 2006, the government has already issued oil bonds of Rs191bn during 9m FY07. According to the petroleum ministry, oil bonds of Rs30-40 bn would need to be issued in Q4FY07. This would compensate for the losses suffered on sale of petroleum products at below international parity prices. Issuing of these bonds would also nullify the impact of reduction in auto fuel prices. The working capital requirements of PSU oil

Amit Whabi
+91 22 67069900
amit.whabi@investsmartindia.com

marketing companies, however, would be impacted till these bonds are issued; this is because, these companies would be forced to borrow to make up for the shortfall in selling fuels at lower than RTP (Refinery Transfer Price).

Positive: IOC, HPCL and BPCL

3) Announcement:

Adjustments in custom and excise duty of auto fuels

Impact:

The government has indicated that the duty structure on auto fuels would be changed to partially compensate for the losses incurred due to price reduction. There are reports in the media that custom duty on petrol and diesel may be reduced from 7.5% to 5% and ad valorem excise duties on both the products may be reduced from 8% to 6%.

The reduction in customs duty to 5% would improve price realisations by Re 1 in case of diesel and Re 0.50 in case of petrol. The reduction in excise duty to 6% would improve price realisations by Re 0.45 in case of diesel and Re 0.35 in case of petrol.

In case of reduction in customs duty, the tariff protection for refiners will reduced by $ 0.70–0.80/bbl to less than $0.50/bbl, thus reducing the GRMs.

Positive: IOC, HPCL and BPCL

Negative: Chennai Petroleum and MRPL

Conclusion:

We believe that due to inflationary pressures and the upcoming UP state elections, the government has decided to appease the masses by reducing the prices of auto fuels. The losses to PSU oil marketing companies in the aforementioned scenario are expected to be made good through steps such as issuing oil bonds and duty adjustments. Thus, the net effect on these companies would be revenue neutral.

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