

Sing GRM down to US\$5.2/bbl last week; RIL GRM US\$4.2-5.8

Sing GRM last week lowest in over 1 year; down 31% in Nov

Reuters' Singapore refining margin (GRM) for the week ended November 25 has slumped to US\$5.2/bbl, which is the lowest level since early November 2010. Singapore GRM is down 31% month-on-month (MoM) at US\$7.0/bbl in November 2011. Theoretical GRM of Reliance Industries (RIL) works out to just US\$4.2-5.8/bbl for the week ended Nov 25 and at US\$5.1-6.2/bbl in November 2011.

Petrol, fuel oil & diesel cracks fall driver of recent GRM fall

Reuters' Singapore GRM has declined from US\$8.2/bbl in the week ending Nov 11 to US\$5.2/bbl in the week ended Nov 25. Almost all product cracks have declined in the last two weeks but GRM have been most hit by US\$4.6-5.6/bbl decline in fuel oil and petrol cracks. Petrol cracks (US\$18.7/bbl in Oct'11 and US\$16.5/bbl in Apr-Oct 2011) are down to US\$1.3/bbl last week. Diesel cracks have declined the most (US\$2.6/bbl) last week but remain high at US\$18/bbl.

RIL 3Q GRM (US\$6.8-7.6/bbl) below Sing GRM (US\$8.7/bbl)

RIL's 3Q TD FY12 theoretical GRM at US\$6.8-7.6/bbl is below Reuters' Sing GRM of 8.7/bbl. RIL has been hit mainly by steep declines in naphtha and LPG cracks and light-heavy crude spread. Arab heavy-Dubai spread at US\$0.7/bbl in 3Q is at the lowest level in 9 quarters. RIL's GRM is also QoQ lower than its 2Q FY12 GRM of US\$10.1/bbl and YoY lower than its 3Q FY11 GRM of US\$9/bbl.

RIL and Sing GRM lower by end-3Q given falling trend

Reuters' Singapore GRM, which is US\$8.7/bbl to date in 3Q, may average just US\$7.4/bbl if the rest of 3Q is at the same level as last week. Average 3Q RIL GRM may be just US\$5.8-6.9/bbl if its GRM in the rest of 3Q is same as it was last week. Some bounce back in RIL and Singapore GRM from last week's level is possible but still 3Q GRM being lower than it has to date appears likely.

RIL's FY12-13 earnings to be hit if GRM weakness continues

RIL's 3Q FY12 net profit works out to Rs51.0-55.3bn at our 3Q TD theoretical GRM of US\$6.8-7.6/bbl despite assuming a weaker rupee of Rs50.8. If 3Q profit is as we expect, it would be 3-11% QoQ lower than its profit of Rs57bn in 2Q FY12. It would be down 1% to 8% YoY higher than its 3Q FY11 profit of Rs51.4bn. If 4Q profit is the same as 3Q, FY12 EPS would be Rs65.9-68.5 (up 7-11% YoY). RIL's FY13 EPS would be Rs62.3-67.6 if it is annualized at the 3Q FY12 level.

R&M companies GRM up QoQ; at US\$2.4-2.5/bbl last week

BPCL and HPCL theoretical 3Q FY12 GRM at US\$2.5-2.9/bbl is up US\$0.9-1.0/bbl QoQ. However, their theoretical GRM has weakened to 2.4-2.5/bbl for the week ending November 25.

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Table 1: RIL's 3Q FY12 theoretical GRM at discount to Sing GRM and both trending down

US\$/bbl	Nov 21-25	11-Nov	3Q TD
Reuters' Sing GRM	5.2	7.0	8.7
RIL theoretical GRM	4.2-5.8	5.1-6.2	6.8-7.6
Premium/(discount)	(1.0)-0.7	(0.8-2.0)	(1.1-1.9)

Source: Reuters

Table 2: RIL's FY12E and FY13E earnings if profit in line with 3Q FY12E profit

	3Q FY12 GRM	
	Low	High
RIL's net profit (Rs bn)		
3Q FY12	51.0	55.3
FY12 (1H + 2x 3Q FY12)	215.6	224.2
FY13 (4x 3Q FY12)	204.0	221.0
EPS (Rs/share)		
FY12	65.9	68.5
FY13	62.3	67.6
Share price	754	754
PE multiple based on		
FY12 EPS	11.4	11.0
FY13 EPS	12.1	11.2
Assumptions		
RIL's GRM	6.8	7.6
Exchange rate	50.8	50.8

Source: BofA Merrill Lynch Global Research

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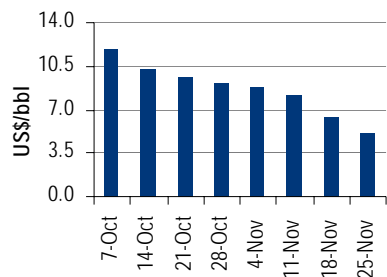
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Refer to important disclosures on page 9 to 12. Analyst Certification on Page 7. Price Objective Basis/Risk on page 7. Link to Definitions on page 7. 11113974

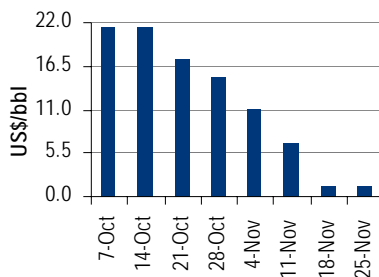
Sing GRM down to US\$5.2/bbl last week

Chart 1: Singapore GRM weekly trend in 3Q FY12TD



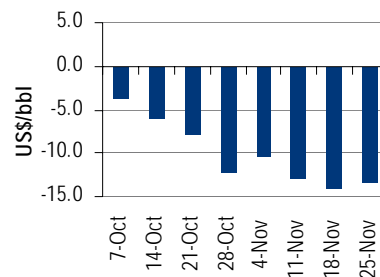
Source: Reuters

Chart 2: Petrol crack weekly trend in 3Q FY12TD



Source: Bloomberg

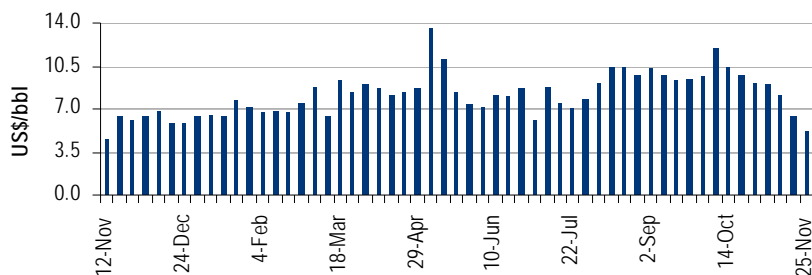
Chart 3: Naphtha crack weekly trend in 3Q FY12TD



Source: Bloomberg

Sing GRM last week lowest in over 1 year

Chart 4: Singapore GRM for the week ended 25-November at US\$5.2/bbl lowest since the week ended November 12, 2010



Source: Reuters

RIL 3Q TD and November GRM below Sing GRM

Table 3: RIL's 3Q theoretical GRM at discount to Singapore GRM and both trending down

US\$/bbl	Week ending Nov 25	Nov-11	3Q FY12TD
Reuters' Singapore complex GRM	5.2	7.0	8.7
RIL's theoretical GRM assuming			
Use of one crude	4.2	5.1	6.8
Use of best crude mix	5.8	6.2	7.6
RIL's premium/(discount) to Reuters' Singapore GRM			
RIL's GRM assuming use of one crude	-1.0	-2.0	-1.9
RIL's GRM assuming use of best crude mix	0.7	-0.8	-1.1

Source: Reuters, Bloomberg, BofA Merrill Lynch Global Research

RIL's product cracks down more QoQ than Sing RIL's 3Q product cracks down US\$2.6/bbl QoQ

Table 4: Weighted average crack spread in 3Q FY12 for RIL is down QoQ

	RIL's product slate	QoQ change (US\$/bbl)	
		Product crack	RIL's weighted average crack spread
Gasoline	18%	-5.4	-1.0
Jet/Kerosene	7%	1.0	0.1
Diesel	39%	1.2	0.5
LPG	5%	-2.9	-0.1
Naphtha	11%	-7.2	-0.8
Propylene	3%	-23.8	-0.7
Reformate	4%	-7.2	-0.3
Petroleum coke	12%	-1.9	-0.2
	100%		-2.60

Source: BofA Merrill Lynch Global Research

Reuters' Sing GRM 3Q product cracks down US\$1.2/bbl QoQ

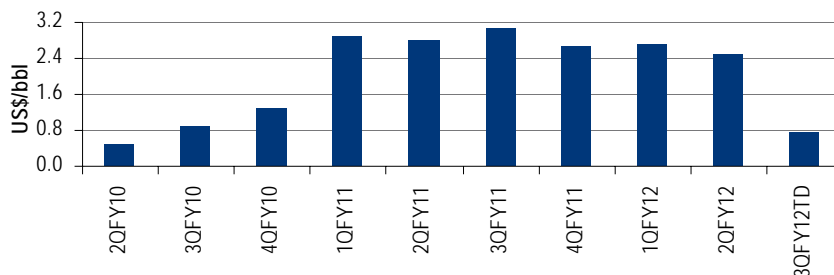
Table 5: Weighted average crack spread in 3Q FY12 for Singapore GRM is down QoQ

	Sing GRM's product slate	QoQ change (US\$/bbl)	
		Product crack	Sing GRM's weighted average crack spread
Gasoline	32%	-5.4	-1.7
Jet/Kerosene	19%	1.0	0.2
Diesel	16%	1.2	0.2
Fuel oil	23%	3.1	0.7
LPG	3%	-2.9	-0.1
Naphtha	7%	-7.2	-0.5
	100%		-1.24

Source: BofA Merrill Lynch Global Research

Arab heavy-Dubai spread at lowest level in 9 quarters

Chart 5: Arab heavy-Dubai spread at US\$0.7/bbl in 3Q FY12TD lowest in 9 quarters since 2Q FY10



Source: Bloomberg

FY12 EPS Rs66.1-68.7 if 4Q profit same as 3Q FY13 EPS Rs62.8-68 if in line with 3Q FY12 (ie annualized)

Our base case EPS for FY12E is Rs72.1 and for FY13E is Rs77.2. RIL's FY12 EPS, if 4Q FY12 earnings were to come in the same as 3Q FY12E, would be 5-9% lower than our base case. RIL's FY13E earnings, if annualized at 3Q FY12E's level, would be 13-19% lower than our base case.

Table 6: FY12 and FY13 earnings if profit in line with 3Q FY12 profit

	3Q FY12 GRM	
	Low	High
RIL's net profit (Rs bn)		
3Q FY12	51.0	55.3
FY12 (1H + 2x 3Q FY12)	215.6	224.2
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Assumptions		
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Source: BofA Merrill Lynch Global Research

R&M companies GRM up QoQ 3Q TD GRM US\$2.5-2.9/bbl vis-à-vis US\$1.6-1.9/bbl in 2Q

Table 7: BPCL and HPCL 3Q FY12TD GRM at US\$2.5-2.9/bbl

US\$/bbl	BPCL	HPCL
Weighted average product cracks	7.8	7.7
Premium of crude mix to Dubai	-2.9	-2.9
Hit from 3% octroi on crude for Mumbai refineries	-1.9	-1.5
Inventory gain	-0.4	-0.4
GRM	2.5	2.9

Source: BofA Merrill Lynch Global Research

R&M companies' GRM at US\$2.4-2.5/bbl last week

Table 8: BPCL and HPCL GRM at US\$2.4-2.5/bbl for the week ended 25 November

US\$/bbl	BPCL	HPCL
Weighted average product cracks	5.3	4.9
Premium of crude mix to Dubai	-0.6	-0.6
Hit from 3% octroi on crude for Mumbai refineries	-1.9	-1.5
Inventory gain	-0.4	-0.4
GRM	2.4	2.5

Source: BofA Merrill Lynch Global Research

Retain Buy on RIL and HPCL

GRM weakness a concern but recovery not fully ruled out

Weak rupee and higher other income to boost earnings

In our view, weakness in GRM poses risk to RIL's FY12E and FY13E earnings outlook. However, there are some positives, too, which could bring recovery in GRM and an improved earnings outlook. The positives for RIL are:

- Strong diesel and jet fuel (46% of RIL's product slate) cracks. Diesel and jet fuel cracks to date in 3Q are strong at US\$18.8-19.8/bbl with cracks in the last week being US\$18.0-18.9/bbl. If diesel and jet fuel cracks remain strong and light distillate cracks and light- heavy crude spread were to recover, RIL's GRM would recover
- Weaker rupee. The rupee has weakened to Rs52/US\$. RIL benefits from a weak rupee. RIL's oil & gas price, refining and petrochemical margin, which is denominated in US dollars, boosts its profit in rupees when the rupee is weak
- Higher other income. RIL had cash of US\$12.6bn in end-September 2011, which has gone up further to US\$15.6bn in early October on receipt of last tranche of consideration from BP. Rising surplus cash and high interest rates would mean higher other income

We retain our Buy rating on RIL.

HPCL inexpensive at 0.76x FY11 book value

Despite some weakness in HPCL's FY12E earnings outlook, there are some positives for the shares such as healthy marketing margins on petrol and QoQ higher GRM. In our view, HPCL is inexpensive at P/B of 0.76x on FY11. We retain our Buy rating on HPCL.

Appendix I

Product cracks trend since FY01

Table 9: Trend in Asian product cracks based on Dubai crude

	Diesel	Petrol	Naphtha	LPG	Jet fuel	Fuel oil
FY01	5.9	6.5	2.2	0.6	7.9	-2.9
FY02	4.3	4.1	1.0	-2.2	5.1	-2.3
FY03	4.9	5.2	2.0	-0.4	5.2	-1.3
FY04	5.9	9.2	3.4	-2.4	6.5	-2.2
FY05	13.3	13.4	7.1	-3.4	15.8	-7.6
FY06	14.3	12.1	1.1	-10.8	18.8	-9.6
FY07	16.0	12.6	2.6	-17.0	18.7	-14.8
FY08	18.8	14.8	5.9	-16.7	20.0	-13.8
FY09	22.8	8.8	-4.8	-28.0	25.2	-14.2
FY10	7.2	9.0	-0.8	-18.4	7.8	-6.1
FY11	13.7	10.3	0.2	-19.3	14.7	-9.4
FY12TD	18.6	15.2	-4.2	-35.6	19.7	-8.9

Source: Bloomberg, BofA Merrill Lynch Global Research

Price objective basis & risk

Hindustan Petro. (XHTPF)

Our PO of Rs430 is based on PE of 9.0x on HPCL's FY12E EPS (excluding dividend income from MRPL) of Rs35.8 in line with the stock's three-year average P/E. It also includes the market value of investments in MRPL (ONGC's subsidiary), Oil India (OIL) and cost of investment in JV refinery HPCL Mittal Energy Ltd. of Rs108. Upside risks: (1) Significant reserve accretion in HPCL's E&P exploration assets in India and abroad (2) Subsidy R&M companies have to bear is lower than assumed by us or oil sector is fully deregulated, (3) Refining margins are higher than forecast by us, (4) Rise in market prices of MRPL. Downside risks: (1) Indian oil sector continues to be regulated and HPCL is not adequately compensated for subsidies it has to bear, (2) steep decline in regional and hence HPCL's refining margins, and (3) steep decline in the market price of MRPL.

Reliance Inds (XRELF)

Our PO of Rs950 (GDR US\$40.14) is a sum-of-the-parts valuation. It includes EV of RIL's 3 businesses of Rs945/share and net cash of Rs4/share. The EV of the refining, petrochemical and E&P business is calculated on a DCF basis, using a WACC of 11.8pct. Refining and marketing (Rs433) is 46pct of the EV, E&P valuation (Rs195) 21pct, and petrochemicals (Rs317) 34pct. Downside risks are (1) Refining and petrochemical margins being lower than expected due to global economic slowdown (2) 7-year income tax holiday being disallowed on gas production, which would mean lower cash flow, profit and fair value, (3) Lower-than-expected oil price, and (4) Large acquisitions that are value dilutive. Upside risks are (1) Refining and petrochemical margins being better than expected, (2) Higher-than-expected oil price, (3) Significant reserve accretion in the next 12 months and (4) Large acquisitions that increase fair value significantly.

Link to Definitions

Basic Materials

Click [here](#) for definitions of commonly used terms.

Energy

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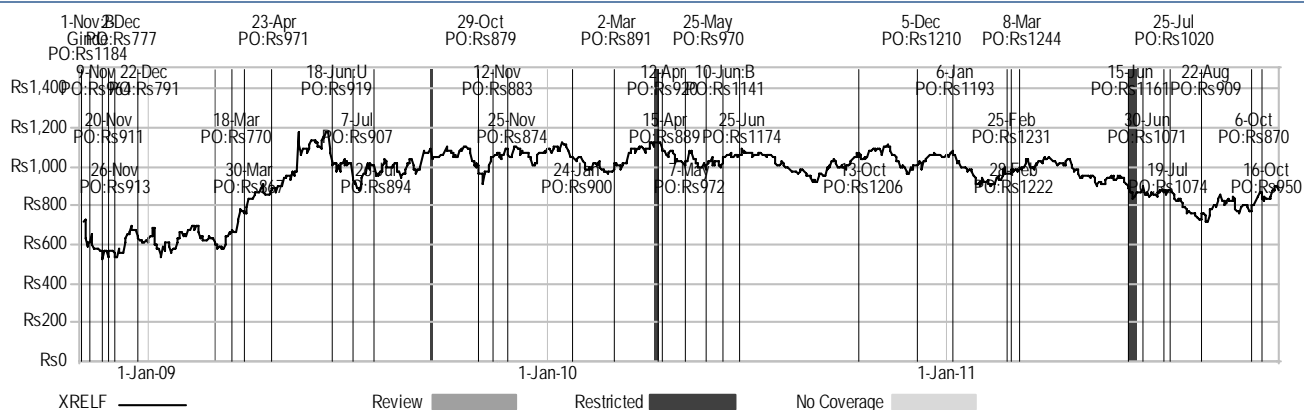
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	Kunlun Energy	CNPXF	135 HK	Vitus Leung
	LG Chem	LGCLF	051910 KS	Kenneth Whee
	Nan Ya Plastics	NNYPF	1303 TT	Joon-Ho Lee
	Oil India Ltd	XLCRF	OINL IN	Vidyadhar Ginde
	Oriental Union Chemical	OLUNF	1710 TT	Joon-Ho Lee
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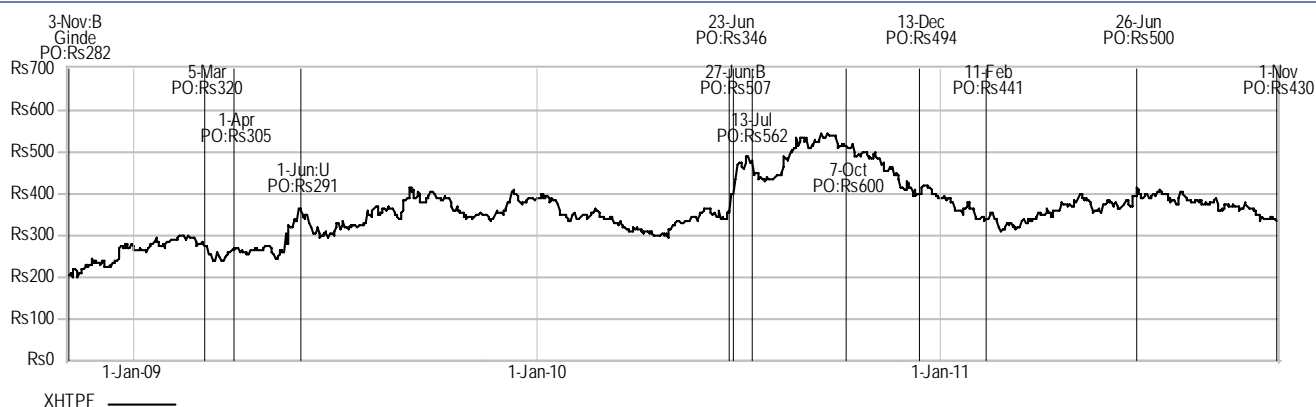
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B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR : No Rating

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XHTPF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR : No Rating

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Buy	54	50.94%	Buy	22	47.83%
Neutral	29	27.36%	Neutral	16	61.54%
Sell	23	21.70%	Sell	7	30.43%

Investment Rating Distribution: Energy Group (as of 01 Oct 2011)

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Neutral	71	25.09%	Neutral	32	55.17%
Sell	48	16.96%	Sell	20	48.78%

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Neutral	961	25.09%	Neutral	460	52.57%
Sell	796	20.78%	Sell	287	38.32%

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