

## Petrol Price Hike

24 May 2012

### Heralding Stagflation?

State-owned oil companies increased petrol prices by Rs7.50/litre with effect from Wednesday midnight. They hiked petrol prices by Rs6.28/litre excluding local sales tax or VAT. The price hike came just a day after Prime Minister Mr. Manmohan Singh called for implementation of strict measures to help the economy. The government had decontrolled petrol prices in June 2010 and since then they were hiked just once in November 2011. While the hike was on the cards and expected, the quantum of the hike has surprised all. While the move may bring some short-term reprieve for oil marketing companies (OMCs) grappling with higher under-recoveries, it would lead to inflationary pressure as other administered prices would also increase even as Wholesale Price Index (WPI) in April 2012 stood at 7.2% YoY and food inflation at 10.5%. We have factored in such price hikes for our FY13 WPI inflation estimate of 8.5%. The immediate inflationary impact may be limited on account of petrol having a lower weight in WPI.

The hike in petrol prices by state-owned oil companies should not merely be viewed in isolation but as part of a broader strategy of increasing administered prices and reducing subsidies. The petrol hike will have no impact on fiscal deficit and hence we can expect diesel, public distribution scheme kerosene, domestic liquefied petroleum gas (LPG), urea, and electricity prices also to be hiked in future as the government wants to align domestic prices with global prices. Such a strategy, policy makers believe, will result in short-term spike in inflation but will thereafter result in higher GDP growth. We believe the rise in administered prices will result in higher inflation, higher interest rates, and decelerating demand with no assurance of laying a foundation for future economic growth. Indeed, stagflation may be the likely fallout of such a policy. We reiterate our negative stance on the banking sector and view this development as a major setback for sustained efforts by the Reserve Bank of India (RBI), which has been struggling to contain inflationary pressures.

**Oil & Gas:** The steep petrol price hike could bring some respite to the financials of OMCs, but what is important is the intention behind the price hike – is it meant to ease the financial stress on OMCs or is an indicator of forthcoming bold decisions for other regulated petroleum products. India is currently facing a double whammy of elevated crude oil prices and a sliding rupee and in such a state, without a hike in the prices of regulated petroleum products, the overall under-recoveries may touch Rs2,000bn(US\$36.36bn) in FY13E compared to Rs1,385bn(US\$28.76bn) in FY12. The government, in the 2012-13 budget, mandated only Rs430bn of oil subsidy for FY13E and showed its intention to rein in subsidy to 2% of GDP and so keeping in mind the strain on government finances, we believe the hike in the prices of regulated petroleum products is imminent. We have already factored in Rs5/litre hike in the price of diesel, Rs50 hike per LPG cylinder and Rs3/litre hike in kerosene in our FY13E under-recoveries estimate. We believe the petrol price hike and restricting upstream companies' subsidy burden at ~40% in FY12 could bring some semblance of positive undertone for companies in our coverage universe, but we will review our ratings and target prices only after the likely revision in the prices of regulated petroleum products.

**Automobiles:** We believe it will be negative for the automobile sector and the major impact of the petrol price hike would be visible in the demand for small car passenger cars, which account for 60% of the domestic car industry's sales. Following the steep increase in petrol price, we expect the sales of petrol cars to take a hit, thereby impacting their volumes in the near term. In the case of two-wheelers, we don't expect any significant pressure on demand because of their higher fuel efficiency.

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**Petrol hike: Dud reform signals or heralding bold decisions?**

24 May 2012

**Steep Petrol Price Hike: Is This The Beginning of Bold Decisions?**

The government, on late Wednesday hiked petrol prices by Rs6.28/litre (excluding VAT/sales tax) with effect from 24 May 2012. Petrol prices, including all taxes, in Delhi would be dearer by Rs7.54/litre at Rs73.18/litre, a steep increase of 11.49%. Petrol prices, in percentage as well as absolute terms, witnessed the biggest hike since March 2003. Prior to this hike, oil marketing companies (OMCs) faced an under-recovery of Rs7.5/litre on petrol and even after the precipitous hike, their under-recovery stands at Rs1.5/litre.

**Hike was expected, but effective date was the key:** Petrol prices were de-regulated in June 2010 and OMCs, in theory, were supposed to review petrol prices on a fortnightly basis, but given the populist measures ahead of assembly elections and pressure from the ruling United Progressive Alliance government's partners, petrol prices were kept unchanged since November 2011, despite global motor spirit prices inching up 14.5% and the rupee/dollar exchange rate deteriorating by 3.2% from Rs51.50 to Rs53.17 till mid May 2012. In FY12, OMCs' under-recovery from sale of petrol stood at Rs49bn, which was entirely absorbed by them, as it does not constitute as under-recovery for oil subsidy calculation purpose. OMCs, since the last revision in petrol prices in November 2011, suffered under-recoveries of Rs46.51bn until March 2012 and so far in FY13 have suffered under-recoveries of Rs23.30bn on sale of petrol. Given the mounting under-recoveries on petrol sales, OMCs are increasing pressure on the government to include petrol under-recoveries under the oil subsidy mechanism.

**Fuel price hike and impact on inflation:** Petrol has a weight of 1.09% in the Wholesale Price Index (WPI), implying that a 11.49% hike in petrol price in Delhi would result in ~12.5bps impact on inflation..

**High taxes on petrol adds to woes:** OMCs would hike petrol price by Rs6.28/litre but the impact on consumers would be higher by Rs0.94 to Rs2.07/litre over and above Rs6.28/litre on account of the huge variance in sales tax/value added tax structure across the states - from 15% to 33% - and this would be over and above the existing sales tax of Rs10.30 to Rs18.74/litre. Currently, taxes constitute ~40-45% of retail selling price of petrol.

**Petrol consumption growth slips below 5% in FY12:** After the 11.9% hike in petrol prices, petrol would be 79% costlier than diesel. With the spread between petrol and diesel prices increasing, petrol consumption growth is on the decline. Petrol consumption in India grew 4.41% YoY to 14.82mt in FY12 compared to 10.7%/13.9% annual consumption growth in FY10/FY11, respectively. The proportion of diesel car sales has steadily risen from 21.4% in FY08 to 28.42% in FY11. However, in FY12, at least 40% of the total cars sold in the country ran on diesel.

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**What the petrol price hike indicates:** The steep petrol price hike could bring some respite to the financials of OMCs, but what is important is the intention behind the price hike – is it meant to ease the financial stress on OMCs or is an indicator of forthcoming bold decisions for other regulated petroleum products. On regulated products, the under-recovery on diesel is Rs13.46/litre, kerosene Rs31.49/litre and liquefied petroleum gas Rs480.50/cylinder. The prices of regulated petroleum products have been unchanged since June 2011 and a meeting of the EGOM (empowered group of ministers) is scheduled on 25 May 2012 to take stock of the prices of regulated petroleum products. India is currently facing a double whammy of elevated crude oil prices and a sliding rupee and in such a state, without a hike in the prices of regulated petroleum products, the overall under-recoveries may touch Rs2,000bn(US\$36.36bn) in FY13E compared to Rs1,385bn(US\$28.76bn) in FY12. The government, in the 2012-13 budget, mandated only Rs430bn of oil subsidy for FY13E and showed its intention to rein in subsidy to 2% of GDP and so keeping in mind the strain on government finances, we believe the hike in the prices of regulated petroleum products is imminent. We have already factored in Rs5/litre hike in the price of diesel, Rs50 hike per LPG cylinder and Rs3/litre hike in kerosene in our FY13E under-recoveries estimate. We believe the petrol price hike and restricting upstream companies' subsidy burden at ~40% in FY12 could bring some semblance of positive undertone for companies in our coverage universe, but we will review our ratings and target prices only after the likely revision in the prices of regulated petroleum products. With no assembly elections scheduled before the end of 2012 and only one budget to be presented in March 2013, the next six to eight months would be an appropriate time for the UPA government to take some harsh decisions.

### Exhibit 1: Price build-up of Petrol

C&F price of Petrol	\$/bbl	130
Exchange rate	Rs/\$	56
Refinery transfer price	Rs/ltr	45.79
Price charged to dealers(ex excise & VAT)	Rs/ltr	38.42
Specific excise duty@Rs14.78/ltr	Rs/ltr	14.78
Dealer commission	Rs/ltr	1.5
VAT@20%	Rs/ltr	10.94
Retail selling price	Rs/ltr	65.64
Unregulated selling price	Rs/ltr	73.01
Under-recoveries on Petrol	Rs/ltr	7.37

Source: Nirmal Bang Institutional Equities Research

### Exhibit 2: Petrol price change (Price in Delhi)

	Price	Chg	Absolute chg
	(Rs/ltr)	(%)	(Rs/ltr)
24-May-12	73.18	11.49	7.54
1-Dec-11	65.64	(1.17)	(0.78)
16-Nov-11	66.42	(3.23)	(2.22)
4-Nov-11	68.64	2.69	1.8
16-Sep-11	66.84	4.93	3.14
1-Jul-11	63.7	0.52	0.33
15-May-11	63.37	8.57	5
2-Mar-11	58.37	0.00	0
16-Jan-11	58.37	4.47	2.5
16-Dec-10	55.87	5.59	2.96
9-Nov-10	52.91	0.61	0.32
2-Nov-10	52.59	0.00	0
17-Oct-10	52.59	1.47	0.76
21-Sep-10	51.83	0.52	0.27
8-Sep-10	51.56	0.25	0.13
26-Jun-10	51.43	7.30	3.5
1-Apr-10	47.93	1.05	0.5
27-Feb-10	47.43	6.06	2.71
2-Jul-09	44.72	10.09	4.1

Source: Indian Oil Corporation

**Exhibit 3: Petrol consumption**

	Qty in '000 tons	YoY (%)
FY07	9,286	7.4
FY08	10,332	11.3
FY09	11,258	9
FY10	12,818	13.9
FY11	14,192	10.7
FY12	14,822	4.4

Source: PPAC

**Exhibit 4: Diesel consumption**

	Qty in '000 tons	YoY (%)
FY07	42,897	6.7
FY08	47,669	11.1
FY09	51,710	8.5
FY10	56,242	8.8
FY11	60,071	6.8
FY12	63,913	6.4

Source: PPAC

**Exhibit 5: Upcoming state elections**

States	Assembly tenure ends
Gujarat	Jan-13
Himachal Pradesh	Jan-13
Meghalaya	Mar-13
Nagaland	Mar-13
Tripura	Mar-13
Karnataka	Jun-13
Madhya Pradesh	Dec-13
Mizoram	Dec-13
NCR Delhi	Dec-13
Rajasthan	Dec-13

Source: Election Commission of India

**Exhibit 6: Under-recovery build up**

(Rsbn)	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
LPG	102	107	155	176	143	218	300	382	357
SKO	144	179	191	282	174	195	274	239	208
Petrol	27	20	73	52	52	22	49	0	0
Diesel	126	188	352	523	93	347	812	813	467
<b>Total</b>	<b>400</b>	<b>494</b>	<b>771</b>	<b>1,033</b>	<b>462</b>	<b>782</b>	<b>1,385</b>	<b>1,434</b>	<b>1,032</b>

Note: Petrol not consider for calculation in FY11 and FY12

Source: Nirmal Bang Institutional Equities Research

**Exhibit 7: Subsidy break up**

(Rsbn)	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
<b>Upstream</b>	<b>141</b>	<b>205</b>	<b>257</b>	<b>329</b>	<b>144</b>	<b>303</b>	<b>550</b>	<b>602</b>	<b>434</b>
ONGC	120	170	220	282	116	249	445	500	360
Oil India	10	20	23	30	15	33	73	72	48
GAIL	11	15	14	17	13	21	32	30.11	26.01
<b>Govt of India</b>	<b>115</b>	<b>241</b>	<b>353</b>	<b>713</b>	<b>260</b>	<b>410</b>	<b>835</b>	<b>731</b>	<b>516</b>
<b>OMC's</b>	<b>145</b>	<b>48</b>	<b>161</b>	<b>-9</b>	<b>56</b>	<b>69</b>	<b>0</b>	<b>100</b>	<b>83</b>

Source: Nirmal Bang Institutional Equities Research

**Exhibit 8: Subsidy sharing**

(%)	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E
Upstream	35.2	41.5	33.3	31.8	31.3	38.7	39.7	42.0	42.0
Gol	28.7	48.8	45.8	69.0	56.5	52.4	60.3	51.0	50.0
OMC	36.2	9.7	20.9	(0.9)	12.2	8.8	0.0	7.0	8.0

Source: Nirmal Bang Institutional Equities Research

## Automobile Sector

24 May 2012

### Steep Hike In Petrol Price To Hurt Car Sales

The government late Wednesday announced a hike in the price of petrol by Rs7.54/litre to Rs73.18/litre (in Delhi) with effect from 24 May 2012- the steepest hike ever. We believe it will be negative for the automobile sector and the major impact of the petrol price hike would be visible in the demand for small car passenger cars, which account for 60% of the domestic car industry's sales. Following the steep increase in petrol price, we expect the sales of petrol cars to take a hit, thereby impacting their volumes in the near term. In the case of two-wheelers, we don't expect any significant pressure on demand because of their higher fuel efficiency.

**No hike in diesel price:** The government did not hike diesel price, which has further increased the already high differential between petrol and diesel prices. Following the Rs7.54/litre hike in petrol price, the price differential between two fuels now stands at 44.1% from 37.7% earlier. Currently, diesel cars are witnessing strong demand due to the huge differential between petrol and diesel prices, which is expected to strengthen further in the near term in the wake of the petrol price hike.

**Petrol price hike negative for passenger cars, neutral for two-wheelers:** We believe the petrol price hike is negative for passenger car manufacturers having a strong presence in the entry-level segment, which is skewed towards petrol models. Market leaders in the passenger car segment such as Maruti Suzuki, Hyundai Motors and Tata Motors would be impacted the most because of the petrol price hike. In the case of two-wheeler makers, we do not believe the petrol price hike will lead to any downward pressure on demand because of higher fuel efficiency offered by these vehicles.

**We trim our FY13/FY14 volume assumptions for Maruti Suzuki:** We have cut our volume assumptions for Maruti Suzuki by 5.4% and 4% for FY13/FY14, respectively, in the wake of the steep hike in petrol price. Our revised volume assumptions for FY13/14 stand at 1.27mn units and 1.49mn units from 1.34mn units and 1.55mn units, respectively, earlier. Due to the reduction in volume assumptions, our earnings estimates stand revised downwards by 7.5%/5.2% for FY13/FY14, respectively. We retain our **Buy** rating on the stock with a revised target price of Rs1,383, implying an upside of 20% from the current market price.

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### Change in our FY13, FY14 estimate

(Rsmn)	Old assumption		New assumption		Change (%)	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Volumes	1,344,747	1,553,354	1,272,747	1,491,914	(5.4)	(4.0)
Net sales	434,223	518,012	413,061	499,308	(4.9)	(3.6)
EBITDA	35,808	47,007	33,853	45,146	(5.5)	(4.0)
PAT	23,404	31,228	21,646	29,596	(7.5)	(5.2)
EPS	81	108	75	102	(7.5)	(5.2)

Source: Nirmal Bang Institutional Equities Research

## Disclaimer

### Stock Ratings Absolute Returns

BUY > 15%

HOLD 0-15%

SELL < 0%

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