

ESSAR OIL

Superior operations achieved; deleveraging awaited

India Equity Research | Oil, Gas and Services



Essar Oil (ESOIL) reported Q3FY13 profit of INR320mn, lower than our INR1030mn estimate due to higher interest cost and forex losses. However, operationally the performance was superior. This was the first quarter reflecting full benefits of the expanded complex refinery. While the refinery operated at 102.8% utilisation (5.14 mmt), clean GRMs rose to USD9.75/bbl reflecting the rise in complexity to 11.8. ESOIL used 84% heavy and ultra-heavy crude and produced 85% light and middle distillates. Going forward, reduction in debt and lower financing costs via raising ECB will be key. Maintain 'BUY' with a target price of INR101.

Higher petcoke, lower naphtha boost clean GRMs to USD9.75/bbl

While Essar Oil's book GRMs were USD8.83/bbl (estimate USD9/bbl), clean GRMs were USD9.75/bbl, the difference being inventory and hedging losses. The refinery used 67% ultra-heavy and 17% heavy crude with an average API of 27.1. While the light-heavy spread widened in Q3FY13 led by lower fuel-oil demand, the refinery also capitalised on higher coking margins through conversion of fuel oil to petcoke. No downstream petrochemicals integration also means ESOIL has a lower naphtha yield than other complex refiners. The coal-based captive power plant has been fully synchronised in November 2012 and the company expects a saving of at least USD1/bbl in margins.

Opex at USD2.5/bbl; rising financing expenses continue to hurt

Interest expense at INR8.8bn and forex loss at INR3.45bn were higher (estimate INR6bn and INR2bn) leading to lower PAT. With high leverage (~8-9x) and funding costs (~11%), interest expense was ~80% of EBITDA in past two quarters. Following CDR exit, ESOIL has received RBI's nod to raise USD2.27bn via ECB which should improve profitability. The company has paid the first installment of the sales tax liability.

Outlook and valuations: Refining margins to remain high; 'BUY'

We are positive on refining margins as capacity closures will offset global additions leading to CY12-14E net addition of 1.5mbpd versus demand growth of 2.4mbpd and improvement in global utilisation from 81.2% in CY11 to 82.6% in CY14. Lower fuel oil demand and wider light-heavy spreads is also a positive. We value refining at 6x EV/EBITDA and maintain 'BUY/Sector Outperformer' with a Mar'13 target of INR101.

Financials

(INR mn)

Year to March	Q3FY13	Q3FY12	YoY %	Q2FY13	QoQ %	FY12	FY13E	FY14E
Net revenues	238,170	128,510	85.3	209,630	13.6	583,366	894,066	866,345
EBITDA	10,020	4,000	150.5	9,770	2.6	16,760	28,573	47,016
Profit after tax	320	(39,860)	NA	1,050	(69.5)	(12,855)	(12,990)	5,489
Diluted EPS (INR)	0.2	0.2	10.3	0.8	(69.5)	(0.4)	(9.5)	4.0
Diluted P/E (x)						(208.5)	(7.7)	18.2
EV/EBITDA (x)						15.3	11.1	7.0
ROAE (%)						(1.4)	(45.2)	22.0

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperformer
Risk Rating Relative to Sector	High
Sector Relative to Market	Underweight

MARKET DATA (R: ESRO.BO, B: ESOIL IN)

CMP	: INR 73
Target Price	: INR 101
52-week range (INR)	: 76 / 42
Share in issue (mn)	: 1,365.7
M cap (INR bn/USD mn)	: 100/ 1,827
Avg. Daily Vol.BSE/NSE('000)	: 3,529.5

SHARE HOLDING PATTERN (%)

	Current	Q2FY13	Q1FY13
Promoters *	16.0	16.0	16.0
MF's, FI's & BK's	1.6	1.6	1.6
FII's	1.7	1.7	2.1
others	80.7	80.7	80.4
* Promoters pledged shares (% of share in issue)			32.9

PRICE PERFORMANCE (%)

	Stock	Nifty	EW O & G Index
1 month	6.6	2.1	1.1
3 months	14.3	6.3	4.4
12 months	16.6	23.1	0.6

Niraj Mansingka, CFA

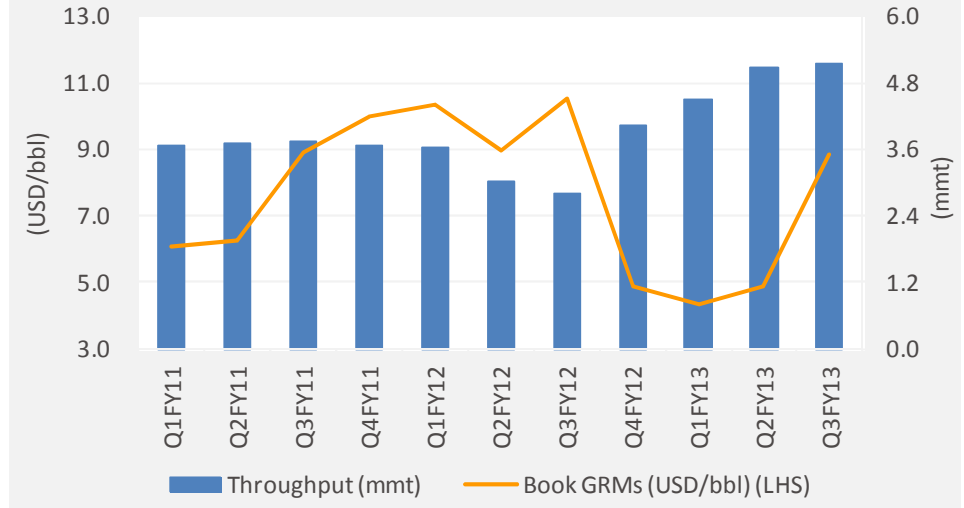
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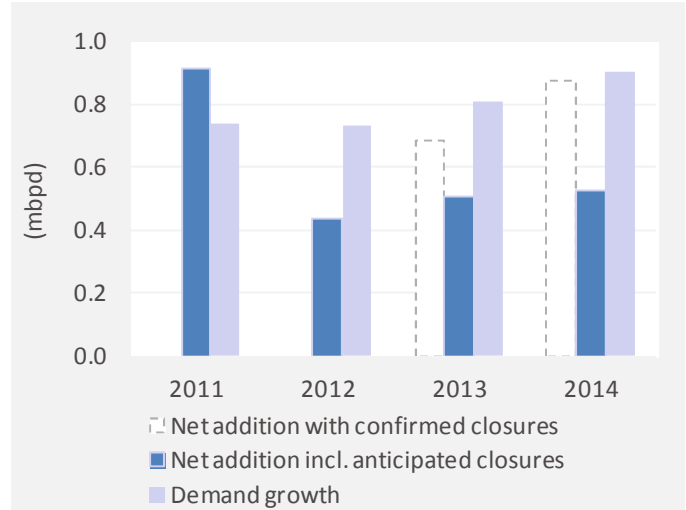
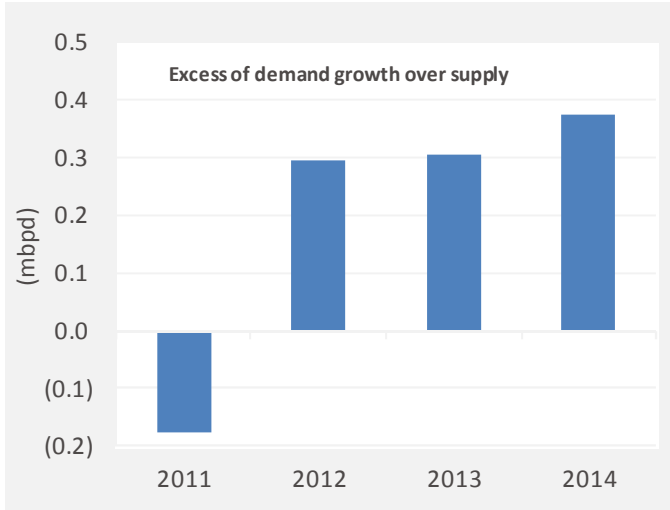
January 16, 2013

Chart 1: GRMs improve in line with refinery expansion and higher complexity



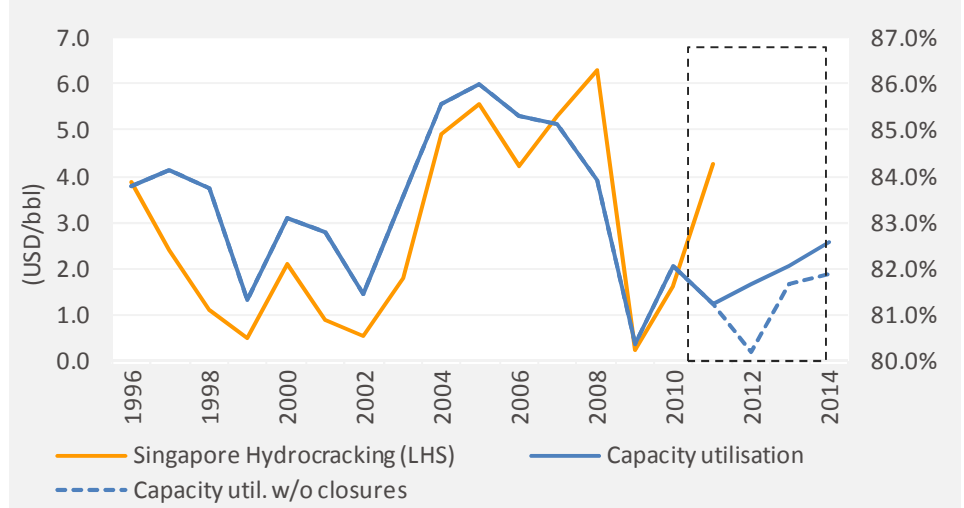
Source: Company, Edelweiss research

Chart 2: Net global capacity addition over CY12-14E of 1.5mbpd, lower than demand growth of 2.4mbpd



Source: Edelweiss research

Chart 3: Leading to an improvement in capacity utilisation as well as refining margins



Source: BP Statistical Review, Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q3FY13	Q3FY12	% change	Q2FY13	% change	YTD13	FY13E	FY14E
Net revenues	238,170	128,510	85.3	209,630	13.6	647,730	894,066	866,345
Raw material costs	219,720	117,220	87.4	199,460	10.2	611,210	839,289	797,868
Gross profit	18,450	11,290	63.4	10,170	81.4	36,520	54,776	68,477
Employee expenses	480	370	29.7	460	4.3	1,390	1,830	2,013
Other expenses	2,940	3,450	(14.8)	3,000	(2.0)	8,960	24,373	19,448
EBITDA	10,020	4,000	150.5	9,770	2.6	15,390	28,573	47,016
Depreciation & amortization	3,270	1,890	73.0	3,260	0.3	9,710	13,048	13,414
EBIT	6,750	2,110	219.9	6,510	3.7	5,680	15,525	33,602
Other income	2,390	900	165.6	1,920	24.5	5,550	5,464	3,531
Interest	8,820	3,540	149.2	7,380	19.5	25,040	33,979	31,644
Profit before tax	320	(530)	(160.4)	1,050	(69.5)	(13,810)	(12,990)	5,489
Tax		(820)	(100.0)					
Core profit	320	290	10.3	1,050	(69.5)	(13,810)	(12,990)	5,489
Extraordinary items		(40,150)	(100.0)					
PAT	320	(39,860)	(100.8)	1,050	(69.5)	(13,810)	(12,990)	5,489
Diluted EPS (INR)	0.2	0.2	10.3	0.8	(69.5)	(10.1)	(9.5)	4.0

As % of net revenues

Gross profit	7.7	8.8		4.9		5.6	6.1	7.9
EBITDA	4.2	3.1		4.7		2.4	3.2	5.4
Adjusted net profit	0.1	0.2		0.5		(2.1)	(1.5)	0.6
Tax rate	-	-		-		-	-	-

Change in Estimates

	FY13E			FY14E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	894,066	725,293	23.3	866,345	801,665	8.1	Higher crude prices
EBITDA	28,573	33,016	(13.5)	47,016	43,985	6.9	FY13 – higher opex FY14 – higher refining margins
EBITDA Margin	3.2	4.6		5.4	5.5		
Core profit	(12,990)	4,590	(383.0)	5,489	8,736	(37.2)	Higher interest expense, forex loss and working capital charges
PAT Margin	(1.5)	0.6		0.6	1.1		
Capex	25,700	21,782	18.0	2,000	1,900	5.2	Higher capex in FY13 for refinery optimization

Company Description

ESOIL is one of the major arms of the Essar Group, and currently has operations primarily in refining and marketing of fuels. Historically, the company had a business of oil exploration rigs, which it has exited. ESOIL aims to be a vertically integrated entity, and has therefore embarked on acquisition of upstream assets. However, its core business remains refinery-centric.

ESOIL has a 20.0 MMTPA, 11.8 NCI (Nelson Complexity Index) refinery at Vadinar, near Jamnagar in Gujarat. The refinery started trial production in mid-FY08, and FY09 was its first full year of operations. ESOIL has interests in the upstream sector as well, and aims to transform into a true integrated oil and gas entity through forays into the E&P segment. It has interests in blocks in India (both E&P and CBM), and some assets lying with other group companies of ESOIL are pending approval for transfer to ESOIL.

Investment Theme

- Expanded high-complexity refinery to outperform peers on multiple fronts. The share of Heavy and Ultra-Heavy crudes to rise from 72% to 84%, while the share of heavy distillates in the output to fall from 25% to 15%
- Robust domestic demand despite global slowdown provides comfort on offtake
- Exploratory upsides and CBM monetisation to add value
- Current blended cost of debt is 11%+ which will fall dramatically if the company is able to convert it to USD based debt.

Key Risks

- Faster than anticipated global capacity ramp-ups could dent refining margins
- Rupee appreciation may harm refining realisations
- Marketing segment's growth may be constrained due to regulatory disparity
- Signing of PSC for Ratna E&P block

Financial Statements

Key Assumptions

Year to March	FY12	FY13E	FY14E	FY15E
Macro				
GDP(Y-o-Y %)	6.5	5.5	6.5	7.0
Inflation (Avg)	8.8	7.8	6.0	6.0
Repo rate (exit rate)	8.5	7.5	6.8	6.0
USD/INR (Avg)	47.9	54.5	54.0	52.0
Sector				
USD/INR (Avg)	47.9	53.5	54.0	52.0
Brent Crude (USD/bbl)	115.4	110.0	100.0	102.0
Company				
Refining				
Refining throughput (mmt)	13.5	19.4	20.0	20.8
Book GRMs (USD/bbl)	8.5	7.2	8.7	8.8
Opex (USD/bbl)	1.6	1.0	1.0	1.0
G&A expenses % of revenues	0.8	0.5	0.6	0.6
Financial assumptions				
Gross debt (INR bn)	177	235	252	256
Capex (INR bn)	15	26	2	2
WC expense (% of short term debt)	8.9	10.9	7.6	6.2
Debtor days	20	21	25	25
Inventory days	45	42	53	52
Payable days	58	56	67	64
Cash conversion cycle (days)	7	7	12	12
Depreciation as % of gross block	4.0	5.0	4.8	4.8
Interest cost on term loans (%)	5.8	11.0	10.0	8.0

Income statement

(INR mn)				
Year to March	FY12	FY13E	FY14E	FY15E
Net revenue	583,366	894,066	866,345	884,278
Materials costs	543,083	839,289	797,868	814,907
Gross profit	40,283	54,776	68,477	69,371
Employee costs	1,346	1,830	2,013	2,214
Other Expenses	22,178	24,373	19,448	19,576
EBITDA	16,760	28,573	47,016	47,581
Depreciation & Amortization	7,619	13,048	13,414	13,510
EBIT	9,141	15,525	33,602	34,070
Other income	4,248	5,464	3,531	4,451
Interest expenses	13,868	33,979	31,644	27,013
Profit before tax	(480)	(12,990)	5,489	11,508
Net profit	(480)	(12,990)	5,489	11,508
Extraordinary income/ (loss)	(12,375)	-	-	-
Profit after minority interest	(12,855)	(12,990)	5,489	11,508
Shares outstanding (mn)	1,366	1,366	1,366	1,453
Diluted EPS (INR)	(0.4)	(9.5)	4.0	7.9
CEPS (INR)	5.2	-	13.8	17.2

Common size metrics

Year to March	FY12	FY13E	FY14E	FY15E
Gross margin	6.9	6.1	7.9	7.8
EBITDA margins	2.9	3.2	5.4	5.4
EBIT margins	1.6	1.7	3.9	3.9
Net profit margins	(2.2)	(1.5)	0.6	1.3

Growth ratios (%)

Year to March	FY12	FY13E	FY14E	FY15E
Revenues	24.0	53.3	(3.1)	2.1
EBITDA	(32.9)	70.5	64.5	1.2
Net profit	(105.8)	2,605.1	(142.3)	109.7
EPS	(105.8)	2,605.1	(142.3)	97.1

Balance sheet		(INR mn)			
As on 31st March	FY12	FY13E	FY14E	FY15E	
Equity capital	13,823	13,823	13,823	14,693	
Reserves & surplus	21,385	8,395	13,884	23,589	
Shareholders funds	35,207	22,218	27,706	38,283	
Short term debt	55,216	70,362	66,590	68,952	
Long term debt	122,028	164,428	185,652	186,848	
Borrowings	177,244	234,790	252,242	255,800	
Sources of funds	212,452	257,007	279,948	294,083	
Tangible assets	212,999	234,951	223,537	212,026	
Intangible assets	200	200	200	200	
CWIP (incl. intangible)	17,605	8,305	8,305	8,305	
Total net fixed assets	230,804	243,456	232,041	220,531	
Non-current investments	1,030	1,030	1,030	1,030	
Cash and equivalents	20,609	16,704	23,703	28,974	
Inventories	76,817	117,576	113,930	116,289	
Sundry debtors	39,969	61,237	59,339	60,567	
Loans and advances	6,390	10,729	10,396	10,611	
Other current assets	25,278	35,763	34,654	35,371	
Total current assets	169,062	242,009	242,022	251,812	
Trade payable	108,100	149,463	142,086	145,120	
Others current liabilities	80,344	80,025	53,059	34,170	
Total current liabilities &	188,445	229,487	195,145	179,291	
Net current assets (ex cash)	(39,992)	(4,183)	23,174	43,547	
Uses of funds	212,452	257,007	279,948	294,083	
Book value per share (INR)	25.8	16.3	20.3	26.4	

Free cash flow		(INR mn)			
Year to March	FY12	FY13E	FY14E	FY15E	
Net profit	(12,855)	(12,990)	5,489	11,508	
Depreciation	7,619	13,048	13,414	13,510	
Others	4,815	28,514	28,113	22,562	
Gross cash flow	(421)	28,573	47,016	47,581	
Less: Changes in WC	566	35,809	27,356	20,374	
Operating cash flow	(987)	(7,236)	19,660	27,207	
Less: Capex	14,897	25,700	2,000	2,000	
Free cash flow	(15,884)	(32,936)	17,660	25,207	

Cash flow metrics		FY12	FY13E	FY14E	FY15E
Year to March					
Operating cash flow		(987)	(7,236)	19,660	27,207
Investing cash flow		(15,994)	(20,236)	1,531	2,451
Financing cash flow		18,440	23,567	(14,192)	(24,387)
Net cash flow		1,458	(3,905)	6,999	5,271
Capex		(14,897)	(25,700)	(2,000)	(2,000)

Profitability & efficiency ratios		FY12	FY13E	FY14E	FY15E
Year to March					
ROAE (%)		(1.4)	(45.2)	22.0	34.9
ROACE (%)		5.4	7.2	13.6	13.1
Inventory day		45	42	53	52
Debtors days		20	21	25	25
Payable days		58	56	67	64
Cash conversion cycle (days)		7	7	12	12
Debt/EBITDA		10.6	8.2	5.4	5.4
Net Debt/Equity		4.4	9.8	8.2	5.9

Operating ratios		FY12	FY13E	FY14E	FY15E
Year to March					
Total asset turnover		3.0	3.8	3.2	3.1
Fixed asset turnover		2.7	3.8	3.6	3.9
Equity turnover		16.5	31.1	34.7	26.8

Valuation parameters		FY12	FY13E	FY14E	FY15E
Year to March					
Diluted EPS (INR)		(0.4)	(9.5)	4.0	7.9
Y-o-Y growth (%)		(105.8)	2,605.1	(142.3)	97.1
CEPS (INR)		5.2	-	13.8	17.2
Diluted PE (x)		(208.5)	(7.7)	18.2	9.3
Price/BV (x)		2.8	4.5	3.6	2.8
EV/Sales (x)		0.4	0.4	0.4	0.4
EV/EBITDA (x)		15.3	11.1	7.0	7.0

Peer comparison valuation

Name	Market Cap (USD mn)	Diluted PE (X)		EV/EBITDA (X)		ROAE (%)	
		FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Essar Oil	1,826	(7.7)	18.2	11.1	7.0	(45.2)	22.0
Bharat Petroleum Corporation	5,041	14.2	9.7	8.9	7.4	10.7	14.4
Chennai Petroleum Corporation	404	12.5	6.8	6.4	5.4	4.4	7.4
Hindustan Petroleum Corporation	2,015	7.1	6.3	7.3	6.7	11.3	11.8
Indian Oil Corporation	13,151	12.4	10.0	7.4	6.4	9.5	11.2
Reliance Industries	51,448	12.3	11.3	8.3	7.2	11.7	11.8
Median	-	12.4	9.8	7.9	6.8	10.1	11.8
AVERAGE	-	8.5	10.4	8.2	6.7	0.4	13.1

Source: Edelweiss research

Additional Data

Directors Data

Shashi Ruia	Chairman	Naresh K Nayyar	Managing Director & Chief Executive Officer
Lalit Kumar Gupta	Managing Director & CEO	C Manoharan	Director - Refineries
Prashant Ruia	Non Executive Director	K V Krishnamurthy	Independent Non-Executive Director
K N Venkatasubramanian	Independent Non-Executive Director	Dilip J Thakkar	Independent Non-Executive Director
V K Sinha	Nominee Director - LIC	Melwyn Rego	Nominee Director - IDBI
Manju Jain	Nominee Director - IFCI	Philip Aiken	Non Executive Director

Auditors - Deloitte Haskins & Sells

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Dimensional Fund Advisors	0.31	Morgan Stanley	0.24
Wells Fargo	0.03	Eaton Vance Management	0.03
Nomura International Plc	0.01	Vanguard Group Inc	0.01
Prudential Financial Inc	0.01	Emerging Global Shares	0.01
Legal & General	0.00	Axa Rosenberg Intl	0.00

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Aban Offshore	REDUCE	SU	H	Bharat Petroleum Corporation	BUY	SO	M
Cairn India	HOLD	SO	M	Chennai Petroleum Corporation	BUY	SO	H
Essar Oil	BUY	SO	H	GAIL (INDIA)	HOLD	SP	L
Gujarat State Petronet	HOLD	SP	M	Hindustan Petroleum Corporation	BUY	SO	L
Indian Oil Corporation	BUY	SO	M	Indraprastha Gas	BUY	SO	M
ONGC	BUY	SO	L	Petronet LNG	BUY	SO	L
Reliance Industries	BUY	SO	M				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return



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Coverage group(s) of stocks by primary analyst(s):

Aban Offshore, Bharat Petroleum Corporation, Cairn India, Essar Oil, GAIL (INDIA), Gujarat State Petronet, Hindustan Petroleum Corporation, Indraprastha Gas, Indian Oil Corporation, Chennai Petroleum Corporation, ONGC, Petronet LNG, Reliance Industries

Recent Research

Date	Company	Title	Price (INR)	Recos
14-Jan-13	Petronet LNG	Good quarter; Kochi scale-up key; <i>Result Update</i>	165	Buy
04-Dec-12	Reliance Industries	BP says 'stay tuned'; <i>EdelFlash</i>	804	Buy
27-Nov-12	Reliance Industries	Reiterating refining upsides; <i>Company Update</i>	786	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	118	46	17	181
* - stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	117	57	7	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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