

# Cut FY12 earnings and PO

## Cut FY12 EPS by 22% and PO by 12%; retain Neutral

As discussed in our note [Upstream & govt may have to bear most of FY12 subsidy, 03 November 2011](#), R&M companies' FY12 earnings outlook has worsened. R&M companies have been hit by weak GRM in 1H FY12 and a worsening subsidy situation. We have, therefore, cut our FY12 earnings estimate for Bharat Petroleum (BPCL) by 22%, to Rs30.4/share, mainly due to the cut in GRM. As a result of the cut to FY12 EPS, we have lowered our PO by 12%, to Rs601/share. Our revised PO implies potential upside of 9%. We retain our Neutral rating on BPCL.

## FY12 EPS cut mainly due to cut in refining margin

BPCL's 1H FY12 GRM was down 28% YoY, at US\$2.3/bbl, hit by a sharp rise in the premium it has to pay for light crude like Bonny light. Bonny light or similar domestic crudes are 50-55% of BPCL's crude mix. The Bonny light-Dubai spread was up to US\$8.8/bbl in 1H FY12 from US\$3.1/bbl in 1H FY11. The premium of indigenous oil (benchmarked to Bonny light), which BPCL uses, to Dubai was US\$10.3/bbl in 1H FY12 vis-à-vis US\$4.0/bbl in 1H FY11.

## Cut PO by 12% to Rs601/share; implies 9% potential upside

We have cut our FY12 EPS by 22%. It has meant a 22% cut in the value of BPCL's core business, to Rs276/share from Rs355/share earlier. The 22% cut in the value of core business has meant cut in our PO by 12%, to Rs601/share, as the value of E&P assets and investments remain unchanged. The revised PO implies potential upside of 9% based on the last closing price of Rs550/share.

### Estimates (Mar)

| (Rs)                       | 2010A    | 2011A  | 2012E  | 2013E  | 2014E  |
|----------------------------|----------|--------|--------|--------|--------|
| Net Income (Adjusted - mn) | 23,494   | 19,936 | 10,991 | 19,907 | 20,553 |
| EPS                        | 64.98    | 55.14  | 30.40  | 55.06  | 56.85  |
| EPS Change (YoY)           | 270.7%   | -15.1% | -44.9% | 81.1%  | 3.2%   |
| Dividend / Share           | 14.00    | 14.00  | 10.00  | 18.00  | 18.00  |
| Free Cash Flow / Share     | (173.48) | 92.01  | 3.92   | 114.67 | 105.96 |

### Valuation (Mar)

|                       | 2010A   | 2011A  | 2012E  | 2013E  | 2014E  |
|-----------------------|---------|--------|--------|--------|--------|
| P/E                   | 8.46x   | 9.97x  | 18.09x | 9.99x  | 9.67x  |
| Dividend Yield        | 2.55%   | 2.55%  | 1.82%  | 3.27%  | 3.27%  |
| EV / EBITDA*          | 7.33x   | 6.45x  | 9.90x  | 6.96x  | 6.76x  |
| Free Cash Flow Yield* | -31.54% | 16.73% | 0.712% | 20.85% | 19.27% |

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 6.

## Bank of America Merrill Lynch

**Vidyadhar Ginde >>** +91 22 6632 8673  
Research Analyst  
DSP Merrill Lynch (India)  
vidyadhar.ginde@baml.com

**Akash Gupta >>** +91 22 6632 8684  
Research Analyst  
DSP Merrill Lynch (India)  
akash.gupta2@baml.com

### Stock Data

|                             |                   |
|-----------------------------|-------------------|
| Price                       | Rs550.00          |
| Price Objective             | Rs601.00          |
| Date Established            | 14-Nov-2011       |
| Investment Opinion          | C-2-7             |
| Volatility Risk             | HIGH              |
| 52-Week Range               | Rs529.35-Rs796.90 |
| Mrkt Val / Shares Out (mn)  | US\$3,967 / 361.5 |
| Market Value (mn)           | Rs198,848         |
| Average Daily Volume        | 412,562           |
| BofAML Ticker / Exchange    | XBPCF / BSE       |
| Bloomberg / Reuters         | BPCL IN / BPCL.BO |
| ROE (2012E)                 | 6.9%              |
| Net Dbt to Eqty (Mar-2011A) | 117.1%            |
| Est. 5-Yr EPS / DPS Growth  | 4.0% / 26.5%      |
| Free Float                  | 35.7%             |

### Key Changes

| (Rs)             | Previous | Current  |
|------------------|----------|----------|
| Price Obj.       | 681.00   | 601.00   |
| 2012E EPS        | 38.74    | 30.40    |
| 2012E EBITDA (m) | 35,120.3 | 30,681.4 |

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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 4. Price Objective Basis/Risk on page 4. Link to Definitions on page 4. 11109887

## *iQprofile*<sup>SM</sup> BPCL

| Key Income Statement Data (Mar)          | 2010A     | 2011A     | 2012E     | 2013E     | 2014E     |
|--|-----------|-----------|-----------|-----------|-----------|
| <b>(Rs Millions)</b>                     |           |           |           |           |           |
| Sales                                    | 1,239,007 | 1,537,251 | 1,760,373 | 1,821,889 | 1,612,647 |
| Gross Profit                             | 63,987    | 72,853    | 61,111    | 75,528    | 78,403    |
| Sell General & Admin Expense             | (22,522)  | (25,709)  | (30,430)  | (31,901)  | (33,446)  |
| Operating Profit                         | 27,020    | 28,230    | 13,814    | 25,973    | 26,516    |
| Net Interest & Other Income              | 11,566    | 3,983     | 3,899     | 4,377     | 4,693     |
| Associates                               | 0         | 0         | 0         | 0         | 0         |
| Pretax Income                            | 38,586    | 32,213    | 17,714    | 30,350    | 31,208    |
| Tax (expense) / Benefit                  | (10,522)  | (11,062)  | (5,891)   | (9,919)   | (10,143)  |
| Net Income (Adjusted)                    | 23,494    | 19,936    | 10,991    | 19,907    | 20,553    |
| Average Fully Diluted Shares Outstanding | 362       | 362       | 362       | 362       | 362       |

### Key Cash Flow Statement Data

|   |          |          |          |          |          |
|---|----------|----------|----------|----------|----------|
| Net Income                              | 27,189   | 20,080   | 10,991   | 19,907   | 20,553   |
| Depreciation & Amortization             | 14,446   | 18,914   | 16,867   | 17,654   | 18,441   |
| Change in Working Capital               | 39,399   | (44,406) | 23,472   | (4,080)  | 490      |
| Deferred Taxation Charge                | NA       | NA       | NA       | NA       | NA       |
| Other Adjustments, Net                  | (88,788) | 86,153   | (46,113) | 8,683    | (469)    |
| Cash Flow from Operations               | (7,754)  | 80,740   | 5,217    | 42,165   | 39,015   |
| Capital Expenditure                     | (54,967) | (47,475) | (3,801)  | (706)    | (706)    |
| (Acquisition) / Disposal of Investments | 44,677   | 34,723   | 36,163   | 0        | 0        |
| Other Cash Inflow / (Outflow)           | 0        | NA       | NA       | NA       | NA       |
| Cash Flow from Investing                | (10,290) | (12,752) | 32,363   | (706)    | (706)    |
| Shares Issue / (Repurchase)             | (495)    | (492)    | (142)    | (177)    | (173)    |
| Cost of Dividends Paid                  | (5,707)  | (5,707)  | (4,076)  | (7,337)  | (7,337)  |
| Cash Flow from Financing                | 18,327   | (21,265) | (63,073) | (47,515) | (7,511)  |
| Free Cash Flow                          | (62,721) | 33,265   | 1,416    | 41,459   | 38,309   |
| Net Debt                                | 259,637  | 195,669  | 161,743  | 127,676  | 96,904   |
| Change in Net Debt                      | 24,246   | (61,790) | (33,361) | (33,944) | (30,799) |

### Key Balance Sheet Data

|                               |         |         |         |         |         |
|-------------------------------|---------|---------|---------|---------|---------|
| Property, Plant & Equipment   | 245,716 | 275,133 | 265,937 | 248,989 | 231,254 |
| Other Non-Current Assets      | 123,177 | 88,454  | 48,436  | 48,436  | 48,436  |
| Trade Receivables             | 26,627  | 26,644  | 27,049  | 27,998  | 24,775  |
| Cash & Equivalents            | 7,284   | 56,185  | 31,257  | 25,324  | 56,096  |
| Other Current Assets          | 214,954 | 222,475 | 246,962 | 253,897 | 238,622 |
| Total Assets                  | 617,758 | 668,892 | 619,640 | 604,643 | 599,183 |
| Long-Term Debt                | 99,516  | 112,412 | 72,000  | 32,000  | 32,000  |
| Other Non-Current Liabilities | 11,477  | 13,074  | 14,031  | 14,031  | 14,031  |
| Short-Term Debt               | 167,405 | 139,442 | 121,000 | 121,000 | 121,000 |
| Other Current Liabilities     | 188,568 | 240,513 | 241,932 | 253,896 | 234,908 |
| Total Liabilities             | 466,966 | 505,442 | 448,963 | 420,926 | 401,939 |
| Total Equity                  | 150,792 | 167,066 | 170,678 | 183,717 | 197,244 |
| Total Equity & Liabilities    | 617,758 | 672,507 | 619,640 | 604,643 | 599,183 |

### *iQmethod*<sup>SM</sup> - Bus Performance\*

|                            |       |       |      |       |       |
|----------------------------|-------|-------|------|-------|-------|
| Return On Capital Employed | 6.4%  | 5.4%  | 2.7% | 5.2%  | 5.4%  |
| Return On Equity           | 17.1% | 13.4% | 6.9% | 12.0% | 11.5% |
| Operating Margin           | 2.2%  | 1.8%  | 0.8% | 1.4%  | 1.6%  |
| EBITDA Margin              | 3.3%  | 3.1%  | 1.7% | 2.4%  | 2.8%  |

### *iQmethod*<sup>SM</sup> - Quality of Earnings\*

|                          |        |        |       |       |       |
|--------------------------|--------|--------|-------|-------|-------|
| Cash Realization Ratio   | -0.3x  | 4.0x   | 0.5x  | 2.1x  | 1.9x  |
| Asset Replacement Ratio  | 3.8x   | 2.5x   | 0.2x  | 0x    | 0x    |
| Tax Rate (Reported)      | 27.3%  | 34.3%  | 33.3% | 32.7% | 32.5% |
| Net Debt-to-Equity Ratio | 172.2% | 117.1% | 94.8% | 69.5% | 49.1% |
| Interest Cover           | 2.4x   | 2.3x   | 1.2x  | 2.5x  | 2.9x  |

### Key Metrics

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 6.

### Company Description

BPCL is a refining and marketing company with a refinery capacity of 240kbpd. It owns 54.8% in Kochi Refinery (160kbpd) & 62.9% in Numaligarh refinery (60 kbpd). LPG, kerosene, diesel and gasoline prices (77% of marketing volumes) are regulated, which impacts BPCL's earnings as international oil prices fluctuate. Refining margins, however, track international margins. Govt owns 67% of BPCL.

### Investment Thesis

BPCL has been in the black since FY06 only due to government grants to compensate for subsidies. Grants make earnings difficult to predict and increase earnings volatility. BPCL's peak EPS since FY06 is 4.3x lowest EPS.

### Stock Data

Price to Book Value 1.2x

## FY12 EPS and PO cut

EPS cut by 22% and PO by 12%

Table 1: BPCL's FY12 EPS and PO cut by 12-22%

| Rs/share       | FY12 EPS    | PO          |
|----------------|-------------|-------------|
| <b>Revised</b> | <b>30.4</b> | <b>601</b>  |
| Earlier        | 38.7        | 681         |
| <b>Change</b>  | <b>-22%</b> | <b>-12%</b> |

Source: BofA Merrill Lynch Global Research

## BPCL's PO cut by 12%, to Rs601/share

Value of core business cut due to cut in FY12 EPS by 22%

Table 2: PO based on FY12E EPS

| Rs/share                                    | BPCL        |
|---|-------------|
| FY12E EPS (ex dividend income)              | 29.1        |
| PER (x)                                     | 9.5         |
| Core business value                         | 276         |
| Value of E&L assets                         | 194         |
| Add: Value of listed equity investments     | 82          |
| Add: Equity invested in unlisted refineries | 50          |
| <b>Revised PO</b>                           | <b>601</b>  |
| Old PO                                      | 681         |
| <b>Change</b>                               | <b>-12%</b> |

Source: BofA Merrill Lynch Global Research

## Price objective basis & risk

### BPCL (XBPCF)

Our PO of Rs601/share is based on a P/E of 9.5x on BPCL's FY12E consolidated EPS (excluding dividend income from IGL and PLNG) of Rs29.1/share, in line with the stock's three-year average P/E. Our PO includes the value of BPCL's share in oil reserves in Wahoo block (Brazil) and gas resources in Mozambique at Rs194/share. It also includes the market value of investments in Indraprastha Gas (IGL), Petronet LNG (PLNG), Oil India (OIL) and cost of investment in the Bina oil refinery of Rs131/share.

Upside risks: (1) Government compensation/grants are higher than our expectations, (2) Government eliminates subsidies on all products, (3) Refining margins are higher than forecast by us, (4) Rise in market prices of IGL and PLNG. (5) Significant reserve accretion in BPCL's E&P exploration assets in India and abroad. Downside risks: (1) Government does not issue enough compensation, (2) government reverts to a cost-plus-based regulated pricing mechanism, (3) steep decline in regional and, hence, BPCL's refining margins, and (4) steep decline in the market price of IGL and PLNG.

## Link to Definitions

### Energy

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

## Analyst Certification

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Address – Mafatlal Centre, 8th Floor, Nariman Point, Mumbai, India. 400021

Tel : +91 22 6632 8000

**APR - Energy Coverage Cluster**

| Investment rating   | Company                        | BofA Merrill Lynch ticker | Bloomberg symbol | Analyst          |
|---------------------|--------------------------------|---------------------------|------------------|------------------|
| <b>BUY</b>          |                                |                           |                  |                  |
|                     | Citic Resources                | CTJHF                     | 1205 HK          | Vitus Leung      |
|                     | Formosa Plastics               | FSAPF                     | 1301 TT          | Joon-Ho Lee      |
|                     | Hindustan Petro.               | XHTPF                     | HPCL IN          | Vidyadhar Ginde  |
|                     | Honam Petrochemical            | HBBHF                     | 011170 KS        | Kenneth Whee     |
|                     | 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      |
|                     | PetroChina                     | PCCYF                     | 857 HK           | Thomas Wong      |
|                     | PetroChina - A                 | PTR                       | PTR US           | Thomas Wong      |
|                     | PTT Global Chemical PLC        | XPGOF                     | PTTGC TB         | Komsun Suksumrun |
|                     | Reliance Inds                  | XRELF                     | RIL IN           | Vidyadhar Ginde  |
|                     | Reliance Inds -G               | RLNIY                     | RIGD LI          | Vidyadhar Ginde  |
|                     | Sinopec                        | SNPMF                     | 386 HK           | Thomas Wong      |
|                     | Sinopec - A                    | SNP                       | SNP US           | Thomas Wong      |
|                     | Sinopec Shanghai Petrochemical | SPTJF                     | 338 HK           | Joon-Ho Lee      |
|                     | SK Innovation                  | XVERF                     | 096770 KS        | Kenneth Whee     |
|                     | S-Oil                          | SOOCF                     | 010950 KS        | Kenneth Whee     |
| <b>NEUTRAL</b>      |                                |                           |                  |                  |
|                     | BPCL                           | XBPCF                     | BPCL IN          | Vidyadhar Ginde  |
|                     | CNOOC                          | CEO                       | CEO US           | Thomas Wong      |
|                     | CNOOC                          | CEOHF                     | 883 HK           | Thomas Wong      |
|                     | COSL                           | CHOLF                     | 2883 HK          | Vitus Leung      |
|                     | Formosa Chemicals & Fibre      | XFUMF                     | 1326 TT          | Joon-Ho Lee      |
|                     | Formosa Petrochemical          | FPTCF                     | 6505 TT          | Kenneth Whee     |
|                     | MIE Holdings                   | XMEEF                     | 1555 HK          | Vitus Leung      |
|                     | Sinopec Yizheng Chemical Fibre | YZCFF                     | 1033 HK          | Joon-Ho Lee      |
| <b>UNDERPERFORM</b> |                                |                           |                  |                  |
|                     | GS Holdings                    | GSHDF                     | 078930 KS        | Kenneth Whee     |
|                     | Kolon Industries               | XKLNF                     | 120110 KS        | Joon-Ho Lee      |
|                     | KP Chemical                    | KPCHF                     | 064420 KS        | Joon-Ho Lee      |
|                     | Petronet LNG Ltd               | POLNF                     | PLNG IN          | Vidyadhar Ginde  |
| <b>RSTR</b>         |                                |                           |                  |                  |
|                     | Cairn India                    | XCANF                     | CAIR IN          | Vidyadhar Ginde  |
|                     | IOC                            | IOCOF                     | IOCL IN          | Vidyadhar Ginde  |
|                     | ONGC                           | ONGCF                     | ONGC IN          | Vidyadhar Ginde  |

**iQmethod<sup>SM</sup> Measures Definitions**

| <b>Business Performance</b> | <b>Numerator</b>  | <b>Denominator</b>  |
|-----------------------------|---|---|
| Return On Capital Employed  | $\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$                                  | Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill |
| Return On Equity            | Net Income  | Shareholders' Equity  |
| Operating Margin            | Operating Profit  | Sales   |
| Earnings Growth             | Expected 5-Year CAGR From Latest Actual   | N/A   |
| Free Cash Flow              | Cash Flow From Operations – Total Capex   | N/A   |
| <b>Quality of Earnings</b>  |   |   |
| Cash Realization Ratio      | Cash Flow From Operations   | Net Income  |
| Asset Replacement Ratio     | Capex   | Depreciation  |
| Tax Rate                    | Tax Charge  | Pre-Tax Income  |
| Net Debt-To-Equity Ratio    | Net Debt = Total Debt, Less Cash & Equivalents  | Total Equity  |
| Interest Cover              | EBIT  | Interest Expense  |
| <b>Valuation Toolkit</b>    |   |   |
| Price / Earnings Ratio      | Current Share Price   | Diluted Earnings Per Share (Basis As Specified)                     |
| Price / Book Value          | Current Share Price   | Shareholders' Equity / Current Basic Shares                         |
| Dividend Yield              | Annualised Declared Cash Dividend   | Current Share Price   |
| Free Cash Flow Yield        | Cash Flow From Operations – Total Capex   | Market Cap. = Current Share Price * Current Basic Shares            |
| Enterprise Value / Sales    | $\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$ |   |
| EV / EBITDA                 | Enterprise Value  | Basic EBIT + Depreciation + Amortization                            |

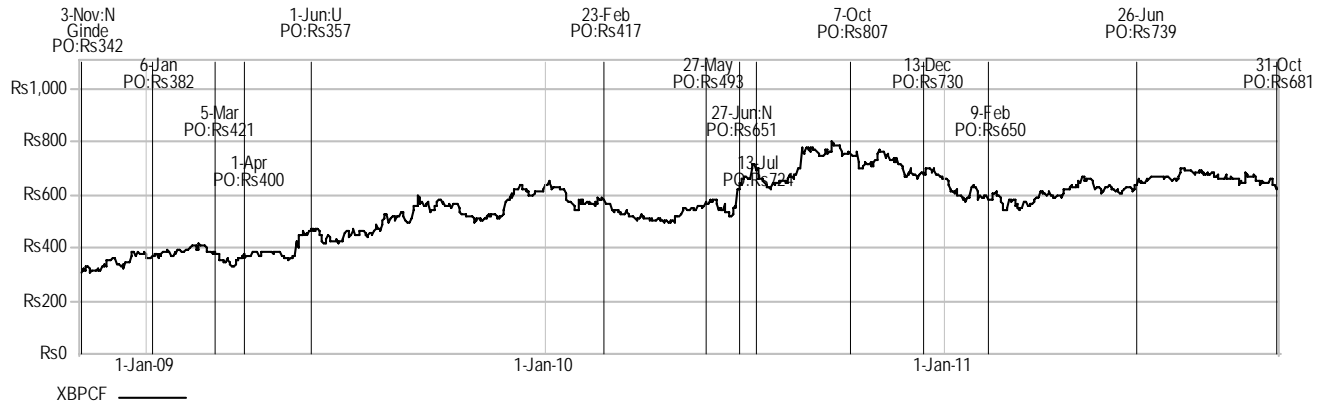
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### XBPCF Price Chart



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

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [October 31, 2011] or such later date as indicated.

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

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|-------------------|-------|---------|-----------------------------|-------|---------|
| Buy               | 164   | 57.95%  | Buy                         | 92    | 60.93%  |
| Neutral           | 71    | 25.09%  | Neutral                     | 32    | 55.17%  |
| Sell              | 48    | 16.96%  | Sell                        | 20    | 48.78%  |

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

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|-------------------|-------|---------|-----------------------------|-------|---------|
| Buy               | 2073  | 54.13%  | Buy                         | 923   | 49.12%  |
| Neutral           | 961   | 25.09%  | Neutral                     | 460   | 52.57%  |
| Sell              | 796   | 20.78%  | Sell                        | 287   | 38.32%  |

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster* |
|-------------------|---|---|
| Buy               | ≥ 10%   | ≤ 70%   |
| Neutral           | ≥ 0%  | ≤ 30%   |
| Underperform      | N/A   | ≥ 20%   |

\* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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