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Government asks ONGC, OIL to pay Rs 369 bn in fuel subsidy, Profit is likely to hit badly

- The government has asked upstream oil firms like OIL and ONGC to give about Rs 369 bn in fuel subsidy during April to December 2011.
- Fuel retailers Indian Oil Corp (IOC), Hindustan Petroleum (HPCL) and Bharat Petroleum (BPCL) lost Rs 973 bn in revenue on selling diesel, LPG and kerosene at government controlled rates during the first nine months of current fiscal. Of this, the upstream companies have been asked to make good 37.91 per cent.
- ONGC, Oil India and GAIL India had in first six months paid fuel subsidy at the rate of 33.33 per cent of the revenue loss on fuel sales. And so, they will pay extra in the third quarter to average the payout at 37.91 per cent for the April-December period.
- ONGC, OIL and GAIL will pay Rs 302.96 bn, 44.78 bn and 21.20 bn in fuel subsidy during April to December 2011.

Our Take

FY12 under-recoveries are set to increase to Rs. 1.3t, led by continued high oil prices and rupee depreciation. Further, due to ongoing assembly elections, the government is unlikely to hike petroleum prices in the near term.

Historical and Estimated under-recoveries and Subsidy sharing

Particulars	FY07	FY08	FY09	FY10	FY11	FY12E old	FY12E New
Brent (USD/bbl)	65	83	85	70	87.0	105.0	105.0
Rs/USD exchange rate	45.2	40.3	45.8	47.4	45.6	47.0	47.0
Total under-recoveries (Rs bn)	293.8	334.49	1033	461	782.0	980.0	1,297.3
Subsidy sharing							
Upstream share (Rs bn)	205	256	330	144	302.6	392.0	492.0
share of ONGC (Rs bn)	170	220	282	116	248.8	322.2	403.9
share of OIL (Rs bn)	20	23	30	15	33.0	42.7	59.0
share of GAIL (Rs bn)	15	13	18	13	21.2	27.4	28.3
OMCs (Rs bn)	48	161	-10	56	70.0	87.2	126.8
Gol share (Rs bn)	241	354	713	260	409.0	500.8	678.5
% share							
Upstream share	41.5%	33.2%	32.0%	31.3%	38.7%	40.0%	37.9%
share of ONGC	83.0%	85.9%	85.5%	80.1%	82.2%	82.2%	82.1%
share of OIL	9.7%	9.0%	9.2%	10.7%	10.9%	10.9%	11.99%
share of GAIL	7.3%	5.1%	5.4%	9.2%	7.0%	7.0%	5.7%
OMCs	9.6%	20.9%	-1.0%	12.2%	8.9%	8.9%	9.8%
Gol share	48.8%	45.9%	69.0%	56.5%	52.3%	51.1%	52.3%

Source: Company Filings; IndiaNivesh Research

We had modeled upstream sharing at 40% in our old assumption and total under-recoveries Rs. 980 bn. Now we change our assumption for FY12 with 38% upstream sharing and under-recoveries increase to Rs. 1.3t from 980 bn.

Impact Analysis

Company Name	Average Realization(USD/bbl)		EPS (Rs.)	
	FY12E old	FY12E New	FY12E old	FY12E New
ONGC	53	45	31	25
OIL	68	56	138	117

Source: Company Filings; IndiaNivesh Research

We expect increase in subsidy burden would lead to deteriorate Average net realization and EPS of ONGC in FY12 by more than 15% than earlier estimates (EPSRs. 31 in FY12). Oil India net realization would decline to USD 56 per barrel against our earlier estimate of USD 68 per barrel and EPS would slide to Rs.117 against Rs.138 of our earlier estimates. However, Impact on Gail will be minimal as total contribution is very small (5.7% of upstream subsidy sharing). We advise investor's to exit from ONGC and OIL at this level. We have buy rating on the Oil India at Rs. 1135 with target price of Rs. 1410. We advise investors to book profit in the stock which is trading at Rs.1290.

Valuation

At CMP of Rs 283 ONGC is trading at 4.70x FY12E and 4.20x FY13E EV/EBITDA while At CMP of Rs 1290 Oil India is trading at 4.50x FY12E and 4.10x FY13E EV/EBITDA.



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