

22 June 2009

India Oil & Gas

Underweight

Deregulation – Many a slip...

Nifty/Sensex: 4314/14522

- **Underweight.** Crude prices and stock prices have run up too much too fast, in our view, and sustaining both seem improbable. And deregulation in India looks a non-starter or a timid one at the most. We thus have an Underweight on the sector, and we maintain Sell ratings on HPCL, BPCL, IOC and GAIL and downgrade ONGC to Hold.
- **Global demand and margin trend not supportive.** We estimate that actual demand (from refining and petrochemicals) does not justify higher crude prices. With crude prices rising over the past few weeks, refining margins have been under pressure, a clear sign that passing on higher crude prices has become difficult
- **De-regulation in India – many a slip...** The new government has shown, at least in words, a resolve to de-regulate the retail pricing structure in the sector. The likelihood of words being converted into solid action is small.
- **ONGC, GAIL valuations discounting higher upside.** We estimate that ONGC and GAIL are discounting a higher upside than what realistic pricing deregulation could offer. We lower ONGC to a Hold, and re-iterate a Sell on GAIL.
- **OMCs cheap, but relatively.** OMCs look relatively cheaper on a PE basis than others in the sector. But the low PE is justified by manufactured earnings and regulatory uncertainties on subsidy sharing. We maintain Sell on all three OMCs.

Sector valuation matrix

	ONGC	GAIL	IOC	BPCL	HPCL
Rating	Hold	Sell	Sell	Sell	Sell
Market Price (Rs)*	1,010	288	552	424	302
Target price (Rs)	950	260	490	380	270
FY10e EPS (Rs)	90.7	19.2	35.7	40.5	26.4
1-yr fwd PE (x)	11.1	15.0	15.4	10.4	11.1
FY11e EPS (Rs)	91.2	22.4	51.9	49.3	42.3
2-yr fwd PE (x)	11.1	12.8	10.6	8.6	7.0
FY10e NAV (Rs)	382.0	128.0	424.0	410.0	352.0
1-yr fwd PB (x)	2.6	2.3	1.3	1.0	0.8

Source: Anand Rathi Research, *as of 19 June 2009

Sensex vs BSE Oil Index



Source: Bloomberg, Anand Rathi Research

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