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Bharat Petroleum Corporation Ltd.

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Bharat Petroleum Corporation Limited (BPCL) is an Indian state-controlled oil and gas company headquartered in Mumbai, Maharashtra. It has business interests primarily in refining and marketing of crude oil. The refining and marketing segment contributes ~99% of the total revenue. Its products include LPG, diesel, petrol, bharat metal cutting gas, kerosene, aviation fuel, bitumen, naphtha, auto lubes, lubricants, grease and oil. Its secondary segment constitutes Exploration and Production (E&P) activities. As of June 2015, the company has participating interests in 17 exploration blocks; in consortium with other companies.

Investment Rationale

Expanding capacities to catalyse revenue growth: BPCL is in the process of expanding current capacities at its refineries. It has chalked out a detail plan in order to carry out phased expansion of its refineries at Kochi, Bina and Numaligarh. From the current level of 30.5 MMT the capacities are expected to go up to 34.5 MMT by the end of 2016. The benefits of these expansions will accrue from FY17E. We estimate a CAGR of 17% in the revenue over FY15-FY17E.

Overseas expansion to drive growth in the E&P segment: Apart from India, BPCL has 10 oil blocks in Mozambique, Brazil, Australia, Indonesia and East Timor in partnership with other operators. It plans to invest Rs. 13,000 crore in energy exploration and production in Mozambique. In Brazil, 4 appraisal wells are in process and 3 more wells will be finalized by end of FY16. The benefits of these expansion activities is likely to commence from FY17E thereby aiding the revenue growth.

Aggressive capex to enhance retail footprint: In FY16 BPCL has outlined a capex of Rs. 10,000 Crore and for FY17 is expected to be in the range of Rs. 8,000-10,000 Crore, out of which Rs. 4,400 Crore would be spent on Kochi and other pipeline expansion. A total of Rs. 500-Rs. 600 Crore will be spent on expanding ~500 outlets during FY15/16. During FY15 company expanded retail network by ~600 outlets. We believe that the company's plans to increase its retail network will increase accessibility and availability of oil products henceforth translating into improved revenue contribution from the retail segment.

Vertically integrating existing businesses to enhance bottom-line: BPCL is planning to develop marginal oilfields in the Northeast region of India and building a 450 km pipeline to Moreah in Manipur to help export diesel and petrol to Myanmar via its Numaligarh Refinery. After the expansion, the refinery will process imported crude oil too, which is envisaged to be transported from a port in East India to Numaligarh through a new pipeline. We believe that this move will aid the capacity utilisation of the NRL and will bring down significant costs hence supporting growth in the bottom-line.

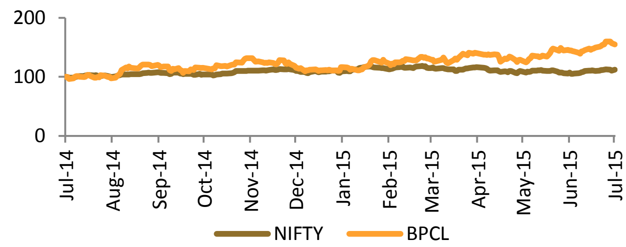
Market Data

Rating	**BUY**
CMP (Rs.)	883
Target (Rs.)	**1,065**
Potential Upside	~21%
Duration	Long Term
Face Value (Rs.)	10.0
52 week H/L (Rs.)	953.0/557.1
Adj. all time High (Rs.)	954.0
Decline from 52WH (%)	7.3
Rise from 52WL (%)	58.5
Beta	1.1
Mkt. Cap (Rs. Cr)	63,848.0
Enterprise Value (Rs. Cr)	80,565.3

Fiscal Year Ended

Y/E	FY14A	FY15A	FY16E	FY17E
Revenue (Rs. Cr)	264,421.1	242,598.5	267,552.4	329,878.9
Net profit (Rs. Cr)	3,910.7	4,806.6	7,433.0	9,287.1
EPS (Rs.)	54.1	66.5	102.8	128.4
P/E (x)	16.3	13.3	8.6	6.9
P/BV (x)	3.3	2.8	2.3	1.8
ROE (%)	20.1	21.3	26.5	26.2

One year Price Chart



Shareholding Pattern	Jun-15	Mar-15	Chg.
Promoters	54.9	54.9	0.0
FII	18.1	17.2	0.9
DII	12.1	12.7	(0.6)
Others	14.9	15.2	(0.4)

Bharat Petroleum Corporation Ltd. - a leading Navratna company

BPCL is India's 3rd largest company by turnover and second largest OMC commanding 21% of the domestic oil retail business in India with a turnover of 34.5 million metric tonnes (MMT).

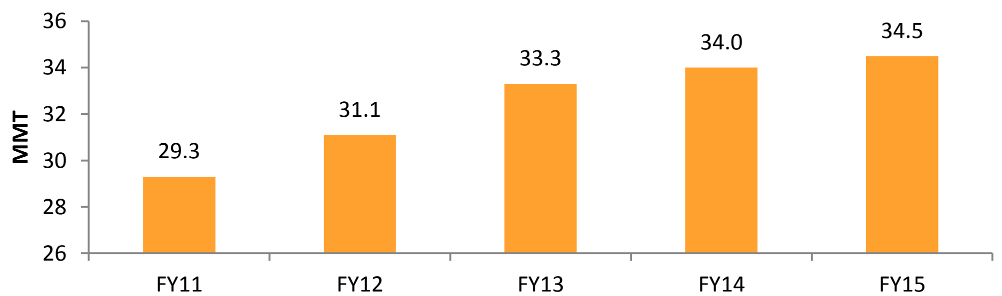
Incorporated in 1952, Bharat Petroleum Corporation Limited (BPCL) is an Indian state-controlled oil and gas company headquartered in Mumbai, Maharashtra. It is India's 3rd largest company by turnover and second largest Oil Marketing Company (OMC) commanding 21% of the domestic oil retail business in India with a turnover of 34.5 million metric tonnes (MMT).

It has business interests in marketing, exploring and refining of crude oil. For its E&P business, BPCL undertakes upstream exploration and production activities, which has participating interest in 19 exploration/appraisal blocks, including 8 blocks in India and 11 are located in Australia, East Timor, Indonesia, Mozambique, and Brazil.

BPCL's largest segment is the downstream business comprising refining and marketing businesses. The segment generates the entire revenue ~99% for BPCL. It has four refineries, out of which two large refineries of the country are located at Mumbai (capacity of 12 million metric tonnes per year) and Kochi (capacity of 9.5 million metric tonnes per year). The other refineries are Bina refinery (capacity of 6 million metric tonnes per year) and Numaligarh refinery (capacity of 3 million metric tonnes per year). Their products include LPG, diesel, petrol, Bharat metal Cutting Gas, kerosene, aviation fuel, bitumen, naphtha, Auto lubes, lubricants, grease and oil. It is engaged in the retailing of petrol, diesel, and kerosene, as well as various non-fuel products and value-added services through its network of 6,553 retail outlets and 1,007 kerosene dealers.

BPCL caters to household and automobile sectors; public and private sectors; and various government establishments, such as defense, railways, state trading corporations, state electricity boards, etc. The Government of India has a majority shareholding in the Company of 54.93% and there also exists explicit Govt. support through under-recovery compensation mechanism.

Increasing sales volume to drive growth



Improved EBITDA despite falling revenue

Net revenue stood at Rs. 51,346.1 Crore in Q4FY15 declining by 11.3% on a QoQ basis. EBITDA was reported at Rs. 4,496 Crore in the last quarter of FY15 showing a growth of 284.3% on a QoQ basis. The major factors which led to the increase in EBITDA were a fall in the stock pileup of the company by 75.5%, lower raw material expenses arising from decline in the crude oil expenses by 20.9% QoQ and purchase of traded goods and by 12.7% QoQ basis. As a result, EBITDA margin saw an increase of 670 bps and stood at 8.8% as compared to 2.0% in Q3FY15. Net profit reached Rs. 2,852.9 Crore, witnessing a considerable growth of 417.6% in Q4FY15 on a QoQ basis. This was mainly driven by higher Gross Refining Margins (GRMs) which stood at stood at USD7.95/bbl (+18% YoY, 5x QoQ), due to higher gasoline, naphtha and FO cracks and lower crude price, which helped to reduce fuel & Loss. The PAT margin increased by 460 bps in Q4FY15 at 5.6%.

The growth in the bottom-line was driven by lower raw material costs due to declining crude prices.

Lower operating expenses offset decline in revenue for FY15

Net revenue for the company stood at Rs. 242,598.5 Crore in FY15, showing a decline of 8.3% as compared to the last year due to subsidy sharing burden. Despite the fall in revenues, EBITDA showed a moderate increase of 4.3% this year and reached at Rs. 9,777.6 Crore primarily due to decline in the operating expenses of the company. Net profit was reported at Rs. 4,806.6 Crore in FY15 showing a growth of 22.9% YoY mainly driven by strong GRMs, lower working capital costs leading to fall in the interest cost by 40.4% and net under recovery benefits due to declining crude prices and increase in other income by 52.9%.

Revamping refining capabilities: a key growth driver

With a refining capacity of 30.5 MMT, BPCL possesses 14% of India's total refining market. It has four strategically placed refineries at Kochi, Mumbai, Numaligarh and Bina. Its largest refinery is situated at Mumbai with a total capacity of 13.0 MMT. Mumbai refinery has been achieving more than 100% capacity utilisation over last four years. The second largest refinery is at Kochi with a capacity of 95 MMT. These refineries contribute ~80% to the total throughput of BPCL whereas its refineries at Bina and Numaligarh account for the rest of the production.

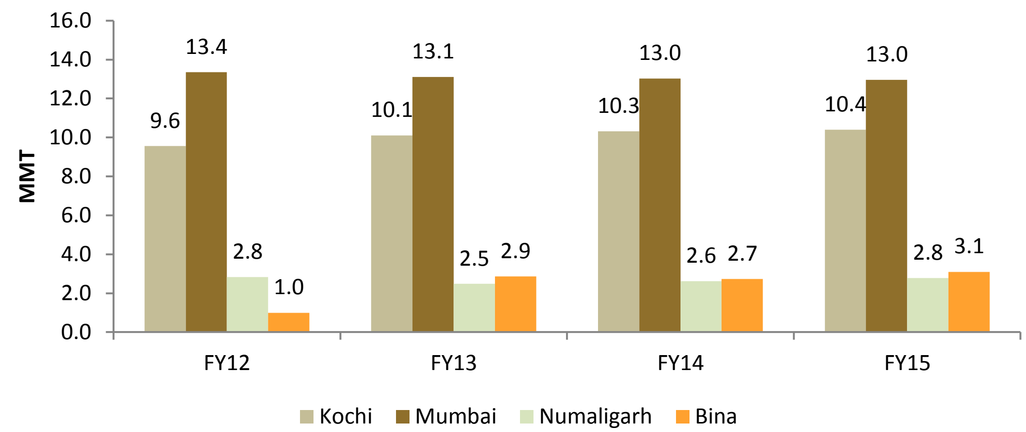
BPCL's aggressive expansion exercise is likely to improve the company's market standing and subsequently aid the top-line.

Bina refinery has a current capacity of 6 MMT and is currently running at ~50% of the total capacity levels. BPCL has a shared interest in Bina Refinery with Bharat Oman Refineries Limited (BORL) with the latter holding 26% in the company. It plans to raise Bina refinery capacity to 15 MMT in two phases - to 7.8 MMT by FY17E from current 6 MMT at a cost of Rs 3,500 crore by 2018 and then to 15 MMT at an additional investment of Rs. 18,000-20,000 crore in 5-6 years.

Additionally, BPCL is intending to upgrade its Kochi refinery in Kerala to process high sulphur crudes by 2016. Kochi refinery capacity is being raised to 15.5 MMT from current 9.5 MMT. Crude grades with high sulphur content are cheaper and refineries that have installed speciality secondary units to process them can lower feed costs and increase their margins. Besides boosting margins with upgrade and expansion, the refinery will also be able to produce fully Euro V/VI compatible petrol and diesel. Also, Numaligarh refinery capacity is being planned to be raised to 9 MMT.

We believe that the aforementioned ramp up activities will enhance the company's capabilities thereby improving its market share along with increasing utilisations and revenues.

Increasing throughput capacity to drive revenue growth



Strategic partnerships pave way for capacity expansion in E&P

In its upstream segment, BPCL has 17 oil blocks out of which 7 are in India and 10 overseas. It is the only OMC to have made significant discoveries in India. It has oil fields in Mozambique, Brazil, Australia, Indonesia, and East Timor apart from India in association with well-established operators hence generating optimal returns without incurring higher expenditure.

The company has 22 discoveries, 7 in Brazil and 3 in India and 1 each in Indonesia and Australia. Reserve certification of these discoveries is yet to be done. In Mozambique, till date, the operator has declared 50 to 70+ trillion cubic feet (tcf) of recoverable natural gas resources. In Brazil, there have been hydrocarbon discoveries in two basins – Campos and Sergipe Alagos.

BPCL has oil fields in Mozambique, Brazil, Australia, Indonesia, and East Timor apart from India in association with well-established operators hence generating optimal returns without incurring higher expenditure.

It plans to invest Rs. 13,000 crore in energy exploration and production in Mozambique. The planned investment is twice the amount the company has spent in exploration and production activity in the last 10 years and is part of the total capital expenditure of Rs. 35,000 crore it has chalked out for the next four years. Procedures would be finalized in H1FY16 between the Mozambique govt. and the management.

In Brazil, 4 appraisal wells are in process and 3 more wells will be finalized by end of FY16. Some more exploration activity is in progress. The investment has been planned keeping in mind the target of commencing production from the Mozambique and Brazil assets by fiscal 2019.

Further, the company has earmarked Rs. 8,500 Crore for the downstream segment for FY16, while Rs. 1,500 Crore for E&P. The benefits of the aforementioned expansion are expected to drive growth in the E&P segment and enhance its contribution to the overall revenue.

Integrating existing businesses to aid bottom-line growth

BPCL is planning to develop marginal oilfields in the Northeast region and building a 450 km pipeline to Moreah in Manipur to help export diesel and petrol to Myanmar via its Numaligarh Refinery. This is in line with governments' strategy of vertically integrating smaller refineries in order to bring down imports of petroleum to 67% of total demand by 2022 from 77% now. The NRL board has already cleared a project to increase its refining capacity to 9 million metric tonnes per annum from 3 mmtpa now. After the expansion, the refinery will process imported crude oil too, which is envisaged to be transported from a port in East India to Numaligarh through a new pipeline. The expansion will be completed in coming four years. We believe that this move will aid the capacity utilisation of the NRL and will bring down significant costs hence supporting growth in the bottom-line.

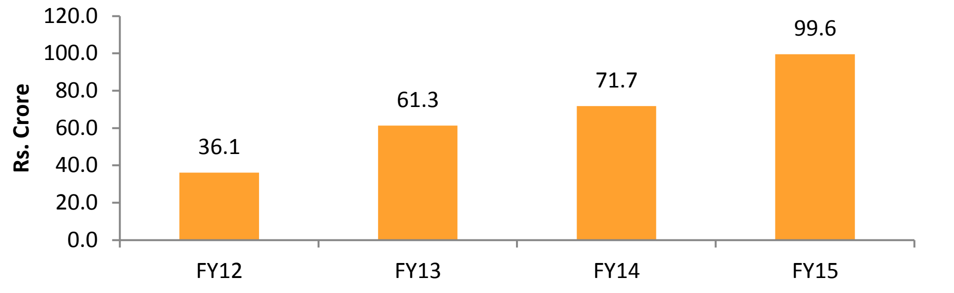
Aggressive capex outlay to enhance retail footprint

The company plans to strategically expand its retail segment through inorganic and organic growth opportunities. Investment in refining and distribution capacities is expected to bridge the gap between sales volumes and production.

In FY16 the company's capex is expected at around Rs. 10,000 Crore and for FY17 is expected in the range of Rs. 8,000-10,000 Crore out of which Rs. 4,400 Crore would be spent on Kochi and other pipeline expansion. Rs. 500-Rs. 600 Crore will be spent on expanding ~500 outlets during FY15/16. During FY15 the company expanded retail network by ~600 outlets.

We believe that the company's plans to expand capacities of its existing pipe-lines and create opportunities for marketing of niche petrochemicals via facility upgrades will improve margins.

Increasing capex outlay

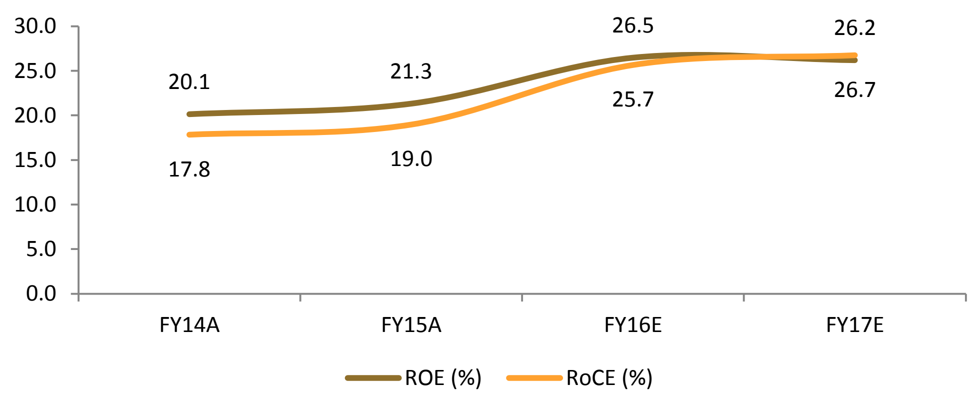


Deregulation of diesel prices – a big positive

Given the government's efforts towards deregulating fuel prices, the under-recoveries of the company are likely to go down significantly.

In H1FY15, the central government announced the fuel reform in which they de-regulated the diesel price in a move to free the economy from the clutches of fuel subsidy. The Finance Minister Arun Jaitley announced that the diesel price stood de-regulated to allow it to move as per market conditions, just like petrol. The reform announced by the government should provide relief to the OMCs in long run as the initiative would ease down the burden of under-recoveries to a significant extent. The eventual deregulation is expected to result in 52% reduction in gross under-recoveries to Rs. 647 billion by FY16 versus FY14. Deregulation allows companies to price their fuel products on the basis of market prices. This is expected to reduce losses as the government's remuneration towards under-recoveries was often delayed thereby hampering the company's gains. Now, the de-regulation will eliminate all these financial issues. And as companies now sell fuel at market-determined rates, we expect the cash flows to improve, thus reducing the overall stress. After the government's decision we expect the debt needed for funding the working capital to decline thereby reducing the interest costs.

Return ratios to improve in the coming years



Key Risks:

- Out of total loan, 86% constitutes foreign currency loan with 4.5% avg cost of debt. Any adverse movement in the currency can increase the finance cost of the company.
- Delay in project execution can hamper the expected revenue growth.
- Rise in selling prices of fuels like High Speed Diesel and Motor Severe Oil could hamper the growth in demand for these products.

Balance Sheet (Consolidated)

Y/E(Rs. Crore)	FY14A	FY15A	FY16E	FY17E
Share Capital	723.1	723.1	723.1	723.1
Reserve and surplus	18,703.2	21,825.4	27,354.9	34,738.5
Net Worth	19,426.3	22,548.5	28,078.0	35,461.6
Minority Interest	1,146.9	1,286.4	1,286.4	1,286.4
Shares of asso.	13.5	13.5	13.5	13.5
Long-term borrowings	21,997.7	19,341.8	19,129.8	20,851.5
Deferred tax liability	1,670.1	1,997.2	2,097.1	2,201.9
Long term Provisions	1,325.8	1,396.9	1,536.5	1,843.9
Other long term liabilities	100.8	184.3	289.6	393.9
Current Liabilities	43,198.3	40,188.4	44,071.0	43,989.1
Total Equity & Liabilities	**88,879.2**	**86,956.9**	**96,501.9**	**106,041.6**
Fixed Assets	36,951.7	44,882.3	54,717.7	66,461.3
Long term loans and advances	2,520.9	2,695.2	3,104.9	3,448.2
Non- Current Investments	2306.4	2351.4	2351.4	2,351.4
Goodwill	0.0	14.5	14.5	14.5
Deferred tax assets	419.0	650.4	650.4	650.4
Other non-current assets	166.6	84.5	99.6	118.2
Current Assets	46,514.65	36,278.69	35,563.54	32,997.7
Total Assets	**88,879.2**	**86,956.9**	**96,501.9**	**106,041.6**

Profit & Loss Account (Consolidated)

Y/E (Rs. Crore)	FY14A	FY15A	FY16E	FY17E
Net Sales	264,421.1	242,598.5	267,552.4	329,878.9
Expenses	255,049.1	232,820.9	252,837.0	311,735.6
EBITDA	**9,372.0**	**9,777.6**	**14,715.4**	**18,143.3**
Other Income	1,386.8	2,120.1	2,565.3	3,104.0
Depreciation	2,610.9	3,026.7	3,830.2	4,652.3
EBIT	8,147.8	8,870.9	13,450.4	16,595.0
Net Interest cost	1,982.1	1,180.5	1,352.4	1,479.3
Profit Before Tax	**6,165.7**	**7,690.5**	**12,098.0**	**15,115.7**
Tax	2,112.7	2,608.5	4,355.3	5,441.7
Minority Interest	(142.3)	(275.4)	(309.7)	(387.0)
Net Profit	**3,910.7**	**4,806.6**	**7,433.0**	**9,287.1**

Key Ratios (Consolidated)

Y/E	FY14A	FY15A	FY16E	FY17E
EBITDA Margin (%)	3.5	4.0	5.5	5.5
EBIT Margin (%)	3.1	3.7	5.0	5.0
NPM (%)	1.5	2.0	2.8	2.8
ROCE (%)	17.8	19.0	25.7	26.7
ROE (%)	20.1	21.3	26.5	26.2
EPS (Rs.)	54.1	66.5	102.8	128.4
P/E (x)	16.3	13.3	8.6	6.9
BVPS(Rs.)	268.7	311.8	388.3	490.4
P/BVPS (x)	3.3	2.8	2.3	1.8
EV/EBITDA (x)	9.9	8.2	5.4	4.8

Valuation and view

BPCL is one of the three key beneficiaries of the retail pricing deregulation implemented by the government as it leads to lower interest cost, relief from subsidy sharing burden and higher auto fuel marketing margins. Besides it is also expected to gain from ramp-up in its business verticals. It is planning to expand its refining capacity by 60% to 48 MT giving it economic moat in terms of improved market position. Moreover, in order to reduce its exposure in under recoveries it is focusing on its E&P vertical. Notably, discoveries in the hydrocarbon reserves in Brazil and gas reserves in Mozambique (recoverable reserves estimated at ~70 tcf) provide high revenue visibility in this segment.

We expect BPCL's net profit to grow at a CAGR of ~38% during FY15-FY17E and the RoE and RoCE to improve to 26.2% and 26.7% respectively. At the current market price (CMP) of Rs. 883, the stock trades at an EV/EBITDA multiple of 5.4x FY16E and 4.8x FY17E. We recommend 'BUY' with a target price of Rs. 1,065, assigning a forward EV/EBITDA multiple of 4.0x, which implies a potential upside of ~21% to the CMP from 12 months perspective.

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