

BSE Sensex
18,308

S&P CNX
5,415

CMP: INR288

TP: INR455

Buy



Stock Info

Bloomberg	BPCL IN
Equity Shares (m)	723.1
52-Week Range (INR)	449/256
1, 6, 12 Rel. Per (%)	-8/-18/-19
M.Cap. (INR b)	208.5
M.Cap. (USD b)	3.3

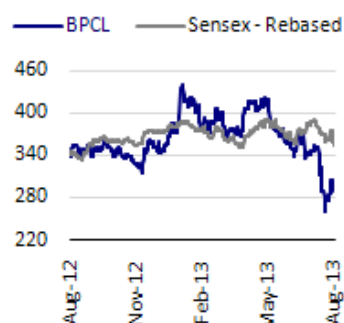
Financial Snapshot (INR Billion)

Y/E March	2013	2014E	2015E
Net Sales	2,422	2,485	2,575
EBITDA	67	71	71
Adj PAT	19	22	26
EPS (INR)	26.0	30.7	35.8
Gr. (%)	140.9	17.9	16.8
BV/Sh. (INR)	232.8	253.9	278.2
RoE (%)	11.5	12.6	13.5
RoCE (%)	8.9	9.6	9.6
P/E (x)	11.1	9.4	8.0
P/BV (x)	1.2	1.1	1.0

Shareholding pattern %

As on	Jun-13	Mar-13	Jun-12
Promoter	55.8	55.8	55.8
Dom. Inst	16.1	16.6	18.1
Foreign	10.3	10.4	9.0
Others	17.9	17.2	17.0

Stock Performance (1-year)



Transition from a downstream to integrated player

E&P remains the key trigger; valuations attractive

- BPCL has underperformed the Sensex by 21% in the past three months. We believe that the correction is overdone, given that BPCL is now trading at a 10-year low valuation (adjusted FY14E P/B of 0.4x) against the backdrop of continued reforms and other positives.
- News flow on E&P, ongoing diesel reforms and expansion of refining capacity to ~1.6x could lead to re-rating of the stock.
- We value BPCL at INR455/sh, which includes INR151/sh for its E&P portfolio and INR51/sh for other investments, post 25% discount. Maintain Buy.

Multi-year low valuations; pessimism overdone; reforms firmly on track

Over the last three months, BPCL has underperformed the Sensex by 21%. The underperformance can be partly justified by the newly emerged concerns like INR depreciation, increase in under-recovery and uncertainty on the refinery transfer pricing (export/trade parity). However, we believe that the correction is overdone given that BPCL is trading at a multi-year low valuation against the backdrop of continued reforms and operational positives.

Our E&P business valuation is at 30% discount to benchmarks

BPCL's Mozambique acreage recoverable reserves are pegged at 35-65tcf, while for Brazil reserves, the estimates from Petrobras operated prolific SEAL basin (five successful wells) are yet to be assessed. Anadarko operated Wahoo reserves are estimated at 150-200mmbbl. To factor some execution risk, we conservatively value BPCL's E&P business at INR151/sh v/s recent benchmark valuation of INR218/sh. We believe there could be significant upside from the awaited reserves in Petrobras operated SEAL basin in Brazil.

Balance sheet comfortable; reforms to re-energize core business

Ongoing diesel reforms will substantially reduce the working capital and in turn interest cost for BPCL, leading to higher earnings. Over the coming period, BPCL is set to expand its refining capacity by 1.6x to 47.5mmt and invest >USD1.7b in E&P development. Operationally, BPCL's GRM has been superior to peers and the relatively strong balance sheet places it in a comfortable position for capex in refining and E&P business.

Key events to watch out (a) reserve certification and final investment decision (FID) at Mozambique, (b) reserves for SEAL basin, (c) clarity on refinery transfer pricing (export/trade) and (d) continuance of diesel reforms.

Valuation and view: While the headline gross D/E stands at ~1.5x, adjusted for subsidy receivables and oil bonds, BPCL's net debt would stand at ~INR120b (gross debt at ~INR190b), implying adjusted net D/E at 0.7x. We maintain BPCL as our top pick among OMCs due to its E&P upside potential. The stock trades at 8x FY15E EPS of INR35.8 and 0.4x FY15E adjusted BV. Maintain **Buy** with a target price of INR455.

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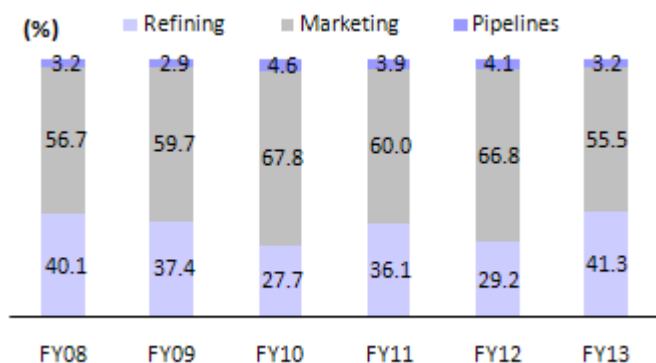
Investors are advised to refer through disclosures made at the end of the Research Report.

BPCL: Story in charts

Moving from downstream to integrated model

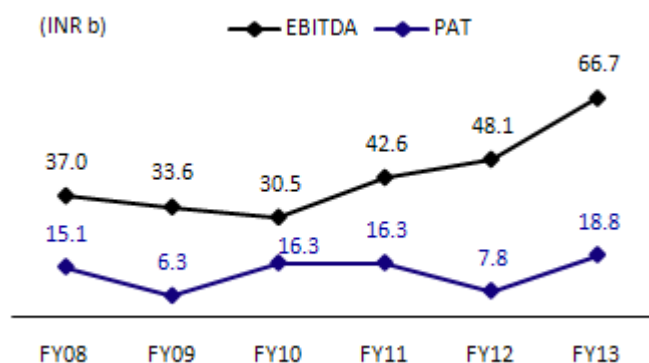
1. BPCL's current earnings largely from refining and marketing
2. however, no secular trend seen in profitability
3. Led by volatile GRM and high interest costs.....
4. Leading to lower return ratios
5. Silver lining led by E&P successes, valuing conservatively at USD1.8b (invested USD1.1b), at 30% discount to benchmark

BPCL's current earning largely from refining & marketing (%)



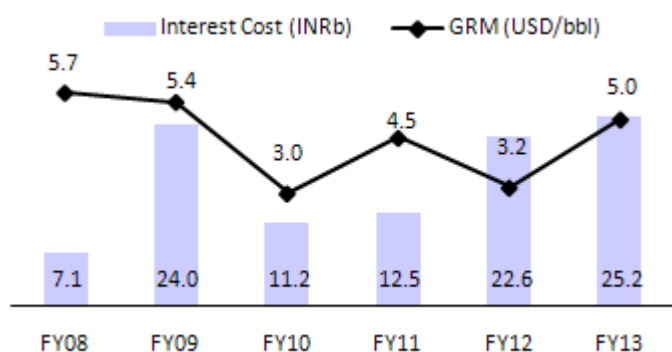
Source: Company, MOSL

however, no secular trend seen in profitability (INRb)



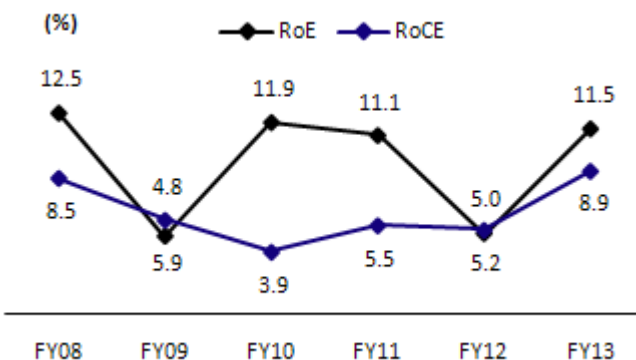
Source: Company, MOSL

.... Led by volatile GRM and high interest costs.....



Source: Company, MOSL

Leading to lower return ratios (%)



Source: Company, MOSL

Silver lining led by E&P successes, valuing conservatively at USD1.8b (invested USD1.1b), at 30% discount to benchmark

Country	Successful wells	Reserves announced	Comments
Mozambique	13	35-65 tcf	We value the block at USD3.5/boe, assuming recoverable reserve production from 2019, implying INR139/share
Brazil (Wahoo & Others)	3	150-200mmbbl (includes only Wahoo discover)	We value the block at USD10/boe, assuming recoverable reserves of production from 2018, implying INR12/share
Brazil (SEAL Basin)	5	Reserves not declared yet	We currently do not assign any value to this block

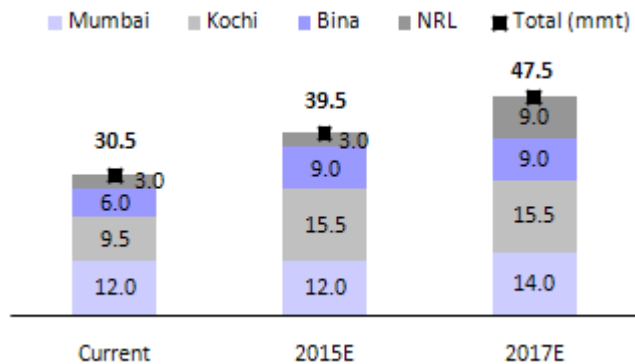
Source: Company, MOSL

BPCL: Story in charts

Expect ongoing reforms to re-energize core business

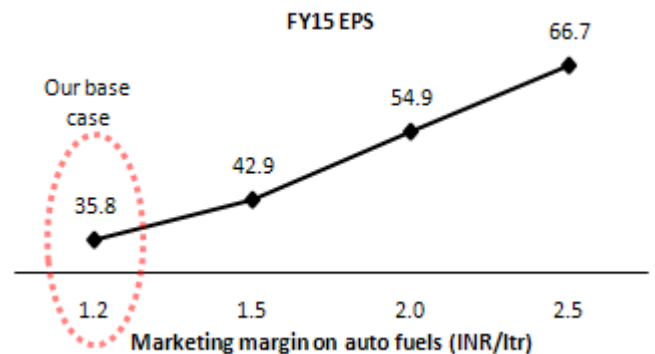
1. Refining capacity set to increase by 1.6x.....
2. ...deregulated era could increase marketing profitability.
3. Expect overall under recovery to reduce 40% ...
4. OMC's to benefit from lower interest costs...
5. Trading at attractive valuation...
6. Value at INR455/sh

Refining capacity set to increase by 1.6x.....



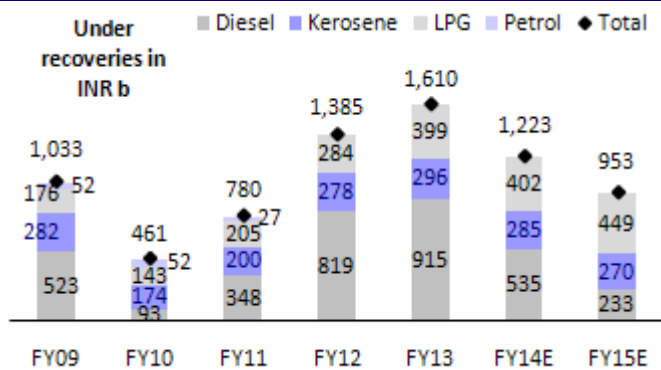
Source: Company, MOSL

...deregulated era could increase marketing profitability



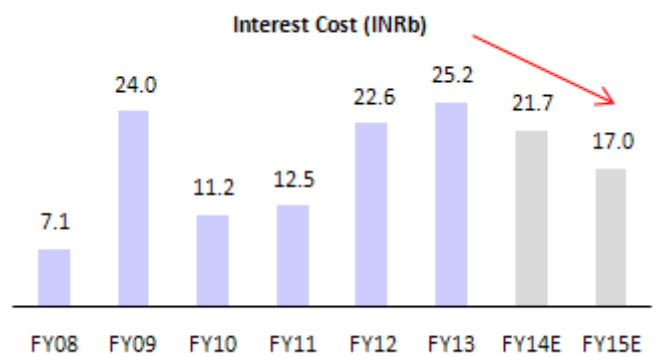
Source: Company, MOSL

Expect overall under recovery to reduce 40% by FY15 (INRb)



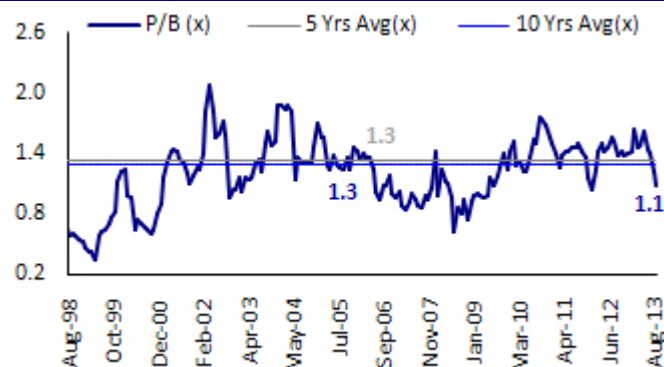
Source: Company, MOSL

BPCL to benefit from lower interest costs in coming years....



Source: Company, MOSL

Trading at multiyear low valuation, trading at 0.4x adj. BV



Source: Company, MOSL

BPCL: Fair value at INR455/share (INR/sh)

EV/EBITDA (FY15E 4.5x)	434
P/B (FY15E 1x)	414
P/E (FY15E 9x)	517
Average	455

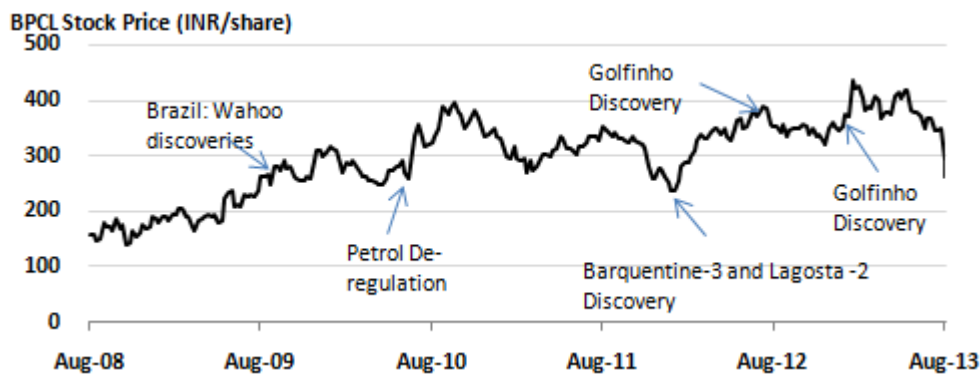
Source: Company, MOSL

BPCL valuations at multiyear low

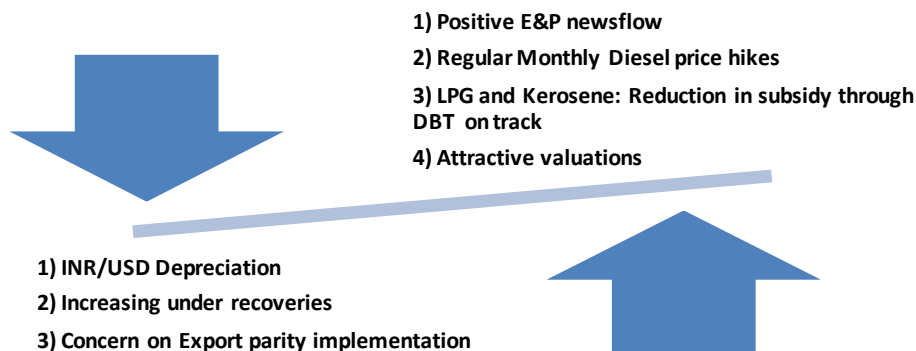
Pessimism overdone; reforms firmly on track

- Over the last 3 months, BPCL has underperformed Sensex by 21%.
- The underperformance can be partly justified by the newly emerged concerns like INR depreciation, increase in under recoveries and uncertainty on the refinery transfer pricing (export/trade parity).
- However, we believe that the correction is overdone given that the BPCL is now trading at a multiyear low valuation against the backdrop of continued reforms and operational positives.

BPCL has witnessed many positive E&P newsflow and reserve accretion



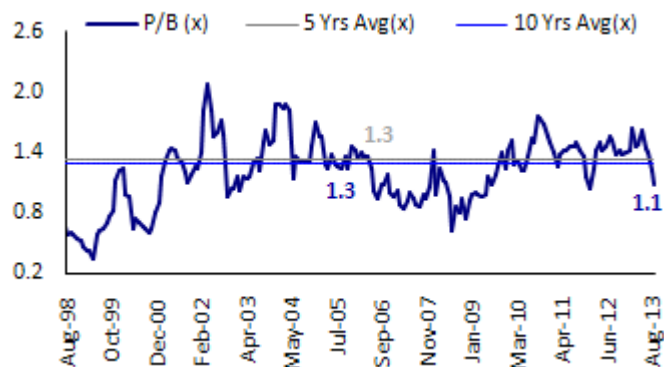
On-track reforms and positive E&P news flows are significant positives



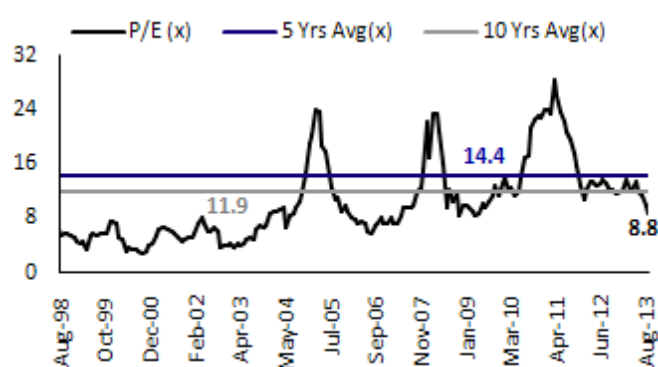
Source: MOSL

However, we believe that the correction is overdone given that the BPCL is now trading at a multiyear low valuation against the backdrop of continued reforms and operational positives.

BPCL 1 year Fwd P/B Chart: Trading at 0.4x adj. FY14E BV



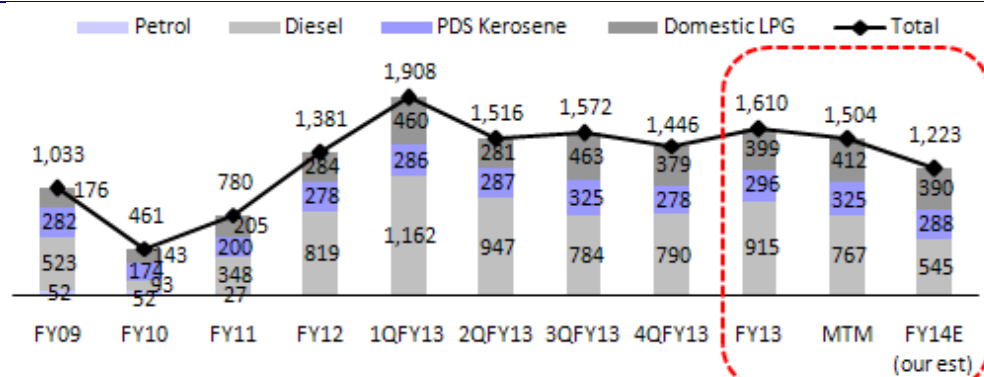
BPCL 1 year Fwd P/E Chart: Trading at multiyear low



Reforms seem to be firmly on track

- After the Petrol price deregulation in June 2010, government has limited the subsidized domestic cylinders to 9 per household per year in end-2012/early-2013.
- Further, in January 2013, government deregulated the prices of bulk diesel and has allowed OMC's to take monthly price hike of INR0.45/ltr (benefit though negated by recent INR depreciation).
- The INR depreciation has pushed back the likely diesel deregulation by almost a year, but the recent 7th price hike just before the Parliament Session, gives the confidence of continuance of reforms.
- Further, over the next 2-3 year period, government will shift LPG and kerosene to direct cash transfer mechanism thereby reducing leakages and eliminating dual pricing in kerosene.
- We currently model monthly diesel price hike of INR0.45/ltr in our estimates and expect the gross under recoveries to reduce by 40% by FY15 to INR945b.

MTM under recoveries stand at INR1.5t; ~7% lower than INR1.6t in FY13 (INRb)



Source: Company, MOSL

Export Parity shift seem difficult; would further complicate matters

- Kirit Parikh Committee, which is currently studying the mechanism to implement Export Parity pricing (for refinery transfer price v/ current mechanism of trade parity) will find it difficult to give any clear solution, given the obvious negative impact on the domestic refiners.
- The combined PAT of all oil PSU's (HPCL, BPCL, IOCL, MRPL and CPCL) stood at INR47/145b during FY13/FY12 v/s proposed likely impact of ~INR128b. The impact on private refiners (RIL and Essar) could be to the tune of INR30b (RIL EPS impact of ~7%). Implementation would complicate matters as the government will have to come up with new compensation mechanism for the impacted refiners.

E&P valuation at 30% discount to benchmarks

Expect further upside potential

- BPCL's Mozambique acreage recoverable reserves are pegged at 35-65tcf while for Brazil reserve estimates from Petrobras operated prolific SEAL basin (5 successful wells) are yet to be assessed. Anadarko operated Wahoo reserves are estimated at 150-200mmbbl.
- To factor in some execution risk, we conservatively value BPCL's E&P business at INR151/sh v/s recent benchmark valuation of INR218/sh.
- We believe that there could be significant upside from the awaited reserves in Petrobras operated SEAL basin, Brazil.

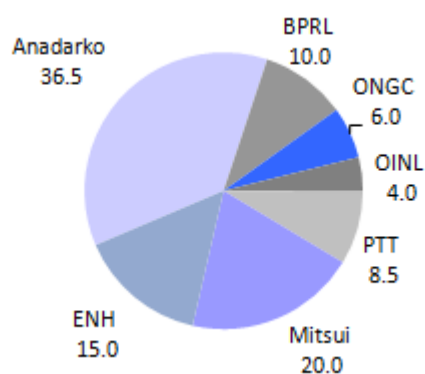
World class Mozambique gas block, 13 successful well till date

BPCL's Mozambique acreage (10% stake) has witnessed 8 discoveries and 5 successful appraisal wells in the block, while the northernmost (gas) acreage yet remains to be explored.

In the last 2 years, Anadarko (operator) has increased the recoverable reserve estimate from 3tcf to 35-65tcf now and which comprises of - Prosperidade complex: 17-30tcf, Golfinho/Atum: 15-35tcf and Tubarao: 2tcf.

Additionally, the consortium has recently announced a new discovery in the Orca well which opens up a 3rd gas accumulation area in the Mozambique block after 1) Prosperidade and 2) Golfinho-Atum complex. The consortium plans to carry 2 appraisal wells to ascertain reserves of the discovery. Appraisal would commence post drilling of the exploration wells in Linguado and Espadarte in the northern part of the block. Only the northern most part of the block is now left unexplored with confirmed gas discoveries in rest of the block

JV partners in the Mozambique block



Source: Company, MOSL

Location of the proposed Mozambique LNG park



Source: Anadarko, Company, MOSL

BPCL has invested INR25b as equity in Bharat Petro Resources (BPRL) and a similar amount as loans, taking its total investment to ~INR60b. The development capex in Mozambique is USD18b-20b for the first two trains and its share (10%) comes to USD1.8b-2b. BPRL will borrow the money in USD terms through "reserve-based funding

Key events to watch out in the near term before the likely FID approval by end-2013 are a) reserve certification and b) gas sales agreement (clarity on gas pricing). We value BPCL's stake at INR139/sh. assuming first gas by 2018, recoverable reserves of 45tcf, valued at USD3.5/boe.

Mozambique recoverable reserves at 35-65tcf; in-place resources of 100tcf

Anadarko, operator, estimates the recoverable reserves from the Mozambique block's at 35-65tcf of natural gas and in-place resources at >100tcf of natural gas. JV estimates reserves at 17-30tcf in Prosperidade complex which consists of four discoveries, Windjammer, Barquentine, Lagosta and Camarao. In northern section of block, JV has made two more discoveries, Golfinho and Atum, and estimate recoverable reserves at 15-35tcf from these two discoveries. As acreage is in exploratory and appraisal stage, there is an upside potential to our reserve estimates.

Mozambique block has witnessed 13 successful wells till date (meters)

No	Discovery/ Appraisal	Date	Oil/Gas	Pay Zone	Water Depth	Depth	Comments
1	Windjammer	Mar-10	Gas	365	1,465	4,250	No resource number available yet
2	Barquentine	Oct-10	Gas	126	1,576	5,115	No resource number available yet
3	Lagosta	Nov-10	Gas	168	1,539	4,221	Recoverable reserves - 3-4 tcf (indicative)
4	Tubarao	Feb-11	Gas	34	900	3,337	Recoverable reserves - 3-4 tcf (indicative)
5	Barquentine-2 (Appraisal)	Aug-11	Gas	70	1,650	2,450	Recoverable reserves - 6 tcf
6	Camarao	Oct-11	Gas	73	1,441	2,409	Recoverable reserves - 10 tcf
7	Barquentine-3 (Appraisal)	Nov-11	Gas	202	1,575	2,509	Recoverable resource range - 15-30tcf
8	Lagosta-2 (Appraisal)	Jan-12	Gas	237	1,467	2,868	Recoverable resource range - 15-30tcf
9	Lagosta - 3 (Appraisal)	Feb-12	Gas	176	1,404	4,180	Recoverable resource range - 15-30tcf
10	Barquentine-4 (Appraisal)	Apr-12	Gas	160	1,650	NA	Recoverable resource range - 17-30+tcf
11	Golfinho	May-12	Gas	59	1,027	4,537	Prosperidade - 17-30 tcf, Other - 7-20+tcf
12	Atum	Jun-12	Gas	92	1,000	3,860	Prosperidade - 17-30 tcf, Other - 10-30+tcf
13	Orca	Apr-13	Gas	58	1,061	4,996	Prosperidade - 17-30 tcf, Golfinho-Atum -15-35+tcf

Source: Company, MOSL

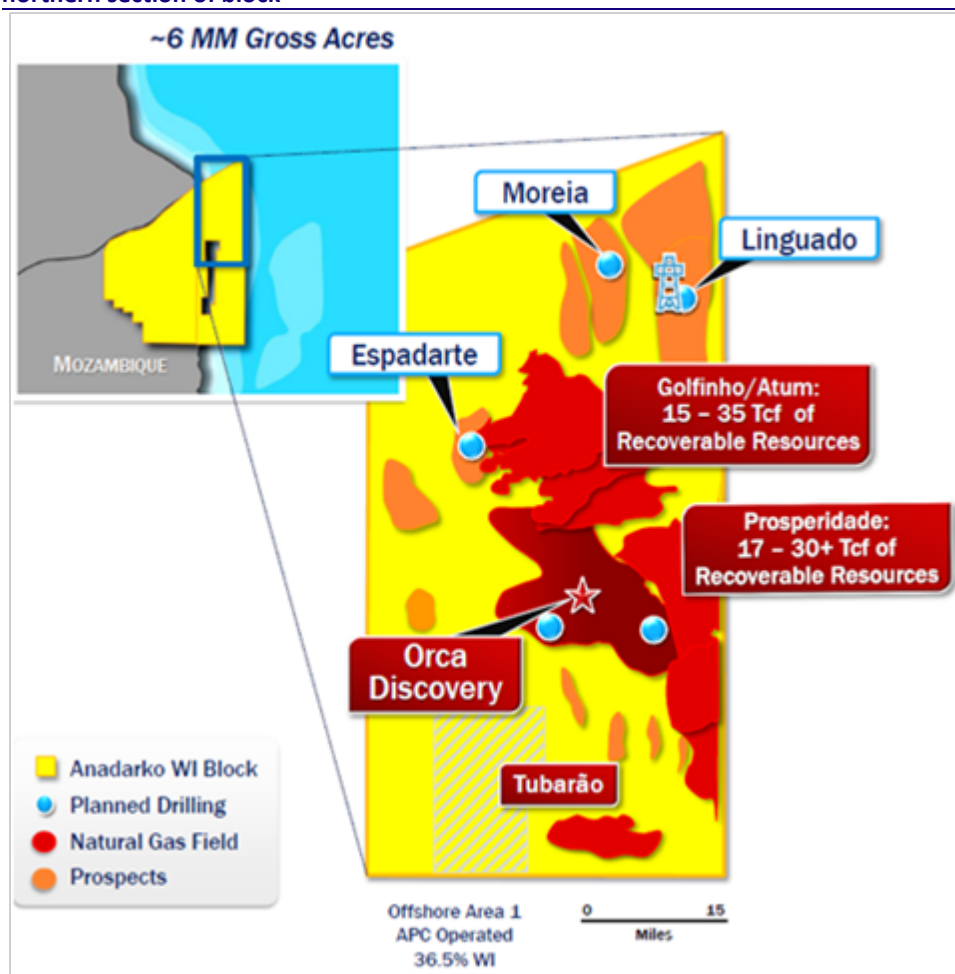
Ongoing drilling program could add further reserves: As the acreage is still in the exploration and appraisal stage, we expect the recoverable reserve number to expand further. With more appraisal drilling planned in CY13 due to planned FID in 2HCY13, we believe that the minimum range of reserves of 35 tcf will gradually move towards the maximum range of 65 tcf. The company has finished drilling activities in the Prosperidade complex while appraisal drilling it is continuing with the appraisal drilling in the Golfinho/Atum complex.

CY13 exploration plans might add further to reserve

Name of the Well	Type
Espadarte	Exploration
Linguado	Exploration
Moreia	Exploration
Golfinho-Atum Complex	2-3 appraisal wells

Source: Company, MOSL

Anadarko estimates recoverable resources at 35-65tcf after two new discoveries in northern section of block



Source: Anadarko, MOSL

Value BPCL's Mozambique at INR139/sh

We value BPCL's stake at INR139/sh. assuming first gas by 2018, recoverable reserves of 45tcf, valued at USD3.5/boe. We have taken a discounting rate of 12% to account for country risk of Mozambique. We believe there could be upside to our numbers, post clarity on reserves after the reserve certification and FID in 2013.

Our valuation at 30% discount to Benchmarks:

- Recently there have been two major M&A deals in the Mozambique oil and Gas space; 1) Cove Energy selling its 8.4% stake to PTT 2) ENI (Italy) selling 20% stake to CNPC (China) and 3) Videocon selling its 10% stake to ONGC/OINL
- Cove Energy sold its 8.4% stake in the Rovuma Area-1 basin, same block where BPCL has 10% stake, to PTT of Thailand at USD1.91b, implying USD2.26b/ INR188/ share value for BPCL for its 10% stake
- Whereas, ENI who is the operator in the adjoining block in Rovuma Area-4 basin, has recently sold 20% stake to China's CNPC for USD4.2b. Area-4 is likely to have 75tcf of gas in place.
- Recently, Videocon sold its 10% stake in the Rovuma Area-1 basin, same block where BPCL has 10% stake, to consortium of ONGC (60%) and OINL (40%) at USD2.48b, implying INR206/ share value for BPCL for its 10% stake.

We assume 45 tcf of recoverable reserves in our base case

	Low	High	Base Case
Likely recovery (tcf)	35.0	65.0	45.0
Likely recovery (mmboe)	6,650	12,350	8,550
Valuation (USD/boe)	3.5	3.5	3.5
Value (USDb)	23.3	43.2	29.9
Value (INR b)	1,373	2,550	1,766
BPCL stake	10%	10%	10%
FY19 Value to BPCL (INRb)	137	255	177
FY19 Value (INR/sh)	190	353	244
FY15E Value to BPCL (INRb)	78	145	100
FY15E value (INR/sh)*	108	200	139
Implied EV/boe (USD)			2.0

*discounted by 5 years @12%

Source: Anadarko, MOSL

Also the reserves from the recently announced Orca discovery are not included in the current reserves estimate of 35-65 tcf. Anadarko's (operator of the block) Sr. Vice President, Worldwide Exploration, Bob Daniel, has termed the discovery as 'Big, distinct and separate natural gas accumulation'. As the net pay of Orca-1 discovery is similar to the Golfinho discovery (~59m of net pay), we do not rule out the possibility of Orca-1 size to be similar to Golfinho discovery (7-20 tcf). We expect the company to announce the reserves number post completion of the appraisal activities. Also this new accumulation is expected to be fully contained within the Offshore Area -1, unitization with ENI (operator of Area 4 located on East-side of Area 1) is unlikely to be applicable.

Mozambique FID in end-2013; first gas in 2018

JV has successfully completed three flow tests at facility which will help in achieving reserve certification and complete FID (final investment decision) for the block by 2HCY13. For monetization of the block, consortium partners have planned to develop two train LNG facility (later expand it) and is targeting first LNG sale in 2018. Further, JV has also announced signing of heads-on-agreement with ENI, whereby the two operators will conduct separate, yet coordinated, offshore development activities, while jointly planning and constructing common onshore liquefaction facilities in the form of an LNG (liquefied natural gas) park in the Cabo Delgado Province of northern Mozambique

Mozambique block's FID expected in 2013; first gas in 2018

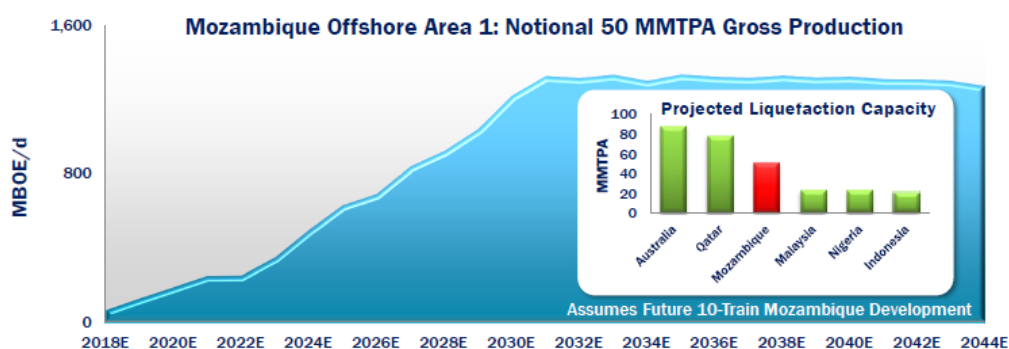


Source: Anadarko, MOSL

LNG development – key for block success

For monetization of this large resource base, Anadarko has decided to build initially a two-train LNG facility of 5mmtpa/year and later expand it. With continued success in basin, Anadarko has indicated that there is possibility of expanding it to 10 trains. The distance of the basin from the shore is only 50km and Mozambique's geographic location is also ideal as it is near to high gas demand areas of Asia. During Dec-12, the JV announced awarding of FEED contracts for both LNG construction and offshore installation.

Production could ramp-up to 50mmtpa (10 trains), Mozambique to become third largest LNG supplier in the world



Source: Anadarko, MOSL

Brazil – a lot more to come

We value Brazil (Wahoo) block at INR12/sh

BPCL has made five discoveries (and 3 successful appraisal wells) in Brazil till date and recoverable reserves estimates are available only for one discovery, Wahoo at 150-200mmbbl.

BPCL's JV block in Brazil has a 3 well appraisal drilling program in 2013 in Sergipe Alagoas basin. Company is very positive on the prospects of this block and expects meaningful reserve accretion (not factored in our numbers).

Petrobras, who is operator in 9 out of 10 BPCL blocks in Brazil, has aggressive E&P investment plan of USD142b over 2012-16. We believe that there could be significant upside from the recently announced discoveries in the Sergipe Alagoas basin.

We value BPCL's stake (only Campos – Wahoo) at INR12/sh. We have assumed the recoverable reserves at 200mmboe and have valued it at USD10/boe. We have taken a discounting rate of 12%. We believe there could be a significant upside to our numbers, post clarity on reserves after the reserve certification for discoveries in the Sergipe and Alagoas (SEAL) basin.

We assume 45 tcf of recoverable reserves in our base case

Wahoo discovery - FY17 Production

Likely recovery (mmboe)	200
Valuation (USD/boe)	10.0
Value (USDm)	2,000
Value (INR m)	118,000
BPCL stake	12.5%
Value to BPCL (INR m)	14,750
Value (INR/sh)	20
FY15E value	12
Implied EV/boe (USD)	6.6
Discounted by (years)	4.5

Source: Anadarko, MOSL

BPCL has stake in 10 blocks in Brazil; recorded 8 successful wells till date

BPCL has stake in 10 offshore blocks in Brazil, out of which four are in Sergipe and Alagoas basin, three in Espirito Santo basin, two in Potiguar basin and one in Campos basin.

BPCL has stake in 10 blocks in Brazil

Block	Status	Stake	Operator
Sergipe and Alagoas			
SEAL-M-349	Discovery	20.0%	Petrobras
SEAL-M-426	Discovery	20.0%	Petrobras
SEAL-M-497	Exploration	20.0%	Petrobras
SEAL-M-569	Exploration	20.0%	Petrobras
Espirito Santo			
ES-24-588	Exploration	15.0%	Petrobras
ES-24-661	Exploration	15.0%	Petrobras
ES-24-663	Exploration	15.0%	Petrobras
Campos			
C-M-30-101	Discovery	12.5%	Anadarko
Portiguar			
POT-16-663	Exploration	10.0%	Petrobras
POT-16-760	Exploration	10.0%	Petrobras

Source: Company, MOSL

BPCL present in 10 blocks in four basins in Brazil

Source: Industry, MOSL

Reserves estimates available for Wahoo discovery

Source: Anadarko, MOSL

Five Discoveries in Brazil blocks till date

Till date, BPCL has made five discoveries in Brazil, one in Campos (Operator-Anadarko) and Espirito Santos (Operator-Petrobras) basin and three in Sergipe-Alagoas (Operator-Petrobras) basin. Out of these five discoveries, only Anadarko has indicated the recoverable reserves estimate of 150-200mmbbl for Wahoo-1 discovery in Campos basin

Total 7 successful wells including 5 discoveries and 3 appraisal wells

No	Discovery/ Appraisal	Date	Basin	Operator	BPCL Stake (%)	Oil/Gas	Pay Zone (m)
1	Wahoo - 1	Oct-08	Campos	Anadarko	12.5	Oil	65
2	Wahoo-2	Nov-09	Campos	Anadarko	12.5	Oil	59
3	Barra	Oct-10	Sergipe-Alagoas	Petrobras	20.0	Oil & Gas	NA
4	Grana Padano	Jul-12	Espirito Santo	Petrobras	15.0	Oil	35
5	Barra -1 (Appraisal)	Aug-12	Sergipe-Alagoas	Petrobras	20.0	Oil & Gas	40
6	Farfan	Oct-12	Sergipe-Alagoas	Petrobras	20.0	Oil	44
7	Cumbe (1-SES-166)	Dec-12	Sergipe-Alagoas	Petrobras	20.0	Oil	98
8	Farfan 1	Aug-13	Sergipe-Alagoas	Petrobras	20.0	Oil	51

Source: Company, MOSL

Drilling activities to pick-up; aggressive investment plan of Petrobras

BPCL has planned drilling of 3 appraisal wells in Brazil in 2H CY13. For Barra discovery in Sergipe-Alagoas basin (JV partner Petrobras), appraisal drilling is planned in 2013 and post that BPCL expects to get some indication on the recoverable numbers in the block. Depending upon commerciality of Wahoo appraisal results, the development activities would start and first oil can come as early as 2017.

We expect drilling activities to further pick up in Brazil as Petrobras, who is operator in 9 out of 10 BPCL blocks in Brazil, has aggressive E&P investment plans. It has planned USD236.5b investment over 2012-16 and 60% (USD141.8b) of which is earmarked for E&P.

BPCL E&P capex at ~INR15b in FY14

BPCL has planned capex of ~INR16b in FY14 (~INR7b each on Mozambique and Brazil and balance on other projects). It has already incurred ~INR35b of capex in Mozambique and Brazil blocks till date. BPCL share of capex (10%) in Mozambique could be to the tune of ~USD2b, most of which will be incurred in next 3-4 years.

Total planned capex of ~INR15b in FY14

	Spent till date (INR b)	FY13 capex		FY14 Capex	
		USD m	INR b	USD m	INR b
Mozambique	13.7	125	6.8	125	7.5
Brazil	20.6	178	9.7	122	7.3
Total	34.3	303	16.5	247	14.8

Source: Company, MOSL

BPCL will refocus on new acquisitions in E&P business, post the start of revenue generation from Brazil (~2017) and Mozambique (~2018). Management is confident about full off-take of gas from Mozambique block and hinted that the consortium is already in talks with Korea, Japan and China for gas sales agreement. Also, management expects meaningful reserve addition from Brazil (Sergipe Alagoas) and Mozambique FID in coming quarters. Currently there are no plans for listing BPCL separately

Timelines for E&P

Asset	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Mozambique										
Upstream	Exploration			Development			Production			
LNG				LNG development			Operate Asset			
Brazil										
Campos, Wahoo discovery	Exploration			Development			Production			
Sergipe-Alagoas	Exploration			Development			Production			
Espirito-Santos	Exploration			Development			Production			

Source: Company, MOSL

Balance sheet comfortable

Ongoing reforms to re-energize core business

- Ongoing diesel reforms will substantially reduce the working capital and in turn interest cost for BPCL leading to higher earnings.
- Over the coming period, BPCL is set to expand its refining capacity by 1.6x to 47.5mmt and invest >USD1.7b in E&P development.
- Operationally, BPCL's GRM have been superior to its peers and relatively strong balance sheet places it in a comfortable position for capex in refining and well as E&P business.

Diesel Reforms positive for BPCL

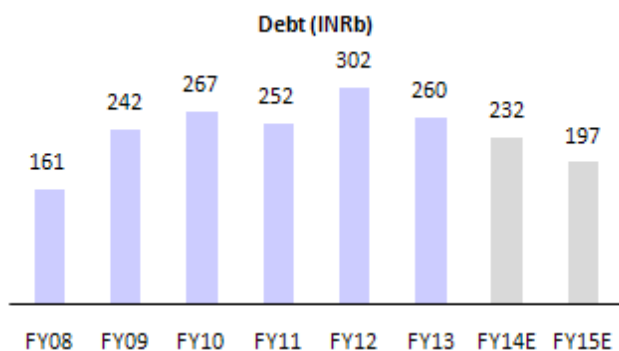
Diesel reforms to reduce under-recovery by 40% in FY15E, positive for OMCs: With (a) diesel reforms, (b) petrol deregulation, (c) capping of LPG cylinders and (d) targeted subsidy through direct cash transfer, we believe the government is nearing its vision of market-linked petro product prices. We estimate the reduction in overall under-recovery by 40% to INR945b in FY15E, against INR1.6t in FY13.

In our recent interaction with BPCL's senior management, they seemed relatively confident about Diesel reforms and expected monthly diesel price hikes to go through ultimately leading to diesel de-deregulation in next 2 years. Although they do not rule out few delays due to volatile political situation and general elections scheduled next year.

While clarity of final subsidy sharing is yet to emerge, a roadmap to meaningful reduction in the under recoveries is nevertheless a positive step for OMCs, in our view.

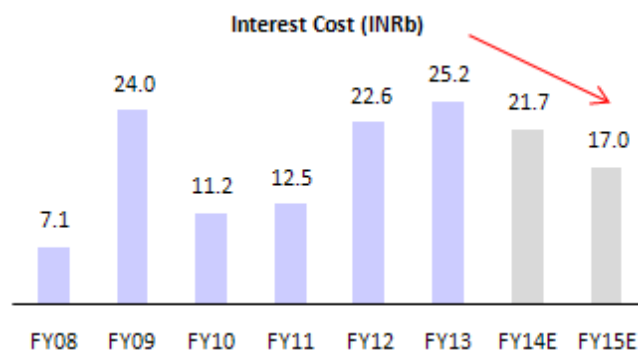
Over the next two years, diesel reforms are unlikely to have any impact on OMC's operating profit as they already do not share any under-recovery and earnings benefit will accrue through reduction in the interest burden led by (a) likely disbursal of subsidy receivables from the government and (b) freeing of working capital.

Expect debt to reduce over next 2-3 years with lower working capital led by diesel reforms



Source: Company, MOSL

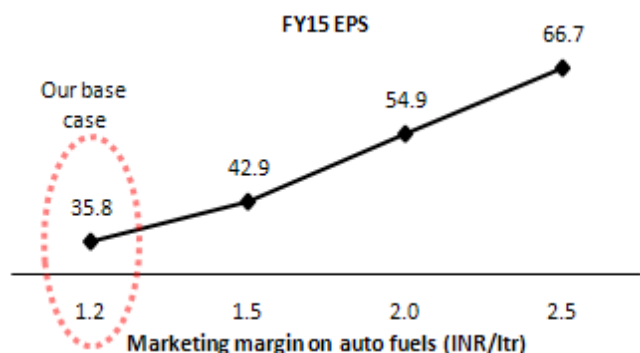
...resulting in lower interest burden



Source: Company, MOSL

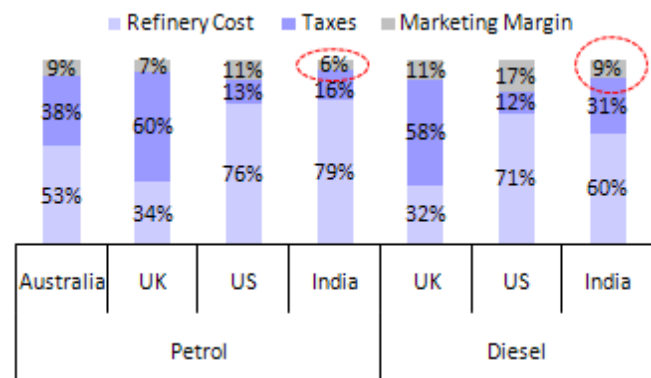
Big jump in profitability through likely increase in marketing margins in deregulated scenario: We believe that in a deregulated scenario, the marketing margin will converge with global peers or at least revert back to FY04 levels (brief period of deregulation) of ~INR2-2.5/ltr. While private players will take some market share, the increase in marketing margin will more than offsets the market share loss. BPCL is currently focusing on improving its infrastructure facilities and marketing network for cost efficiency and is upgrading its inventory management systems.

Significant beneficiary of increase in retail marketing margin



Source: MOSL

India's marketing margin is lowest in the world

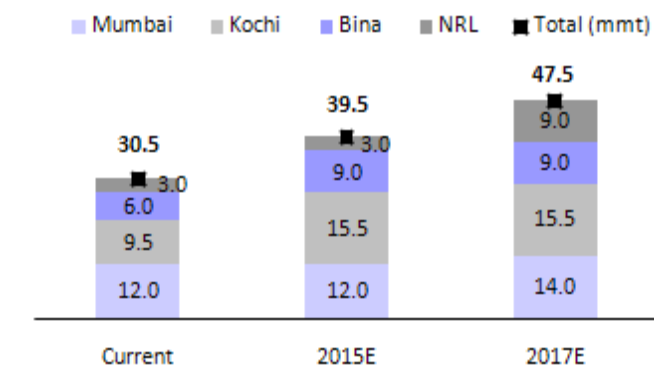


Source: Industry, MOSL

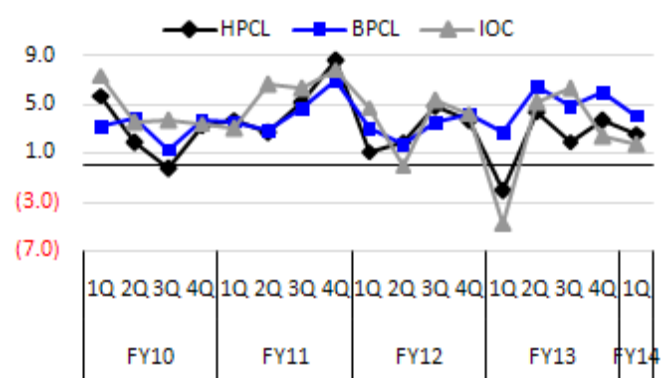
BPCL to increase refining capacity by 1.6x

BPCL's current refining capacity of ~30mmt is just equal to its marketing sales, and given the demand growth of 4-5%, it intends to expand its refining capacity by 1.6x from 30.5mmt to 47.5mmt. Details of the expansion are as follows:-

- Kochi: To expand from current 9.5mmt to 15.5 mmt at a capex of INR150b by Dec 2015;
- Bina (BPCL stake: 49%): To expand from current 6mmt to 9mmt by de-bottlenecking at ~INR20b by Dec 2015;
- Numaligarh refinery (BPCL stake: ~62%): Currently exploring the possibility of expanding capacity from 3mmt to ~9mmt;
- Mumbai: To change CDU at Mumbai refinery, to increase distillation capacity from current 12mmt to 14mmt.

BPCL's refining capacity to increase 1.6x in next 3-4 years

Source: Company, MOSL

Recently, BPCL has reported higher GRM than HPCL/IOCL

Source: Industry, Company, MOSL

BPCL's refining margins have been better than its peers in the recent period helped by its active inventory management as well benefit from the recent government directive which allows the refiners to recover state specific taxes, which were earlier irrecoverable. The prospective implementation began from June 2012 and recently government also allowed the retrospective recovery which will increase BPCL's profit for the next three years by INR6-8b.

On the GRM front, we expect GRM's to remain range bound in medium-term due to (a) subdued global oil demand (0.9mmbbl/d in 2013) led by escalated crude prices (still at ~USD 110/ bbl); and (b) additional refining capacity coming up with almost nil refinery closures in last 8-9 months. Resistance by European governments to shut down the uneconomical refineries has contributed to the lower overall utilization impacting margins.

Balance sheet comfortable for capex plans

BPCL has planned investments of INR400b over the next five years include E&P: INR100b, Marketing: INR70b, Gas Infrastructure: INR50b, Kochi Refinery Expansion: INR150b, and likely Kochi Petchem Project of INR50b.

BPCL's current gross debt stands at INR190b and post the oil bonds on the balance sheet of INR50b and subsidy receivable of ~INR20, its net debt stands at INR120b implying net debt / equity of 0.7x. Also, BPCL can raise funds through its treasury shares (~9% of total equity), whose current market value is ~INR20b.

With net debt of INR120b, net debt / equity stands at 0.7x

Source: Company, MOSL

Valuation & view

- **E&P upside potential key differentiator:** E&P upside potential is BPCL's key differentiator vis-à-vis HPCL and IOCL. BPCL's E&P portfolio has turned out to be a huge success, with multiple discoveries in its Brazil and Mozambique acreage.
- **Value BPCL at INR455/share, including investments at INR202/share:** On FY14E basis, we assign a P/B multiple of 1x, EV/EBITDA multiple of 4.5x and P/E multiple of 9x arriving at a fair value of INR455/share based on the average of P/B, EV/EBITDA and P/E valuation methodologies. We value BPCL's investments at INR202/share, which comprises of E&P potential: INR151/share, listed investments: INR32/share (post 25% discount), and treasury shares: INR18/share
- The stock trades at 8x FY15E EPS of INR35.8 and 0.4x adj. FY15E BV after adjusting for investments. BPCL is our top pick among OMCs. Maintain Buy.
- **Triggers for the stock:** a) Reserve certification for Mozambique and Brazil; b) FID for Mozambique.
- **Key risks are** (a) delays in the diesel reforms and (b) shift of refinery transfer pricing to export parity

We value BPCL at INR455/share

EV/EBITDA (FY15E 4.5x)	434
P/B (FY15E 1x)	414
P/E (FY15E 9x)	517
Average	455

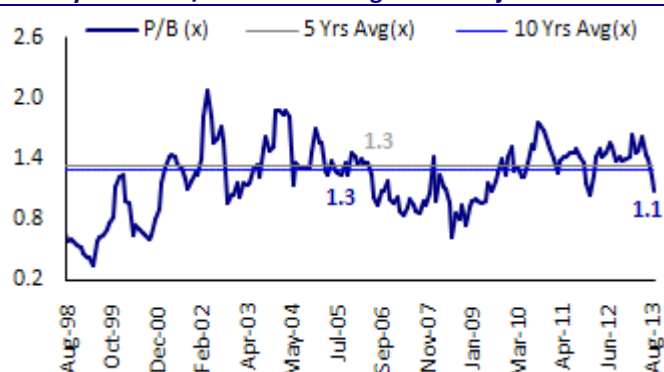
Source: MOSL

We value BPCL's investments at INR202/share

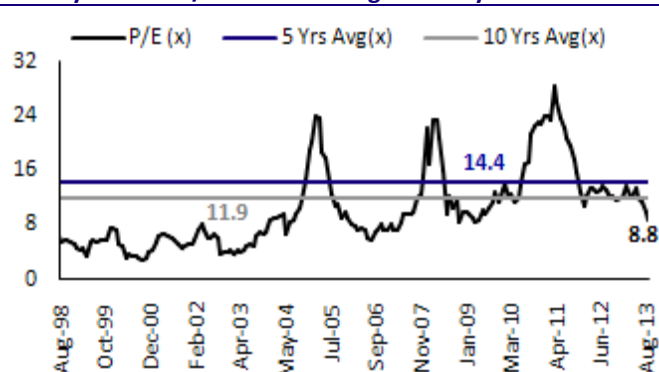
Investments	INR b	INR/sh	
Oil India	9.0	12	25% discount to CMP/TP
Petronet LNG	8.4	12	25% discount to CMP/TP
Indraprastha Gas	5.9	8	25% discount to CMP/TP
Treasury Shares	13.2	18	25% discount to CMP/TP
Unlisted Investments			
E&P Potential	109.2	151	Brazil, Mozambique discoveries
Total	145.7	202	

Source: Company, MOSL

BPCL 1 year Fwd P/B Chart: Trading at 0.4x adj. FY14E BV

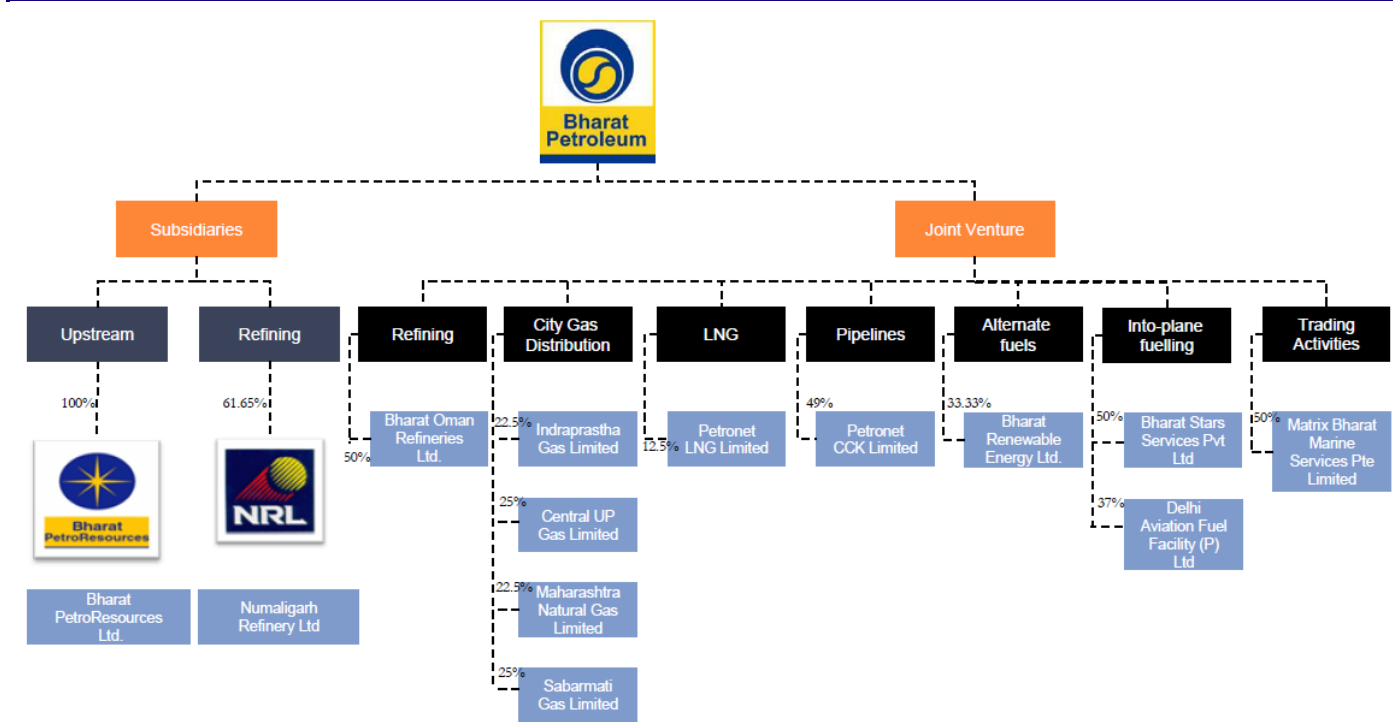


BPCL 1 year Fwd P/E Chart: Trading at multiyear low



BPCL: Company Profile

A Fortune 500 company, BPCL has interests in oil refining and marketing of petroleum products. It is the third largest refining company in India with a capacity of 12mmtpa at its Mumbai facility and 9.5mmtpa at Kochi. BPCL has majority stake (63%) in Numaligarh Refineries, a 3mmtpa refinery in the North East. BPCL has investments in IGL (22.5%) and Petronet LNG (12.5%). BPCL is a public sector firm in which the government of India holds 54.93%.



Source: Company, MOSL

Snapshot of BPCL's performance and key assumptions

	FY11	FY12	FY13	FY14E	FY15E
Refining Throughput (mmt) - A	21.8	22.9	23.2	23.2	23.2
Marketing Volumes (mmt) - B	29.1	31.1	33.3	34.6	36.0
Outside Purchases (mmt) - (C = B - A)	7.3	8.2	10.1	11.4	12.8
Pure Marketing (%) - (C/B)	25%	26%	30%	33%	36%
GRM (USD/bbl)	4.5	3.2	5.0	4.5	5.6
Singapore GRM (USD/bbl)	5.2	8.2	7.7	7.3	7.5
Prem/(Disc) (USD/bbl)	(0.7)	(5.1)	(2.7)	(2.8)	(1.9)
Gross Margin Break-up (INR b)					
Refining	32.6	25.5	46.3	44.2	54.6
Marketing	52.3	56.4	60.2	62.6	65.2
Lubes	2.0	2.0	2.0	2.0	2.0
Pipelines	3.5	3.0	3.6	3.6	3.7
Total	90	87	112	112	125
Gross Margin Break-up (%)					
Refining	36%	29%	41%	39%	44%
Marketing	58%	65%	54%	56%	52%
Lubes	2%	2%	2%	2%	2%
Pipelines	4%	3%	3%	3%	3%
Total	100%	100%	100%	100%	100%

Source: Company, MOSL

Financials and valuation

Income statement

(INR Billion)

Y/E March	2010	2011	2012	2013	2014E	2015E
Net Sales	1,238.2	1,536.4	2,121.4	2,421.8	2,485.2	2,575.5
Change (%)	-9.3	24.1	38.1	14.2	2.6	3.6
EBITDA	30.5	42.6	48.1	66.7	70.6	70.8
EBITDA Margin (%)	2.5	2.8	2.3	2.8	2.8	2.7
Depreciation	14.4	18.9	24.1	24.6	27.3	29.0
EBIT	16.1	23.7	24.0	42.1	43.3	41.8
Interest	11.2	12.5	22.6	25.2	21.7	17.0
Other Income	23.7	17.3	14.6	15.3	11.4	13.3
Extraordinary items	-0.8	0.0	0.0	0.0	0.0	0.0
PBT	29.3	28.5	16.0	32.2	33.0	38.1
Tax	10.5	11.1	7.5	12.8	10.4	11.8
Tax Rate (%)	35.9	38.8	46.8	39.9	31.5	30.9
Reported PAT	18.8	17.4	8.5	19.4	22.6	26.4
Adjusted PAT	16.3	16.3	7.8	18.8	22.2	25.9
Change (%)	157.6	0.2	-52.2	140.9	17.9	16.8
Min. Int. & Assoc. Share	-0.9	-1.1	-0.7	-0.6	-0.5	-0.4
Adj Cons PAT	17.0	15.3	7.1	18.3	21.7	25.5

Balance sheet

(INR Billion)

Y/E March	2010	2011	2012	2013	2014E	2015E
Share Capital	7.2	7.2	7.2	7.2	7.2	7.2
Reserves	134.2	146.3	151.6	161.1	176.3	193.9
Net Worth	141.4	153.5	158.8	168.3	183.5	201.2
Debt	266.9	251.9	301.5	260.2	232.0	197.1
Deferred Tax	11.5	13.1	16.8	16.8	16.6	16.5
Total Capital Employed	429.2	428.4	487.5	456.2	443.5	426.6
Gross Fixed Assets	302.0	344.9	416.7	448.2	475.2	499.7
Less: Acc Depreciation	134.5	152.6	174.4	199.0	226.3	255.3
Net Fixed Assets	167.5	192.3	242.3	249.2	248.9	244.5
Capital WIP	78.2	82.9	45.3	43.9	25.3	25.3
Investments	119.3	84.6	78.9	87.0	125.1	140.1
Current Assets	248.9	305.3	404.0	373.2	343.1	322.2
Inventory	141.1	182.1	211.0	207.0	201.0	204.9
Debtors	26.0	28.8	52.0	33.9	32.8	34.6
Cash & Bank	7.3	8.0	13.3	4.5	14.0	27.5
Loans & Adv, Others	74.5	86.4	127.8	127.8	95.2	55.2
Curr Liabs & Provns	188.6	240.5	290.7	304.7	306.5	313.2
Curr. Liabilities	160.9	206.1	271.4	286.5	290.5	297.0
Provisions	27.7	34.5	19.2	18.1	16.0	16.2
Net Current Assets	60.3	64.8	113.3	68.5	36.6	9.1
Total Assets	429.2	428.4	487.5	456.2	443.5	426.6

E: MOSL Estimates

Financials and valuation

Ratios

Y/E March	2010	2011	2012	2013	2014E	2015E
Basic (INR)						
EPS	22.6	22.6	10.8	26.0	30.7	35.8
Cash EPS	43.5	47.3	43.2	59.3	67.8	75.3
Book Value	195.6	212.3	219.6	232.8	253.9	278.2
DPS	7.0	7.0	5.5	11.0	8.2	9.8
Payout (incl. Div. Tax.)	21.5	38.3	35.5	35.2	35.3	35.3
Valuation(x)						
P/E	12.7	12.6	26.5	11.0	9.3	8.0
Cash P/E	6.6	6.0	6.6	4.8	4.2	3.8
Price / Book Value	1.5	1.3	1.3	1.2	1.1	1.0
EV/Sales	0.2	0.2	0.1	0.1	0.1	0.1
EV/EBITDA	8.5	5.7	6.0	3.8	3.1	2.4
Dividend Yield (%)	2.4	2.4	1.9	3.8	2.9	3.4
Profitability Ratios (%)						
RoE	13.7	11.8	5.5	11.8	12.9	13.7
RoCE	3.9	5.5	5.2	8.9	9.6	9.6
Turnover Ratios (%)						
Asset Turnover (x)	3.0	3.6	4.6	5.1	5.5	5.9
Debtors (No. of Days)	7.7	6.8	8.9	5.1	4.8	4.9
Inventory (No. of Days)	41.6	43.3	36.3	31.2	29.5	29.0
Creditors (No. of Days)	0.0	0.0	0.0	0.0	0.0	0.0
Leverage Ratios (%)						
Net Debt/Equity (x)	1.9	1.6	1.9	1.5	1.3	1.0

Cash flow statement

(INR Billion)

Y/E March	2010	2011	2012	2013	2014E	2015E
OP/(Loss) before Tax	28.5	28.6	16.0	32.2	33.0	38.1
Depreciation	14.4	18.9	24.1	24.6	27.3	29.0
Others	0.0	0.0	0.0	0.0	0.0	0.0
Interest	11.2	12.5	22.3	25.2	21.7	17.0
Direct Taxes Paid	-10.5	-12.5	-6.9	-12.8	-10.5	-11.9
(Inc)/Dec in Wkg Cap	-42.3	13.5	-40.4	36.1	41.4	41.0
CF from Op. Activity	-2.2	48.0	19.1	105.3	112.9	113.1
(Inc)/Dec in FA & CWIP	-51.8	-43.1	-42.2	-30.1	-27.0	-24.5
(Pur)/Sale of Invt	44.0	38.5	19.4	-8.1	-19.6	-15.0
Others	0.0	0.0	0.0	0.0	0.0	0.0
CF from Inv. Activity	-7.8	-4.5	-22.8	-38.2	-46.5	-39.5
Inc/(Dec) in Net Worth	2.3	0.0	0.0	0.0	0.0	0.0
Inc / (Dec) in Debt	28.1	4.1	-14.9	-41.3	-28.3	-34.8
Interest Paid	-13.7	-14.0	-21.9	-25.2	-21.7	-17.0
Divd Paid (incl Tax)	-3.5	-6.4	-6.5	-9.3	-6.9	-8.3
CF from Fin. Activity	11.6	-13.0	-43.8	-75.8	-56.9	-60.1
Inc/(Dec) in Cash	1.6	30.5	-47.5	-8.7	9.5	13.5
Net cash/(debt) adj. for ST borrowings	5.7	-22.5	60.7	13.3	4.5	14.0
Closing Balance	7.3	8.0	13.3	4.5	14.0	27.5

E: MOSL Estimates

NOTES

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