COMPANY UPDATE

Sumit Pokharna
sumit.pokharna@kotak.com
+91 22 6218 6438

MANGALORE REFINERY AND PETROCHEMICALS LTD. (MRPL)

PRICE: RS.122 RECOMMENDATION: BUY
TARGET PRICE: RS.155 FY19E PE: 7.6X

Strong product prices, Robust cracks, and Inventory gains are key triggers

Due to hurricane in USA around 20% of the USA refining capacity got impacted resulting in meaningful jump in global refining margin due to finished product supply disruption. Singapore refining margins have improved 38.4% qoq (till date) to $ 7.5/bbls led by rise in international product prices without similar rise in crude oil prices. We expect MRPL's financial performance to improve on account of strong margins, improvement in operational performance in the medium term and ongoing improvement in financial metrics. Further, if crude remains at elevated levels by quarter end then we can expect inventory gains in Q2FY18.

The expansion of capacity to 15 mmtpa and increase in complexity to 10 NCI (from 5.5 earlier) implies that distillate yield (including propylene) will expand, going forward. MRPL has lined up capex plans for two major projects 1). Up-gradation of refinery to meet BS-VI norms by 2020, which recently received environmental clearance and 2). Further expansion of its capacity from 15 mmtpa to 25 mmtpa.

Going ahead, we expect MRPL's profitability to improve on account of i). Improved product mix, ii). Better refining margins iii). Economies of scale, iv). Forward integration - Polypropylene plant and v). Various tax benefits. At current price, the stock is trading at 7.6x P/E and 1.8x P/B multiples on FY19E earnings. MRPL processed highest total crude throughput in FY17 at 16.3 mmtpa led by completion of phase III capacity. Post expansion, MRPL is one of the best refineries in India which can increase distillate yield, capability to handle heavier and sourer crude and production of higher margin value-added products. We expect throughput of 17 mmtpa and 17.3 mmtpa for FY18E & FY19E respectively. We maintain BUY on MRPL with an unchanged price target of Rs.155, valuing it at 6x FY19E EV/EBIDTA.

Summary table

(Rs mn)	FY17	FY18E	FY19E
Sales	437,548	461,680	491,981
Growth (%)	10	6	7
EBITDA	49,877	43,606	58,606
EBITDA margin (%)	11.4	9.4	11.9
PBT	50,538	26,618	41,459
Adj. Net profit	16,959	18,101	28,010
EPS (Rs)	9.7	10.3	16.0
Growth (%)	139	7	55
CEPS (Rs)	24.4	15.5	21.3
Book value (Rs/share)	54.2	57.5	66.5
DPS (Rs)	6.0	6.0	6.0
ROE (%)	20.4	17.4	24.4
ROCE (%)	19.7	12.3	17.3
Net Cash/(Debt)	(111,158)	(94,201)	(79,776)
NW Capital (days)	8	8	9
P/E (x)	12.6	11.8	7.6
P/BV (x)	2.3	2.1	1.8
EV/Sales (x)	0.74	0.67	0.60
EV/EBITDA (x)	6.5	7.1	5.0

Source: Company, Kotak Securities – Private Client Research

Key developments

Make hey when sun shines - Benchmark refining margins have improved meaningfully in Q2FY18 to US$7.5/bbl, higher by 38.4% qoq. Strong GRMs are supported by higher Diesel spreads (+14.4% qoq), Jet spreads (+16.6% qoq), Petrol spreads (10.9%), Naphtha (17.2%) and lower losses in FO.

Average product spread with Dubai crude ($/bbls)

	Q1FY17	Q2FY17	Q3FY17	Q4FY17	Q1FY18	Q2FY18	QoQ Chg	% chg
INR/USD	66.9	67.0	67.4	67.0	64.5	64.3	(0.2)	(0.3)
Diesel	10.1	10.7	12.1	12.1	11.5	13.2	1.7	14.4
Jet/SKO	10.7	10.8	12.2	11.2	10.5	12.2	1.7	16.6
Petrol	9.5	6.5	10.0	11.2	10.3	11.4	1.1	10.9
Naphtha	13.3	9.7	13.5	15.1	11.2	13.2	1.9	17.2
FO	(14.3)	(10.8)	(9.1)	(10.1)	(9.2)	(8.9)	0.4	(3.9)
Dubai Crude price	43.0	43.4	47.9	52.8	49.7	50.5	0.8	1.7
Brent crude oil	47.0	47.0	51.1	54.6	50.8	52.1	1.3	2.6
Singapore GRM	5.0	4.3	5.5	6.1	5.4	7.5	2.1	38.4
Arab light-heavy	2.8	2.9	2.9	2.7	2.2	1.5	(0.7)	(30.0)
SPOT LNG ($/mmbtu)	4.5	5.3	7.1	6.8	5.3	5.9	0.6	11.5
FO ($/bbls)	28.7	32.5	38.8	42.7	40.6	41.6	1.1	2.6
Naphtha	56.2	53.1	61.2	67.9	62.1	63.6	1.5	2.5

Source: Bloomberg

Merger with HPCL will provide marketing access

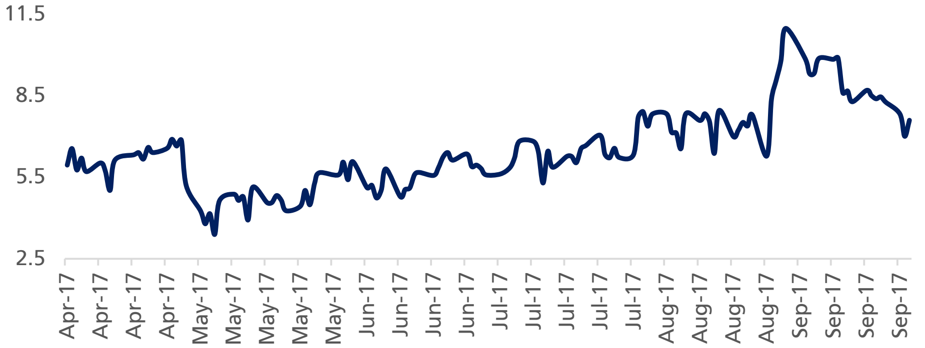
Recently, the cabinet has granted approval for the acquisition of government's stake in HPCL by ONGC, possibility of ONGC funding the deal by transferring its stake in MRPL to HPCL cannot be ruled out. We expect stock to remain in focus on the news flow of merger with HPCL, we opine. Currently, MRPL has only refining capacity and does not have strong distribution/marketing network. On the other hand, HPCL has very strong distribution network (sales to production ratio is ~2x). We believe merger will create a strong synergy and improve margins.

Key Developments:

Refining margins improved

Singapore refining margins have increased by ~38% QoQ (till date) which is a big positive for all refineries in India. Refining margins have increased due to significant rise in international product prices (like Diesel, Jet fuel, etc) due to hurricane in US and affected world's refining capacity.

Singapore refining margin trend ($/bbl)



Source: Bloomberg

New expansion plans in place – Growth is a process: MRPL has set-up the next milestone and is planning to enhance its refining capacity to 25 mmtpa (19% higher than targeted) as against current capacity of 15 mmtpa. Additionally, the company is planning to scale up its petrochemical capacity to boost its margins and up-grade refinery to meet BS-VI norms by 2020. The Company will invest Rs.110 bn in this expansion. We like the sharpened focus of the company on the growth strategy. This will not only boost volumes but will improve margins, going ahead. The expansion is seen as a major margin driver as it will help the company to process cheaper, heavier crudes into high-value products like diesel, liquefied petroleum gas and propylene.

MRPL is venturing into RLNG business: MRPL has signed a memorandum of understanding (MOU) with new Mangalore Port Trust to study the feasibility of setting up an LNG re-gasification terminal at Mangalore. We believe this is at a preliminary stage and will have a long gestation period. However, if materializes then it will help MRPL to lower its refinery operating cost by replacing costlier liquid fuel with cheaper LNG.

Marketing initiatives: MRPL has achieved a 35% market share in Polypropylene in the south zone. MRPL has established strong market presence by way of direct marketing of its products petcoke, sulphur and polypropylene.

Auto fuel up-gradation: MRPL is in the process of upgrading its facilities to produce BS-VI grade MS& HSD by April 2020 in-line with the Supreme Court directive and Auto fuel up-gradation policy of Govt of India.

Re-commencing retail outlets: - MRPL has drawn up plans for opening over 100 retail outlets which will improve its overall margins due to addition of marketing margins. The company is in the process of obtaining statutory approvals. MRPL has also taken over retail outlet of ONGC set up near the refinery unit and has now become a part of MRPL retail outlet map.

Key Risk and Concerns:

- Wide fluctuations in crude, forex and product prices can impact the margins.
- If global supply exceeds demand then margins can be under pressure.
- Any delay in executing the project can significantly impact the valuations.

Valuations & Recommendations:

We recommend BUY on MRPL with a price target of Rs.155

Going ahead, we expect MRPL's profitability to improve on account of i). Improved product mix, ii). Better refining margins iii). Economies of scale, iv). Forward integration - Polypropylene plant and v). Various tax benefits. At current price, the stock is trading at 7.6x P/E and 1.8x P/B multiples on FY19E earnings. MRPL processed highest total crude throughput in FY17 at 16.3 mmtpa led by completion of phase III capacity. Post expansion, MRPL is one of the best refineries in India which can increase distillate yield, capability to handle heavier and sourer crude and production of higher margin value-added products. We expect throughput of 17 mmtpa and 17.3 mmtpa for FY18E & FY19E respectively. We maintain **BUY** on MRPL with an unchanged price target of Rs.155, valuing it at 6x FY19E EV/EBIDTA.

Company background

Mangalore Refinery and Petrochemicals Ltd. (Mini-Ratna status) is a pure play crude oil refiner with strong promoter backing of ONGC (India's biggest government owned exploration Company). MRPL has transformed itself into a large and complex refinery with phase-III capacity expansion and has emerged into a much stronger player in the industry.

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 9 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 9 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 9 months
SELL	–	We expect the stock to deliver negative returns over the next 9 months
NR	–	Not Rated. Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
RS	–	Rating Suspended. Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a Sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA	–	Not Available or Not Applicable. The information is not available for display or is not applicable
NM	–	Not Meaningful. The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 9-month perspective. Returns stated in the rating scale are our internal benchmark.

FUNDAMENTAL RESEARCH TEAM

Sanjeev Zarbade Capital Goods, Engineering sanjeev.zarbade@kotak.com +91 22 6218 6424	Ruchir Khare Capital Goods, Engineering ruchir.khare@kotak.com +91 22 6218 6431	Amit Agarwal Logistics, Paints, Transportation agarwal.amit@kotak.com +91 22 6218 6439	Nipun Gupta Information Technology nipun.gupta@kotak.com +91 22 6218 6433	K. Kathirvelu Production k.kathirvelu@kotak.com +91 22 6218 6427
Teena Virmani Construction, Cement teena.virmani@kotak.com +91 22 6218 6432	Ritwik Rai FMCG, Media ritwik.rai@kotak.com +91 22 6218 6426	Jatin Damania Metals & Mining jatin.damania@kotak.com +91 22 6218 6440	Jayesh Kumar Economy kumar.jayesh@kotak.com +91 22 6218 5373	
Arun Agarwal Auto & Auto Ancillary arun.agarwal@kotak.com +91 22 6218 6443	Sumit Pokharna Oil and Gas sumit.pokharna@kotak.com +91 22 6218 6438	Pankaj Kumar Midcap pankajr.kumar@kotak.com +91 22 6218 6434	Ashini Shah Midcap ashini.shah@kotak.com +91 22 6218 5438	

TECHNICAL RESEARCH TEAM

Shrikant Chouhan shrikant.chouhan@kotak.com 91 22 6218 5408	Amol Athawale amol.athawale@kotak.com +91 20 6620 3350

DERIVATIVES RESEARCH TEAM

Sahaj Agrawal sahaj.agrawal@kotak.com +91 79 6607 2231	Malay Gandhi malay.gandhi@kotak.com +91 22 6218 6420	Prashanth Lalu prashanth.lalu@kotak.com +91 22 6218 5497	Prasenjit Biswas prasenjit.biswas@kotak.com +91 33 6625 9810

Disclosure/Disclaimer

Kotak Securities Limited established in 1994, is a subsidiary of Kotak Mahindra Bank Limited. Kotak Securities is one of India's largest brokerage and distribution house.

Kotak Securities Limited is a corporate trading and clearing member of Bombay Stock Exchange Limited (BSE), National Stock Exchange of India Limited (NSE), Metropolitan Stock Exchange of India Limited (MSE). Our businesses include stock broking, services rendered in connection with distribution of primary market issues and financial products like mutual funds and fixed deposits, depository services and Portfolio Management.

Kotak Securities Limited is also a depository participant with National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL). Kotak Securities Limited is also registered with Insurance Regulatory and Development Authority as Corporate Agent for Kotak Mahindra Old Mutual Life Insurance Limited and is also a Mutual Fund Advisor registered with Association of Mutual Funds in India (AMFI). We are registered as a Research Analyst under SEBI (Research Analyst) Regulations, 2014.

We hereby declare that our activities were neither suspended nor we have defaulted with any stock exchange authority with whom we are registered in last five years. However SEBI, Exchanges and Depositories have conducted the routine inspection and based on their observations have issued advise/warning/deficiency letters/ or levied minor penalty on KSL for certain operational deviations. We have not been debarred from doing business by any Stock Exchange / SEBI or any other authorities; nor has our certificate of registration been cancelled by SEBI at any point of time.

We offer our research services to clients as well as our prospects.

This document is not for public distribution and has been furnished to you solely for your information and must not be reproduced or redistributed to any other person. Persons into whose possession this document may come are required to observe these restrictions.

This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. It is for the general information of clients of Kotak Securities Ltd. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients.

We have reviewed the report, and in so far as it includes current or historical information, it is believed to be reliable though its accuracy or completeness cannot be guaranteed. Neither Kotak Securities Limited, nor any person connected with it, accepts any liability arising from the use of this document. The recipients of this material should rely on their own investigations and take their own professional advice. Price and value of the investments referred to in this material may go up or down. Past performance is not a guide for future performance. Certain transactions -including those involving futures, options and other derivatives as well as non-investment grade securities - involve substantial risk and are not suitable for all investors. Reports based on technical analysis centers on studying charts of a stock's price movement and trading volume, as opposed to focusing on a company's fundamentals and as such, may not match with a report on a company's fundamentals.

Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. Our proprietary trading and investment businesses may make investment decisions that are inconsistent with the recommendations expressed herein.

Kotak Securities Limited has two independent equity research groups: Institutional Equities and Private Client Group. This report has been prepared by the Private Client Group. The views and opinions expressed in this document may or may not match or may be contrary with the views, estimates, rating, target price of the Institutional Equities Research Group of Kotak Securities Limited.

We and our affiliates/associates, officers, directors, and employees, Research Analyst(including relatives) worldwide may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company/company (ies) discussed herein or act as advisor or lender / borrower to such company (ies) or have other potential/material conflict of interest with respect to any recommendation and related information and opinions at the time of publication of Research Report or at the time of public appearance. Kotak Securities Limited (KSL) may have proprietary long/short position in the above mentioned scrip(s) and therefore may be considered as interested. The views provided herein are general in nature and does not consider risk appetite or investment objective of particular investor; readers are requested to take independent professional advice before investing. This should not be construed as invitation or solicitation to do business with KSL. Kotak Securities Limited is also a Portfolio Manager. Portfolio Management Team (PMS) takes its investment decisions independent of the PCG research and accordingly PMS may have positions contrary to the PCG research recommendation. Kotak Securities Limited does not provide any promise or assurance of favourable view for a particular industry or sector or business group in any manner. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and take professional advice before investing.

The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

No part of this material may be duplicated in any form and/or redistributed without Kotak Securities' prior written consent.

Details of Associates are available on our website ie www.kotak.com

Research Analyst has served as an officer, director or employee of subject company(ies): No

We or our associates may have received compensation from the subject company(ies) in the past 12 months.

We or our associates have managed or co-managed public offering of securities for the subject company(ies) in the past 12 months: No

We or our associates may have received compensation for investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company(ies) in the past 12 months. We or our associates may have received compensation or other benefits from the subject company(ies) or third party in connection with the research report. Our associates may have financial interest in the subject company(ies).

Research Analyst or his/her relative's financial interest in the subject company(ies): No

Kotak Securities Limited has financial interest in the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: MRPL - Yes

Our associates may have actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report.

Research Analyst or his/her relatives has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No.

Kotak Securities Limited has actual/beneficial ownership of 1% or more securities of the subject company(ies) at the end of the month immediately preceding the date of publication of Research Report: No

Subject company(ies) may have been client during twelve months preceding the date of distribution of the research report.

"A graph of daily closing prices of securities is available at www.nseindia.com and http://economictimes.indiatimes.com/markets/stocks/stock-quotes. (Choose a company from the list on the browser and select the "three years" icon in the price chart)."

Kotak Securities Limited. Registered Office: 27 BKC, C 27, G Block, Bandra Kurla Complex, Bandra (E), Mumbai 400051. CIN: U99999MH1994PLC134051, Telephone No.: +22 43360000, Fax No.: +22 67132430. Website: www.kotak.com/www.kotaksecurities.com. Correspondence Address: Infinity IT Park, Bldg. No 21, Opp. Film City Road, A K Vaidya Marg, Malad (East), Mumbai 400097. Telephone No: 42856825. SEBI Registration No: NSE INB/INF/INE 230808130, BSE INB 010808153/INF 011133230, MSE INE 260808130/INB 260808135/INF 260808135, AMFI ARN 0164, PMS INP000000258 and Research Analyst INH000000586. NSDL/CDSL: IN-DP-NSDL-23-97. Our research should not be considered as an advertisement or advice, professional or otherwise. The investor is requested to take into consideration all the risk factors including their financial condition, suitability to risk return profile and the like and take professional advice before investing. Investments in securities market are subject to market risks, read all the related documents carefully before investing. Derivatives are a sophisticated investment device. The investor is requested to take into consideration all the risk factors before actually trading in derivative contracts. Compliance Officer Details: Mr. Manoj Agarwal. Call: 022 - 4285 8484, or Email: ks.compliance@kotak.com.

- **Level 1**: For Trading related queries, contact our customer service at 'service.securities@kotak.com' and for demat account related queries contact us at ks.demat@kotak.com or call us on: Online Customers - 30305757 (by using your city STD code as a prefix) or Toll free numbers 18002099191 / 1800222299, Offline Customers - 18002099292
- **Level 2:** If you do not receive a satisfactory response at Level 1 within 3 working days, you may write to us at ks.escalation@kotak.com or call us on 022-42858445 and if you feel you are still unheard, write to our customer service HOD at ks.servicehead@kotak.com or call us on 022-42858208.
- **Level 3:** If you still have not received a satisfactory response at Level 2 within 3 working days, you may contact our Compliance Officer (Mr. Manoj Agarwal) at ks.compliance@kotak.com or call on 91- (022) 4285 8484.
- **Level 4:** If you have not received a satisfactory response at Level 3 within 7 working days, you may also approach CEO (Mr. Kamlesh Rao) at ceo.ks@kotak.com or call on 91- (022) 4285 8301.