Company Update

CHENNAI PETROLEUM CORPORATION LTD (CPCL)

PRICE RS.281 **TARGET RS.314** **BUY**

Stock Details

Market cap (Rs mn)	:	41896
52-wk Hi/Lo (Rs)	:	464 / 221
Face Value (Rs)	:	10
3M Avg. daily vol (Nos)	:	657,181
Shares o/s (m)	:	149

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18	FY19E	FY20E
Revenue	441,892	539,648	548,468
Growth (%)	8.8	22.1	1.6
EBITDA	21,184	15,941	21,488
EBITDA margin (%)	4.8	3.0	3.9
PAT	9,272	5,584	9,342
EPS	62.3	37.5	62.7
EPS Growth (%)	(12)	(40)	67
BV (Rs/share)	268	293	333
Dividend/share (Rs)	18.5	10.8	18.0
ROE (%)	24.9	13.4	20.0
ROCE (%)	15.5	12.2	15.6
P/E (x)	4.5	7.5	4.5
EV/EBITDA (x)	2.9	4.1	2.9
P/BV (x)	1.0	1.0	0.8

Source: Company

Shareholding Pattern (%)

(%)	Dec-18	Sep-18	Jun-18
Promoters	67.3	67.3	67.3
FII	9.0	9.0	9.0
DII	12.9	11.6	11.6
Others	10.8	12.1	12.1

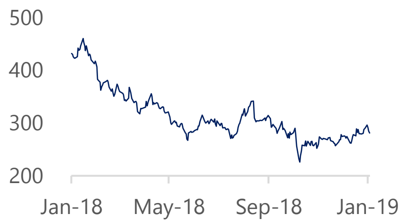
Source: Company

Price Performance (%)

(%)	1M	3M	6M
Chennai Pet	2.1	(3.0)	(4.6)
Nifty	(1.9)	(1.7)	(0.3)

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

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Multiple woes – Lower product prices, weak refining margin, lower crude throughput and Inventory losses will negatively impact the earnings

- **Margin under pressure:** Benchmark Singapore refining margin has declined ~10% qoq to US$ 5.4/bbl (average) and is currently trading around US$ 3/bbl due to weak global product demand. Petrol spread has declined meaningfully by 50% qoq to US$4.1/bbl in Q3FY19. In H1FY19, CPCL's average GRMs stood at US$ 5.98/bbl. CPCL is a standalone, simple refiner and hence it has a very high earning sensitivity to GRMs. We expect the company to report lower GRMs in Q3FY19.
- **Lower production:** Planned maintenance will led to lower crude throughput in Q3FY19 impacting near term earnings. From Oct'18, CPCL has shut a 74,000 bbl/d crude unit at its 210,000 bbl/d Manali refinery for one month for maintenance. The impact of the same will be visible in Q3FY19.
- **Inventory losses:** Brent crude oil price has corrected by 35% from US$ 82.72/bbl (as on 28th Sep'18) to US$ 53.80/bbl (as on 31st Dec'18). We expect most of the refiners to report inventory losses which will further put pressure on earnings.
- **Expansion Plans:** IOC (promoter of CPCL) has indicated that Iran (Naftiran Intertrade, the Swiss subsidiary of National Iranian Oil Company, holds a 15.4% stake in CPCL) is looking to invest in CPCL for expansion and up-gradation of its refinery. CPCL plans to shut down the 1 mmtpa (i.e ~20,000 bbl/d) Nagapattinam refinery and replace it with a new 9 mmtpa unit (i.e ~1,80,000 bbl/d) over the next 5-6 years with an investment of around Rs.356.98 bn (US$ 5.1 bn). CPCL plans to achieve financial closure of the refinery expansion in 2019. It also plans to build a petrochemicals plant of about 0.475 mmtpa. We have not modeled the same as we await a financial closure.

Valuation & outlook

- CPCL is a standalone, simple refiner and has a very high earning sensitivity to GRM. Hence, earnings disappointment is high on account of weak GRMs.
- We have revised our earnings lower to reflect planned shutdown, lower GRMs and inventory losses. However, rupee depreciation, lower operating cost, lower working capital requirement and some improvement from the recently commissioned Rs.31 bn residue upgradation project & the Rs. 3bn revamp of the diesel hydro desulphurization unit will partly mitigate the negative impact. Hence, we now expect CPCL to report an EPS of Rs.37.5/share in FY19E (earlier Rs.61) and an EPS of Rs.62.7 in FY20E (earlier Rs. 67).
- At CMP, we believe that the stock is attractively valued at a PE of 4.5x FY20E earnings. We maintain BUY recommendation on the stock with a revised price target of Rs.314/share (earlier Rs.337/share). We have valued CPCL based on PE multiple of 5x FY20, which is at a significant discount to its peers as it is a standalone and relatively simple refinery resulting in higher earnings sensitivity.

Key Developments

Refining margin is under pressure

Global net refining capacity addition is expected to surpass global refined products demand growth in 2019.

- Benchmark Singapore refining margin has declined ~10% qoq to US$ 5.4/bbl (average) and is currently trading around US$ 3/bbl due to weak global demand. In H1FY19, CPCL's average GRMs stood higher at US$ 5.98 per bbl as against US$ 5.67/bbl in H1FY18. We expect CPCL to report lower GRMs due to decline in benchmark refining margins.

Singapore Refining margins (US$/bbl) trading significantly lower than average

Source: Bloomberg

- Brent crude oil price has corrected by 35% from US$ 82.72/bbl (as on 28th Sep'18) to US$ 53.80/bbl (as on 31st Dec'18). We expect refiners to report inventory losses which will further put pressure on earnings.

Even complex refiners margin will be hit by Naphtha and Petrol cracks.

Average product spread with Dubai crude ($/bbls)

	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	QoQ (US$/bbl)	QoQ (%)
INR/USD	64.7	64.3	67.1	70.1	72.1	2.0	2.9
Diesel	12.4	14.7	15.1	15.3	18.1	2.8	18.3
Jet/SKO	11.7	13.7	12.9	12.3	16.2	3.8	31.2
Petrol	10.3	9.6	8.8	8.3	4.1	(4.1)	(50.1)
Naphtha	18.8	15.5	15.8	17.2	10.7	(6.5)	(37.8)
FO	(11.2)	(13.8)	(15.4)	(12.9)	(6.8)	6.2	(47.7)
Dubai Crude price	59.1	64.1	71.7	73.9	67.4	(6.5)	(8.8)
Brent crude oil	61.5	67.2	75.0	75.8	68.6	(7.2)	(9.5)
Singapore GRM	6.7	6.0	5.4	5.9	5.4	(0.6)	(9.9)
Arab light-heavy	2.2	2.9	3.1	2.3	2.2	(0.1)	(3.8)
SPOT LNG ($/mmbtu)	9.2	9.1	8.5	10.4	9.5	(0.8)	(8.2)
FO ($/bbls)	47.9	50.2	56.3	60.9	60.8	(0.1)	(0.1)
Naphtha	78.0	79.6	87.6	91.1	78.1	(13.0)	(14.3)

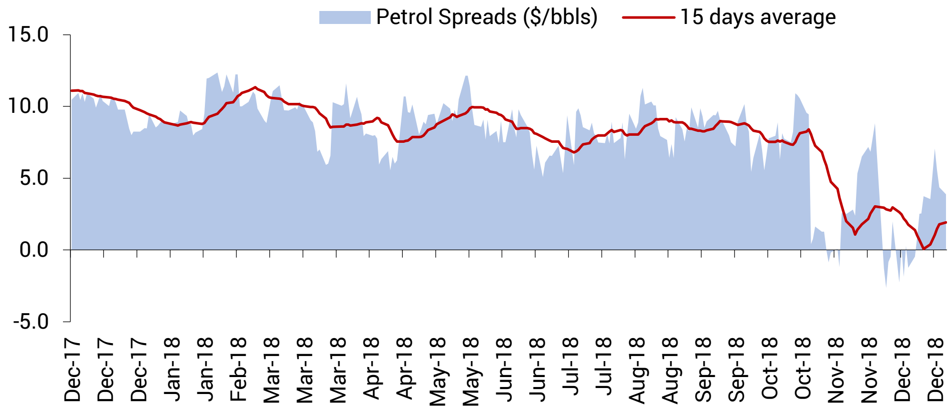
Source: Bloomberg

Gasoline cracks corrected significantly

- Petrol spread has declined meaningfully by 50% qoq to US$4.1/bbl in Q3FY19.

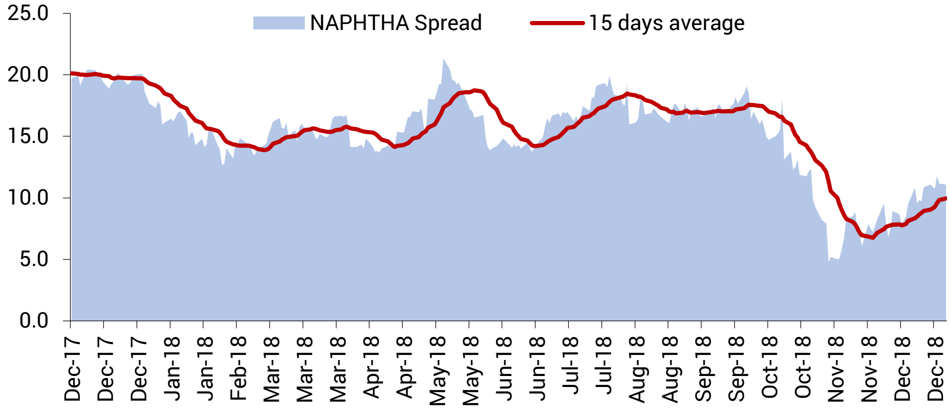
Weakness in Gasoline cracks amid a glut in the gasoline market.

Gasoline spread corrected by 50% qoq



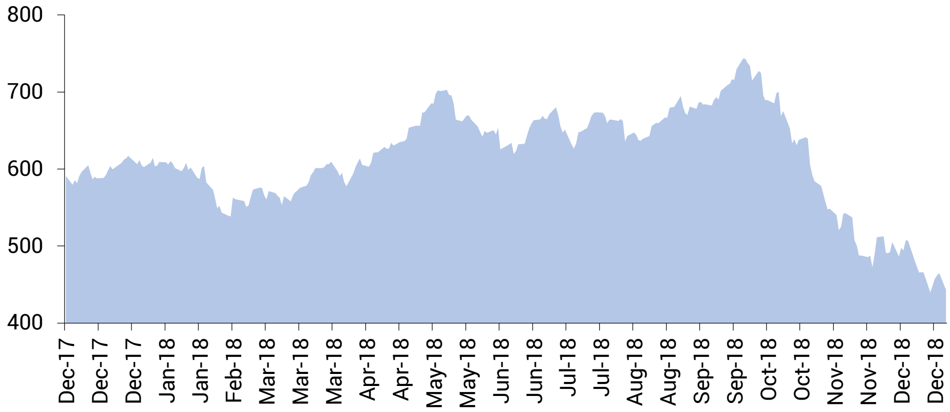
Source: Bloomberg

Naphtha Spreads (US$/bbl) fallen more than 37% qoq



Source: Bloomberg

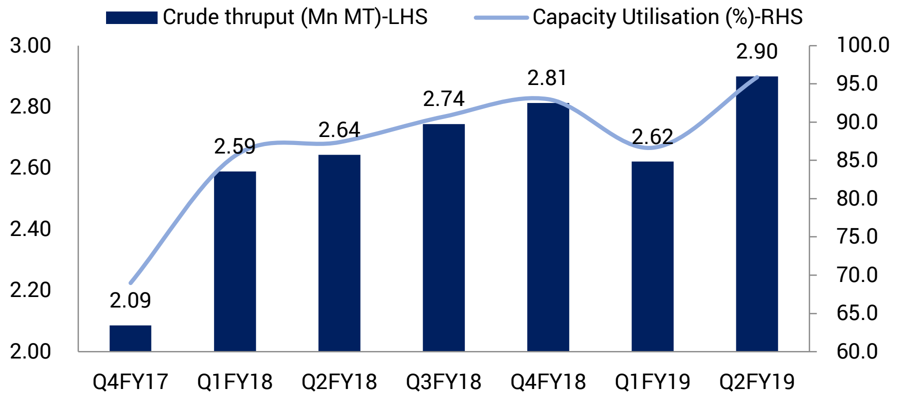
Naphtha product prices (US$/mt)



Source: Bloomberg

- **Planned maintenance**: From 6th Oct'18, CPCL has shut a 74,000 bopd crude unit at its 210,000 bpd Manali refinery in Tamil Nadu for about month for planned maintenance. The company has also shut some secondary units including a 0.8 mmtpa fluidised catalytic cracker and a 2.2 mmtpa delayed coker for maintenance. The impact of the same will be visible in the near term earnings.

CPCL's crude throughput and capacity utilization



Source: Company

- CPCL reported higher crude throughput of 2.9 mmt in Q2FY19 (11% qoq and 10% yoy) resulting in 96% capacity utilization.
- **2019 Planned maintenance:** The Company plans to shut some crude units and the diesel hydro-treater for planned maintenance work between Jul'19 and Dec'19.
- Additionally, it also plans to hook-in the new units for producing BS- VI compliant gasoline and diesel during the planned shutdown. Manali Refinery has 1 diesel hydro-treater with 1.8 mmtpa capacity and 3 crude units. (Crude unit 1: 2.8 mmtpa, Crude unit 2: 3.7 mmtpa and Crude unit 3: 4 mmtpa)
- **Future Projects:** CPCL is currently implementing a number of projects to improve reliability, profitability and to meet product quality specifications. The total cost of these projects which are under implementation is estimated to be Rs.25.4 bn.
- **Pipeline project:** With the completion of the new crude oil pipeline project, the BS-VI Project is likely to be completed in FY20.

Key Risk and Concerns:

- Wide fluctuations in crude, forex and product prices can impact the margins.
- If global fuel supply exceeds demand then margins can be under pressure and vice-versa.
- Any delay in executing the project can significantly impact the valuations.
- Large outlay for new projects exposes CPCL to significant project implementation risks.

Maintain BUY

CPCL is a standalone, simple refiner and has a very high earning sensitivity to GRM. Hence, earnings disappointment is high on account of weak GRMs.

We have revised our earnings lower to reflect planned shutdown, lower GRMs and inventory losses. However, rupee depreciation, lower operating cost, lower working capital requirement and some improvement from the recently commissioned Rs.31 bn residue upgradation project & the Rs. 3bn revamp of the diesel hydro desulphurization unit will partly mitigate the negative impact. Hence, we now expect CPCL to report an EPS of Rs.37.5/share in FY19E (earlier Rs.61) and an EPS of Rs.62.7 in FY20E (earlier Rs. 67).

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Valuation

Particulars Unit FY20E	Unit	
EPS (FY20E)	Rs./share	62.7
Target – P/E	x	5
Target price (Rs/share)	Rs. Mn	314
CMP	Rs. Mn	281
Potential upside/(downside)	%	12

Source: Kotak Securities - Private Client Research

Revised earnings estimate

Change in estimates		FY19E			FY20E	
(Rs mn)	Old	New	% Chg	Old	New	% Chg
Revenue	578,838	539,648	(7)	587,430	548,468	(7)
EBIDTA	21,210	15,941	(25)	22,239	21,488	(3)
EBIDTA Margin (%)	3.7	3.0	(1)	3.8	3.9	0
PAT	9,062	5,584	(38)	10,034	9,342	(7)
EPS (Rs/share)	60.9	37.5	(38)	67.4	62.7	(7)

Source: Kotak Securities – Private client Research

Company Background

Incorporated in 1965, Chennai Petroleum Corporation Limited (CPCL), formerly known as Madras Refineries Limited (MRL) was formed as a joint venture between the Government of India (74%, GoI), AMOCO (13%) and National Iranian Oil Company (13% equity stake) In 1985, AMOCO sold its equity stake to GOI and the shareholding pattern of GOI and NIOC changed to 84.62% and 15.38% respectively. Later in 1992, GOI disinvested 16.92% of the paid up capital in favor of Unit Trust of India, Mutual Funds, Insurance Companies and Banks, thereby reducing its holding to 67.7 %. CPCL came out with a public issue in 1994 wherein GoI and NIOC divested part of their equity stakes and CPCL's shares were listed on stock exchanges. As a part of the restructuring steps taken up by the Government of India, Indian Oil Corporation Ltd. acquired equity from GoI in FY 2001. In July 2003, NIOC transferred their entire shareholding to Naftiran Inter trade Company Limited, an affiliate, in line with the formation agreement, as part of their organizational restructuring.

Financials: Consolidated

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Revenues	**406,074**	**441,892**	**539,648**	**548,468**
% change YoY	16.2	8.8	22.1	1.6
EBITDA	**19,717**	**21,184**	**15,941**	**21,488**
% change YoY	49.1	7.4	-24.7	34.8
Other Income	-277	285	401	408
Depreciation	2,786	3,402	4,276	4,454
EBIT	16,313	17,738	11,665	17,035
% change YoY	48.7	8.7	-34.2	46.0
Net interest	2,728	3,209	3,500	3,176
Profit before tax	**13,585**	**14,530**	**8,165**	**13,859**
% change YoY	NM	7.0	-43.8	69.7
Tax	3,353	5,453	2,776	4,712
as % of PBT	24.7	37.5	34.0	34.0
Profit after tax	**10,232**	**9,077**	**5,389**	**9,147**
Minority interest	0	0	0	0
Share of profit of associates	276	195	195	195
Net income	**10,508**	**9,272**	**5,584**	**9,342**
% change YoY	36.4	-11.8	-39.8	67.3
Shares outstanding (m)	149	149	149	149
EPS (reported) (Rs)	**70.6**	**62.3**	**37.5**	**62.7**
CEPS (Rs)	89.3	85.1	66.2	92.6
DPS (Rs)	21.0	18.5	10.8	18.0

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
Cash and cash equivalents	169	87	55	50
Accounts receivable	10,397	15,695	17,742	18,032
Inventories	32,071	47,591	57,661	58,603
Loans and Adv & Others	5,738	4,928	4,999	5,006
Current assets	48,375	68,301	80,457	81,692
Misc exp.	0	0	0	0
LT investments	1,400	1,526	1,526	1,526
Net fixed assets	66,454	73,233	78,733	84,233
Total assets	**116,229**	**143,060**	**160,716**	**167,450**
Payables	16,522	44,437	55,372	57,105
Others	6,795	24,438	23,007	23,383
Current liabilities	23,316	68,875	78,379	80,487
Provisions	2,878	3,204	3,680	3,726
LT debt	54,978	28,890	32,892	31,545
Min. int and def tax liabilities	646	2,123	2,123	2,123
Equity	1,489	1,489	1,489	1,489
Reserves	32,921	38,480	42,153	48,080
Total liabilities	**116,229**	**143,060**	**160,716**	**167,450**
BVPS (Rs)	231	268	293	333

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBIT	16,313	17,738	11,665	17,035
Depreciation	2,786	3,402	4,276	4,454
Change in working capital	(11,851)	27,628	(1,996)	915
Operating cash flow	**7,248**	**48,768**	**13,946**	**22,404**
Interest	(2,728)	(3,209)	(3,500)	(3,176)
Tax	(3,353)	(5,453)	(2,776)	(4,712)
Cash flow from operations	**1,167**	**40,106**	**7,670**	**14,516**
Capex	(10,946)	(10,181)	(9,776)	(9,954)
(Inc)/dec in investments	(1,258)	(125)	-	-
Cash flow from investments	**(12,204)**	**(10,307)**	**(9,776)**	**(9,954)**
Others	4,965	-	0	-
Increase/(decrease) in debt	9,372	(26,088)	4,003	(1,347)
Proceeds from share premium	-	-	-	-
Dividends	(3,519)	(3,794)	(1,928)	(3,220)
Cash flow from financing	**10,818**	**(29,882)**	**2,076**	**(4,567)**
Opening cash	388	169	87	55
Closing cash	**169**	**87**	**55**	**50**

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY17	FY18	FY19E	FY20E
EBITDA margin (%)	4.9	4.8	3.0	3.9
EBIT margin (%)	4.0	4.0	2.2	3.1
Net profit margin (%)	2.6	2.1	1.0	1.7
Receivables (days)	8.1	10.8	12.0	12.0
Inventory (days)	28.8	39.3	39.0	39.0
Sales/gross assets(x)	5.0	5.5	7.3	6.8
Interest coverage (x)	6.2	5.5	3.3	5.4
Debt/equity ratio(x)	1.6	0.7	0.8	0.6
ROE (%)	36.6	24.9	13.4	20.0
ROCE (%)	16.4	15.5	12.2	15.6
EV/ Sales	0.2	0.1	0.1	0.1
EV/EBITDA	4.4	2.9	4.1	2.9
Price to earnings (P/E)	4.0	4.5	7.5	4.5
Price to book value (P/B)	1.2	1.0	1.0	0.8

Source: Company, Kotak Securities – Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
SELL	–	We expect the stock to deliver negative returns over the next 12 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.
SUBSCRIBE	–	We advise investor to subscribe to the IPO.
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 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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