

**Consumer Brands & Retail**  
**Multiline Retail**  
 Equity – United States

## Underweight (V)

Target price (USD)	25.00
Share price (USD)	29.75
Potential total return (%)	-9.2

Performance	1M	3M	12M
Absolute (%)	24.6	52.1	91.4
Relative <sup>A</sup> (%)	24.0	46.5	72.1

Index <sup>A</sup>	S&P 500
RIC	DK.N
Bloomberg	DK US
Market cap (USDm)	1,521
Enterprise value (USDm)	1646
Free float (%)	100

Note: (V) = volatile (please see disclosure appendix)

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This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, that form part of it.

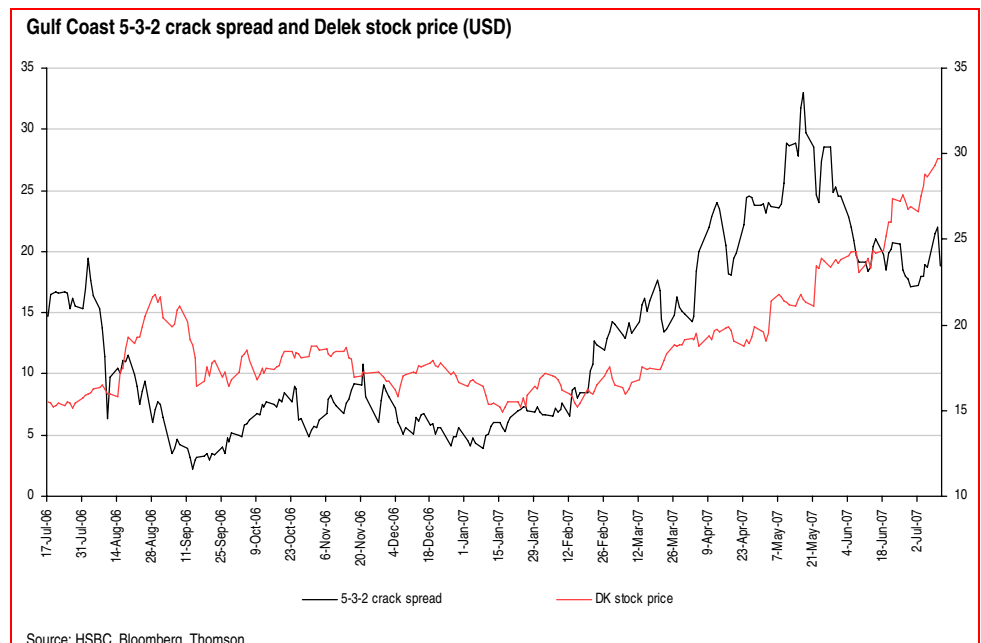
# Delek US Holdings

Price ahead of events: move to reduce rating to Underweight (V) from Neutral (V)

- ▶ **Delek US is an ambitious company with a strong, albeit brief, track record of making well-priced acquisitions and improving operating metrics. Its Texas refinery has also recently been the fortunate beneficiary of record crack spreads**
- ▶ **The stock price has reacted to increased refining margins and increases in underlying value of scarce refining assets. However, they are also likely to have weak retail gas margins**
- ▶ **We are downgrading the stock to Underweight (V) from Neutral (V) and would take profits. Our price target is USD25, down from USD27**

## Great crack margins never last forever

Gulf coast 5-3-2 crack margins are finally starting to cool after a torrid run. The following chart shows Delek's stock price and Gulf Coast 5-3-2 crack spreads.



The conclusion would appear to be, on admittedly little evidence since becoming a public company, that the stock typically cools off after crack spreads have peaked. We cannot be certain that they have peaked but there is no historical precedent for spreads being much higher than in the recent past. Our view then is that the stock is due for a cooling-off period. Our other concern, given Pantry's recent experience with weak retail margins, is that these could take the gloss off an excellent period for refining profitability. There is upside potential in Q2 as we expect crack spreads at USD21 for the period with Delek earning a premium to that. The retail CPG forecast is USD0.152 to which we believe there may be downside risk. Our overall Q2 2007 forecast is for USD1.32 or a 51% increase in EPS year over year. This would of course be positive but the refining margin environment is unlikely to be sustained at this unusually profitable level, in our view.

## Valuation and risks

For DK shares, we are lowering our end-2007 target price to USD25 from USD27, based on a PE analysis and an EV/EBITDA analysis and our calendarized 2008 estimates. Valuing Delek on a PE basis, once we segment Delek's retail and refining business and apply the three-year average multiple of Delek's retail and refining peers, we arrive at an implied fair value of USD27.64.

### Delek: PE valuation, 2008e (USDm)

<b>Retail</b>	
Retail peer group 3yr. average PE multiple	18.4x
Delek retail/other/wholesale EBIT	68.3
Interest expense of retail segment (e)	13.16
Pre-tax	55.2
Co. effective tax rate %	34.0%
Tax	18.8
Retail portion of net income	36.4
% Net income from Retail business	32%
Retail portion of 2008e EPS	0.69
<b>Refining</b>	
Refining peer group 3-yr. average PE multiple	9.8x
Delek refining EBIT	125.9
Interest expense of refining segment (e)	6.58
Pre-tax	119.3
Co. effective tax rate %	34.0%
Tax	40.6
Refining portion of net income	78.7
Total net income	115
% Net income from Refining business	68%
Refining portion of 2008e EPS	1.50
Equity total market cap	1441.5
Implied PE multiple	12.5x
2008e shares	52.15
<b>Implied share price (USD)</b>	<b>27.64</b>

Source: HSBC, Company data

To value Delek on an EV/EBITDA basis, we separate Delek's earnings between refining and retail and apply the respective peer group multiples, yielding an implied value of USD21.87, as shown in the table overleaf.

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**Delek: 2008e EV/EBITDA valuation (USDm)**

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**Retail**

Peer group EV/EBITDA multiple	7.6x
Delek Retail/Other/Wholesale EBITDA	65.6
EV	498

**Refining**

Peer group Refining EV/EBITDA multiple	5.7x
Delek Refining EBITDA	134.7
EV	768

Total EV	1266
Total Company Net Debt	126
Equity market cap total company	1140
Implied EV/EBITDA multiple	6.3x
<b>Implied Share Price (USD)</b>	<b>21.87</b>

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Source: FactSet, HSBC

Under our research model, for stocks with a volatility indicator, the Neutral band is 10 percentage points above and below the hurdle rate for US stocks of 8.3%. Our new target price of USD25 indicates a potential total return of -9.2%, which is below the Neutral band of our model; therefore, we are lowering our rating to Underweight (V) on DK shares from Neutral (V).

## Risks

Risks to our Underweight (V) rating are that the volatile gas markets allow refining margins to stay higher for longer than we have forecast.

# Disclosure appendix

## Analyst certification

The following analyst(s), who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Mark Husson and Diana P. Lawrence

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This report addresses only the long-term investment opportunities of the companies referred to in the report. As and when HSBC publishes a short-term trading idea the stocks to which these relate are identified on the website at [www.hsbcnet.com/research](http://www.hsbcnet.com/research). Details of these short-term investment opportunities can be found under the Reports section of this website.

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HSBC assigns ratings to its stocks in this sector on the following basis:

For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile\*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile\*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

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Prior to this, from 7 June 2005 HSBC applied a ratings structure which ranked the stocks according to their notional target price vs current market price and then categorised (approximately) the top 40% as Overweight, the next 40% as Neutral and the last 20% as Underweight. The performance horizon is 2 years. The notional target price was defined as the mid-point of the analysts' valuation for a stock.

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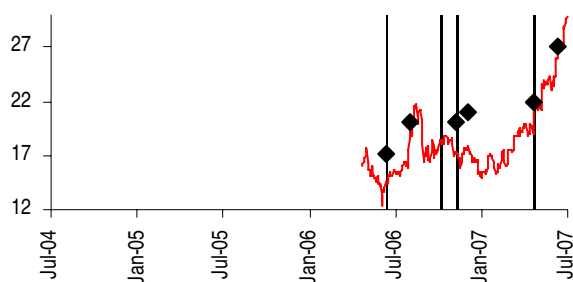
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As of 12 July 2007, the distribution of all ratings published is as follows:

<b>Overweight (Buy)</b>	44%	(25% of these provided with Investment Banking Services)
<b>Neutral (Hold)</b>	36%	(26% of these provided with Investment Banking Services)
<b>Underweight (Sell)</b>	20%	(19% of these provided with Investment Banking Services)

## Share price and rating changes for long-term investment opportunities

Delek US Holdings Share Price performance USD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Overweight	21 June 2006
Overweight	Restricted	16 October 2006
Restricted	Overweight	16 November 2006
Overweight	Neutral	03 May 2007
Target Price	Value	Date
Price 1	17.20	21 June 2006
Price 2	20.00	14 August 2006
Price 3	Restricted	16 October 2006
Price 4	20.00	16 November 2006
Price 5	21.00	11 December 2006
Price 6	22.00	03 May 2007
Price 7	27.00	20 June 2007

Source: HSBC

## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
DELEK US HOLDINGS	DK.N	29.75	12-Jul-2007	5

Source: HSBC

- 1 HSBC\* has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
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