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Oil & Gas

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Another strong quarter on the cards; risk-reward favourable

Based on Q4 ytd trends, OMCs are set for record FY24 earnings despite the cut in retail prices, which eliminate a key overhang. Earnings have been rising for the last one year due to higher refining margins (geo-political tension + low product stocks) and marketing profits (discounted Russian crude + supportive crude prices given strong supplies). However, our FY25e/26e and consensus' factor in a 40-57% drop in earnings over FY24e levels; there is upside risk to our estimates. Post-elections, with stable crude prices, daily price revisions could return, which would cushion marketing earnings volatility. We maintain our estimates and reiterate our Buy ratings on BPC and HPC, and a Hold on IOC with a higher TP as we raise its target multiple to 5.5x EV/EBIDTA (5x earlier) on its continued business strength. Our preferred pick is BPC.

Retail price cut removes a key overhang. Heading into the general elections, the government has cut retail prices of petrol/diesel by Rs2/litre each, a first since May'22. The government had held prices despite crude cooling by ~$30/bbl (from ~$110) to help OMCs recoup FY23 losses. With stable crude prices, we do not rule out daily retail price revisions returning, which would ease marketing earnings volatility, leading to re-ratings. The IEA expects CY24 global oil demand at 1.3m b/d (2.3m in CY23). Adjusted for voluntary supply cuts of OPEC+, the agency expects global supplies to rise by 0.8m b/d, holding prices at ~$80/bbl. We have factored in Rs3.5/Rs4 blended marketing margins for FY25/26.

Q/q rebound in earnings, set for a record FY24. In Q4, OMCs are expected to grow q/q, driven by higher GRMs (Q4 ytd diesel/petrol spreads up $2/$6 a bbl q/q), marketing profits (blended margins ~Rs4/litre vs. Rs2 in Q3) and inventory gains. We expect the three OMCs to report Rs318bn/184bn EBIDTA/PAT (Q3: Rs238bn/120bn).

Record FY24, but consensus factors earnings fall. Powered by the good Q4 results, OMCs are set to report record profits in FY24. Earnings have been on an uptrend for the last one year due to high refining margins and marketing profits. However, our FY25e/26e and consensus' factor in a 40-57% drop in earnings over FY24e levels even though crude prices are range-bound and refining margins are high; there is upside risk to estimates.

Valuation. We retain our Buy ratings on Bharat Petroleum and Hindustan Petroleum and a Hold on Indian Oil with higher 12-mth TPs of Rs672/643/173 (earlier Rs627/561/151), on a sum-of-parts basis (core business at 5.5x FY26e EV/EBITDA; earlier 5x) and add the value of investments at a 20% discount to their market prices. Our pecking order is BPC>HPC>IOC. **Risks:** Lower GRMs, change in crude prices, inventory losses, adverse government policy: subsidy-sharing, anaemic marketing margins.

Avishek Datta
Research Analyst

Non-OPEC supplies, weak demand to keep crude prices in check

Crude oil prices have been volatile since last year as the Russo-Ukraine war pushed up prices. However, strong non-OPEC supplies and the dicey demand context kept prices between $75 and $95 a barrel. Ahead, we expect crude oil prices to hold at ~$80-90/bbl due to

- Strong non-OPEC supplies from the US, Brazil and Guyana
- Weaker demand due to recessionary pressures

Non-OPEC supplies high

OPEC expects crude oil prices at $80-90 a barrel, supporting its capital expenditure plans. To hold prices, it announced production cuts in CY23 of over 2.5m b/d. Besides, Saudi Arabia and Russia announced voluntary cuts of a combined 1.3m b/d from Jul'23 till Dec'23.

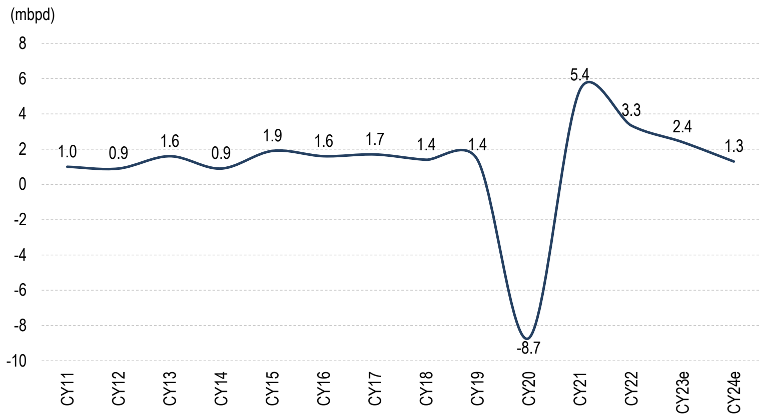
However, non-OPEC supplies from the US, Brazil and Guyana of a combined 1.7m b/d in CY23 would have helped meet demand of 2.4m b/d as stocks shrunk. In CY24, the IEA expects global production to rise by 1.6m b/d.

Strong non-OPEC supplies are likely to keep crude prices at ~$80/bbl even though potentially greater supply cuts could push prices up.

Weaker demand due to recessionary pressures

In CY23, global demand for oil grew 2.4m b/d to 102m b/d, supported by demand recovering in China to 1.8m b/d post pandemic restrictions being removed. For CY24, the IEA expects global oil demand to grow only 1.3m b/d due to recessionary pressures and high interest rates.

Fig 1 – Global oil demand



Source: IEA

Impelled by strong non-OPEC supplies exceeding demand in CY24, we expect crude oil prices to hold at current levels and support OMCs' strong performances.

Refining spreads to be resilient

Refining margins are likely to benefit from strong demand and low product stocks. Geopolitical disturbances due to the ongoing Russo-Ukraine war have distorted product flows (the EU has banned imports of Russian oil products). Accordingly, in FY24 ytd, diesel/petrol/ATF spreads averaged $20/16/21 a barrel.

OMCs also reported strong GRMs: HPC/IOC/BPC spreads at $9.8/13.3/14.7 a barrel. We maintain our product margin assumptions for FY25/FY26.

Fig 2 – Product spreads assumptions

Singapore GRM ($ / bbl)	FY20	FY21	FY22	FY23	FY24e	FY25e	FY26e
Petrol	10.1	4.6	13.7	18.7	18.0	15.0	15.0
ATF / kerosene	13.1	1.4	9.1	33.1	20.0	18.0	15.0
Diesel	13.6	4.7	10.4	35.6	20.0	18.0	16.0
Fuel oil	-7.0	-2.2	-6.6	-16.8	-10.0	-12.0	-12.0
LPG	-22.5	-6.9	-15.1	-33.0	-15.0	-15.0	-15.0
Naphtha	-5.3	-0.8	1.5	-12.4	-10.0	-12.0	-12.0
Calculated Singapore GRM ($ / bbl)	5.3	1.7	5.9	12.2	9.3	7.0	6.2

Source: Industry, Anand Rathi Research

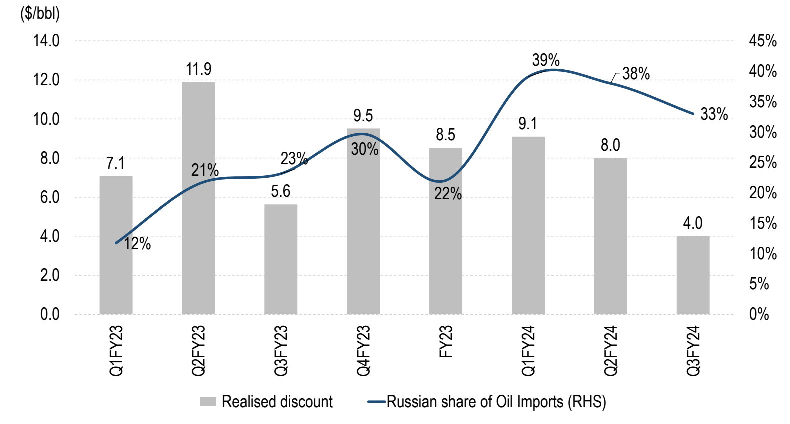
Indian refiners' margins have trailed past (benchmark) Singapore margins; FY23, however, was a standout year as the refiners benefited from

- continued use of discounted Russian crude
- strong diesel and ATF/kerosene spreads

Rising share of Russian crude

In 9M FY24, Bharat Petroleum and Indian Oil reported GRMs of $14.7 and $13.3 a barrel respectively, nearly double the benchmark Singapore's $6.8, while Hindustan Petroleum's GRM of $9.8/bbl was hit by the ongoing commissioning of its Vishakhapatnam unit. The GRMs were supported by greater use of discounted Russian crude, the proportion of which rose to ~39% (from ~2% in FY22) with the discount averaging $7/bbl for 9M FY24.

Fig 3 – Russian crude's share and discounts



Source: The Ministry of Commerce

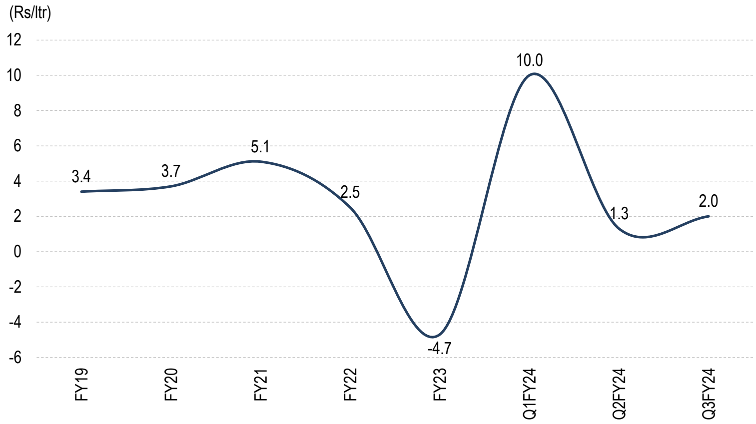
Strong product spreads

Indian refiners also benefited from strong spreads in diesel/ATF ($20/bbl each) and gasoline ($18), which make up ~70% of the refinery product slate. Low inventory levels have also supported higher spreads.

Marketing margins

Marketing margins have been volatile on unchanged retail prices. However, after the recent Rs2/litre cut, we do not expect any further changes heading into the elections. However, if crude prices ease and geopolitical tensions cool, we do not rule out the move to free marketing of products. We have factored in FY24/25/26 marketing margins of Rs3/3.5/4 a litre.

Fig 4 – Marketing margins volatile for OMCs



Source: Industry, Anand Rathi Research

Q4 ytd trends suggest a strong quarter for OMCs

We expect the three OMCs to report Rs318bn/184bn EBIDTA/PAT (Q3: Rs238bn/120bn), aided by inventory gains (Rs54.8bn) and higher GRMs q/q (Q4 diesel/ petrol spreads up $2/$6/bbl). Marketing margins have recovered smartly from Q3 levels as crude prices have been range-bound; we calculate blended margins at ~Rs4 a litre (Q3 ytd average: ~Rs2).

Fig 5 – Q4 estimates for OMCs

	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24e	% chng, Y/Y, est.	% chng Q/Q, est.
Brent ($/bbl)	1,13.0	99.5	88.5	82.0	78.1	86.6	84.3	82.4	*0.5*	-2.3
$/Rs	77.1	79.6	82.1	82.2	**82.1**	82.7	83.2	83.0	*1.0*	-0.2
Singapore GRMs ($/bbl)	21.6	7.8	6.0	8.2	**4.1**	9.5	5.4	7.8	*-4.9*	44.4
Product spreads ($/bbl)										
Gasoline	33.8	12.9	9.7	19.3	16.6	18.7	11.8	17.7	*-8.0*	50.7
Naphtha	-13.1	-21.2	-11.4	-4.1	-12.6	-16.5	-11.9	-6.0	*-44.4*	50.1
Kerosene	38.7	32.8	33.9	27.7	14.3	26.0	23.3	21.9	*-21.1*	-6.0
Diesel	42.3	34.2	39.9	26.2	13.9	26.5	20.2	22.2	*-15.4*	9.7
Fuel oil	-3.9	-24.0	-22.9	-16.0	-9.3	-5.9	-11.8	-11.0	*31.2*	6.6
BPCL										
Sales	1,383,896	1,283,327	1,333,315	1,334,138	1,282,567	1,165,943	1,299,756	1,332,645	*-0.1*	2.5
EBIDTA	(58,650)	14,340	42,339	111,537	158,098	129,079	62,263	106,876	*-4.2*	71.7
PAT	(62,631)	(3,042)	19,596	78,378	105,509	85,011	33,973	67,526	*-13.8*	98.8
Debt	241,230	482,370	402,560	358,550	279,390	225,680	160,170			
Refining thruput (m tpa)	9.69	8.82	9.39	10.63	10.36	9.35	9.86	10.00	*-5.9*	1.4
Refining margin ($/bbl)	27.51	16.79	15.92	20.58	12.64	18.49	13.35	16.35	*-20.6*	22.5
Inventory gains										
Refining	(3,710)	(3,840)	(7,520)	(19,130)	(10,700)	14,970	(3,690)	7,000		
Marketing	(3,710)	(3,840)						11,000		
HPCL										
Sales	1,214,488	1,141,723	1,161,266	1,144,447	1,190,437	1,026,184	1,184,429	1,240,986	*8.4*	4.8
EBIDTA	(124,946)	(14,979)	16,717	47,986	95,253	82,169	21,635	51,080	*6.4*	136.1
PAT	(101,969)	(21,721)	1,724	32,226	60,744	51,182	5,286	31,560	*-2.1*	497.0
Debt	472,830	685,460	642,450	645,170	516,980	517,580	517,580			
Refining thruput (m tpa)	4.81	4.49	4.83	4.96	5.40	5.75	5.34	5.70	*14.9*	6.7
Refining margin ($/bbl)	16.69	8.41	9.14	14.01	7.44	13.35	8.49	11.44	*-18.3*	34.7
Inventory gains										
Marketing	(9,770)	-	-	-	-	12,000	-	8,800		
Refining	-	-	-	-	-	9,000	(7,500)	3,100		
Debt										
IOCL										
Sales	2,519,329	2,283,594	2,281,683	2,264,921	2,211,454	2,023,120	2,230,124	2,188,591	*-3.4*	-1.9
EBIDTA	13,589	19,600	35,934	153,403	221,639	212,171	154,887	160,578	*4.7*	3.7
PAT	(19,925)	(2,724)	4,480	100,587	137,504	129,673	80,634	85,558	*-14.9*	6.1
Debt	1,107,990	1,403,220	1,440,650	1,324,950	1,010,120	994,070	1,061,900	130,558		
Refining thruput (m tpa)	18.94	16.09	18.20	19.12	18.80	17.77	18.50	18.00	*-5.9*	-2.7
Refining margin ($/bbl)	31.81	18.49	12.93	15.28	8.34	18.11	13.60	13.05	*-14.6*	-4.0
Inventory gains										
Marketing	-	-	-	-	-	-	-	9,400		
Refining	69,239	(94)	(48,904)	(42,856)	(8,043)	18,422	40,995	15,200		
Debt	1,822,050	2,571,050	2,485,660	2,328,670	1,806,490	1,737,330	1,739,650		*-32.4*	-3.8
Sector inventory gains										
Marketing	(13,480)	(3,840)	-	-	-	12,000	-	25,300	-	**-**
Refining	65,529	(3,934)	(56,424)	(61,986)	(18,743)	42,392	29,805	29,400	*117.7*	-63.1
Total	**52,049**	**(7,774)**	**(56,424)**	**(61,986)**	**(18,743)**	**54,392**	**29,805**	**54,800**	*131.9*	-33.6

Source: Company, Anand Rathi Research

Valuation and view

We value the OMCs at 5.5x FY26e EV/EBIDTA and add investments at a 20% discount to their market prices. Accordingly, our target prices for BPC/ HPC/IOC work out to Rs672/443/173.

Fig 6 – OMCs' valuations (Rs m)

	BPC	HPC	IOC
FY26e EV / EBITDA (x)	5.5	5.5	5.5
FY26e EBIDTA	252,041	194,285	497,798
EV	1,386,225	1,068,566	2,737,892
Net debt	146,258	283,764	712,025
Investments	103,853	59,311	363,054
E&P	82,444		
Bhatinda Refinery		54,869	
Equity value	1,426,264	912,699	2,388,920
Target Price (Rs/sh)	672	643	173

Source: Anand Rathi Research

Risks

- Sharply lower than anticipated GRMs.
- Persistently high crude prices, resulting in higher marketing losses.

Fig 7 – Consensus factors in waterfalls

	FY24	FY25	FY26	FY24-25	FY24-26
HPC					
EBIDTA	244	181	191	*-26*	*-22*
PAT	151	91	95	*-40*	*-37*
BPC					
EBIDTA	416	230	228	*-45*	*-45*
PAT	270	125	116	*-54*	*-57*
IOC					
EBIDTA	603	338	331	*-44*	*-45*
PAT	410	239	236	*-42*	*-42*

Source: Bloomberg, Anand Rathi Research

Key Financials

Fig 8 – HPC

Year end Mar	FY22	FY23	FY24e	FY25e	FY26e
Sales (Rsbn)	3,510	4,404	3,877	3,626	3,502
EBITDA (Rsbn)	115	-75	277	189	194
Net profit (Rsbn)	77	-90	165	100	104
EPS (Rs)	54.0	-63.2	116.0	70.6	73.4
PE (x)	6.6	-7.4	4.0	6.6	6.4
EVEBITDA (x)	7.4	-15.3	3.6	4.9	4.1
PBV (x)	1.3	2.4	1.7	1.4	1.2
RoE (%)	20.5	-27.0	48.6	22.9	20.3
RoCE (%)	11.3	-9.2	21.4	12.5	12.3
Dividend yield (%)	3.2	-	8.3	5.0	5.2
Net debt/equity (x)	0.9	1.8	0.8	0.5	0.3

Source: Company, Anand Rathi Research

Fig 9 – BPC

Year end Mar	FY22	FY23	FY24e	FY25e	FY26e
Sales (Rsbn)	3,468	4,731	5,754	5,509	5,343
EBITDA (Rsbn)	192	110	441	259	252
Net profit (Rsbn)	115	22	274	146	145
EPS (Rs)	54.1	10.2	128.6	68.5	67.9
PE (x)	6.6	57.3	4.6	8.6	8.6
EVEBITDA (x)	7.0	14.9	3.5	5.7	5.5
PBV (x)	1.5	2.4	1.8	1.6	1.4
RoE (%)	21.8	4.2	45.0	19.6	17.2
RoCE (%)	9.7	5.9	26.1	12.9	11.7
Dividend yield (%)	2.7	0.7	7.7	4.1	4.1
Net debt/equity (x)	1.1	0.7	0.4	0.3	0.2

Source: Company, Anand Rathi Research

Fig 10 – IOC

Year end Mar	FY22	FY23	FY24e	FY25e	FY26e
Sales (Rsbn)	5,893	8,418	7,697	7,142	6,964
EBITDA (Rsbn)	477	307	713	559	532
Net profit (Rsbn)	233	100	406	292	268
EPS (Rs)	25.3	7.2	29.5	21.2	19.5
PE (x)	14.2	22.2	5.5	7.6	8.3
EVEBITDA (x)	12.3	10.9	4.0	4.7	4.7
PBV (x)	3.7	1.6	1.3	1.2	1.1
RoE (%)	19.0	7.3	26.5	16.5	13.5
RoCE (%)	10.8	5.6	14.7	10.5	9.3
Dividend yield (%)	7.8	1.9	7.2	5.1	4.7
Net debt/equity (x)	0.7	0.8	0.4	0.2	0.1

Source: Company, Anand Rathi Research

Appendix

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