Oil & Gas

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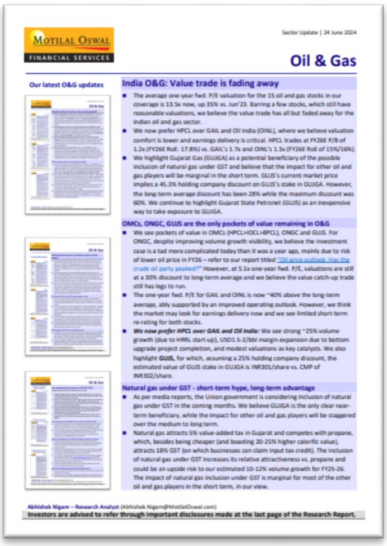
GAIL and ONGC: Multiple growth catalysts beckon!


Sector Update | 24 June 2024

Oil & Gas

India O&G: Value trade is fading away

Robust 3QFY25 trends for OMCs so far

- **In 3QFY25'TD, refining margins have remained stable with current SG GRM at USD5.2/bbl (2QFY25: USD3.6/bbl), even as MS/HSD GRMs are stable QoQ at USD10-13/bbl.**
- **MS/HSD marketing margins have remained robust, averaging INR13.6/INR10.7 per lit in 3QFY25'TD (vs. INR3.3/lit each, we assume for FY26E-27). While crude prices have corrected sharply over the past six months, further downside risks to oil prices remain a source of upside earnings risk for OMCs' marketing business in FY26.**
- **Based on 3QFY25'TD refining and marketing margins and LPG prices, we estimate that OMC EBITDA may rise by 60-80% QoQ in 3QFY25. While LPG's under-recovery has risen QoQ, it will likely be offset by higher marketing margins. We believe that lower inventory losses QoQ in both refining and marketing could also boost profitability.**
- **Assuming 3QFY25'TD profitability to continue in 2HFY25, we see 20%-40% upside risk to our FY25E EBITDA for OMCs. HPCL is our preferred pick among OMCs with a BUY rating and a TP of INR470.**

Refining segment: SG GRM expands

- In 2QFY25, IOCL/HPCL/BPCL posted a 57%/41%/42% miss on our EBITDA estimates due to subdued refining margins, with reported GRMs coming in at USD1.6/USD4.4/USD3.1 per bbl. The weak profitability was a combination of soft core GRMs as well as inventory losses as Brent prices corrected from 1QFY25 average of USD 85/bbl to USD 79/bbl (2QFY25).
- Singapore GRM (SG GRM) has shown steady recovery in 3Q, averaging USD5.2/USD6 per bbl in 3QFY25'TD/Oct'24 (vs. USD3.6/bbl in 2QFY25). MS/HSD GRMs have been stable at USD10-13/bbl range in 3QFY25'TD. We believe that stable to modestly improving refining GRMs, together with lower inventory losses (amid stable to slightly lower crude prices), can drive healthy refining segment EBITDA growth QoQ for OMCs.

Marketing segment: MS/HSD marketing margins rise strongly QoQ

- Marketing margins for both MS and HSD were up 34% QoQ in 3QFY25'TD. Note that the 2QFY25 profitability for OMCs was also impacted by marketing inventory losses due to MS/HSD cracks correcting sharply in 2QFY25 vs 1QFY25.
- In 3QFY25, stable MS/HSD cracks QoQ, together with robust marketing margins, should deliver sequentially strong marketing segment performance in 3Q, we believe.

LPG's under-recovery may increase ~18% QoQ

- In 2Q, OMCs' earnings took a significant sequential hit due to the LPG under-recovery, amounting to INR37b/INR21b/INR21b for IOCL/HPCL/BPCL.
- With Propane prices averaging USD630/ton in 3QFY25'TD (vs. USD592/ton in 2QFY25), we estimate LPG under-recovery to increase ~18% QoQ in 3QFY25.
- We also estimate that for every USD100/ton change in propane prices, the 2QFY25 LPG under-recovery shall change by ~47%.
- With LPG prices averaging USD645/ton and touching a peak of USD940/ton over the last three years, we continue to believe that LPG under-recovery remains a risk to OMCs until any support is received from the government of India.

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OMCs the best way to play downside risk to crude price theme

- IEA estimates global oil demand for CY25 to be ~1mb/d. The persistent weakness in oil demand, as per IEA, is driven by low demand in key oil markets such as China, resumption of crude output from Libya, planned unwinding of OPEC+ production cuts, an expanding EV fleet, and an increase in vehicle efficiency.
- Apart from the gradual unwinding of 2.2mb/d voluntary cuts by OPEC+ from Jan'25, IEA estimates another 1.5mb/d oil supply growth from non-OPEC players in CY25. IEA projects that even if the OPEC+ cuts remain in place, global supply shall exceed demand by more than 1mb/d in CY25.
- While we are building in oil prices of USD75/bbl in FY26, we believe risks to a lower oil price curve continue to rise, given the strong non-OPEC supply response in CY25 and beyond. ***We think that the best way to play a range-bound oil price environment with rising downside risks is OMCs, where HPCL is our preferred pick.***

Valuation and view: HPCL remains our preferred pick

- HPCL/BPCL/IOCL are currently trading at FY26 PB of 1.6/1.5/1 vs the historical average of 1.8/1.9/1.4, respectively.
- **HPCL:** We model a marketing margin of INR3.3/lit for both MS and HSD in FY26E-27E, while the 3QFY25'TD MS/HSD marketing margins are INR13.6/lit and INR10.7/lit, respectively. HPCL is our preferred pick among the three OMCs.
- We see the following as key catalysts for HPCL: 1) demerger and potential listing of the lubricant business, 2) the commissioning of its bottom upgrade unit in 4QFY25, and 3) the start of its Rajasthan refinery in 1QFY26'end.
- HPCL currently trades at 1.6x FY26E P/B, which we believe offers a reasonable margin of safety, as we estimate an FY26E RoE of 15.3%. Our SoTP-based TP includes:
  - The standalone refining and marketing business at 7x Dec'26 EV/EBITDA;
  - INR38/share as the potential value unlocking from the de-merger of the lubricant business;
  - HMEL at 12x P/E based on its FY24 PAT (HPCL's share), deriving a value of INR52/share;
  - Chhara Terminal at 1x P/B and HPCL's HRRL stake at 0.5x of HPCL's equity investment in the project to date. The MRPL stake is valued at MOFSL's TP.
  - All these lead to a TP of INR470. **Reiterate BUY.**

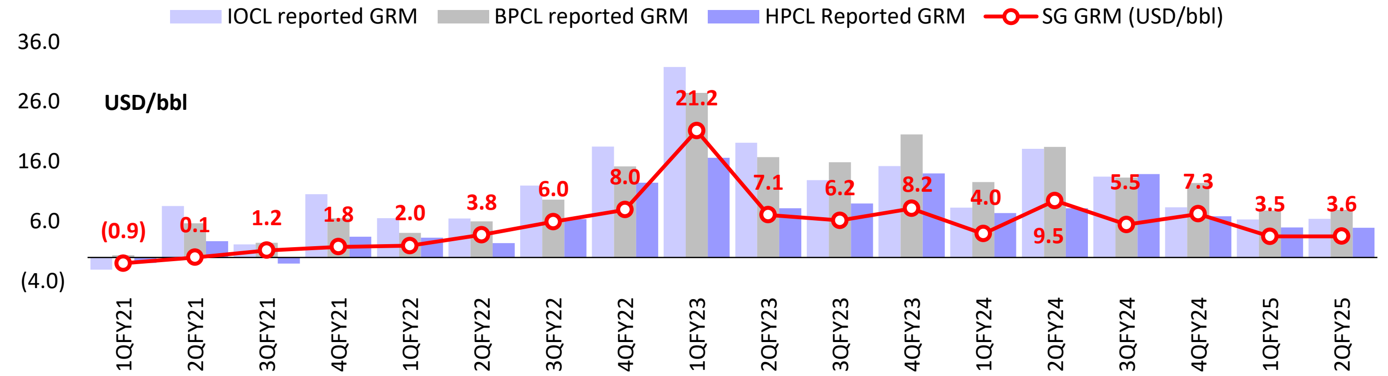
Exhibit 1: HPCL SoTP-based valuation

Particulars	Earning metric		Val metric	Multiple	Amount (INR m)
HPCL standalone	Dec'26E EBITDA	1,76,684	EV/EBITDA	7	12,70,365
(-) Standalone Dec'26E Net Debt					6,17,110
Standalone Market Cap					**6,19,676**
+ Lubricant business- value unlocking	FY24 EBITDA	10,000	EV/EBITDA	8	80,000
+ MRPL	MOFSL TP	38,621			38,621
+ HMEL	FY24 PAT	9,310	P/E	12	1,11,720
+ Chhara terminal	Book Value	12,232	P/B	1	12,232
+ HRRL	Equity invested till date		P/B	0.5	1,05,440
SoTP					**9,67,688**
(/) shares outstanding					**2,128**
TP (INR/share)					**470**

Exhibit 2: IOCL/BPCL/HPCLs 3QFY25E EBITDA to rise 69%/61%/79% QoQ

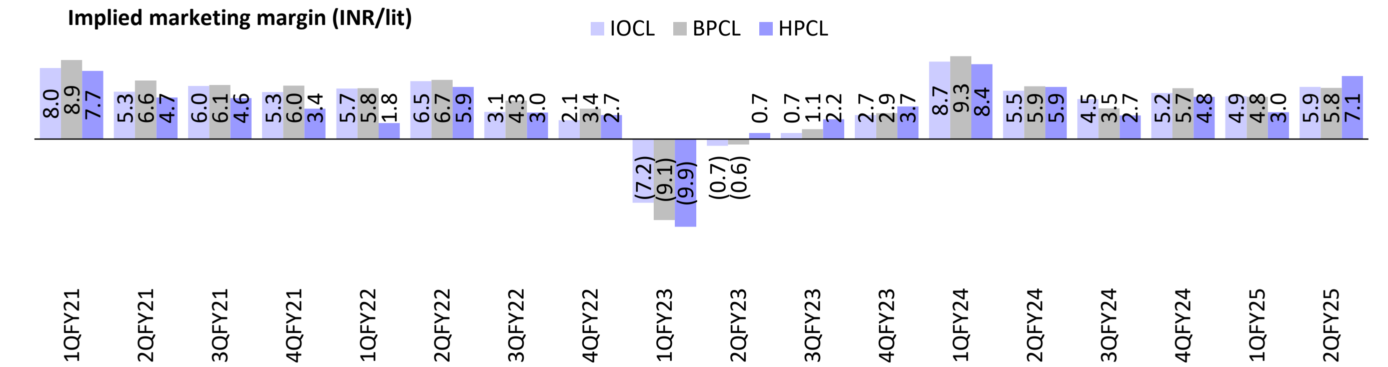
EBITDA (INR b)	3QFY25	2QFY25	QoQ growth (%)
IOCL	64	38	69%
BPCL	73	45	61%
HPCL	50	28	79%

Exhibit 3: OMC reported refining margin (USD/bbl)



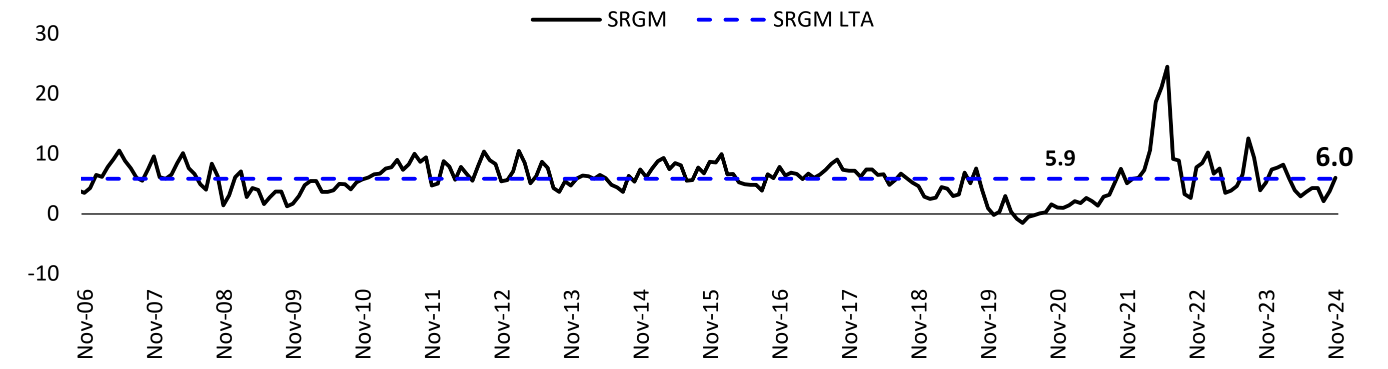
Source: Company, MOFSL

Exhibit 4: Implied gross marketing margin (INR/lit)



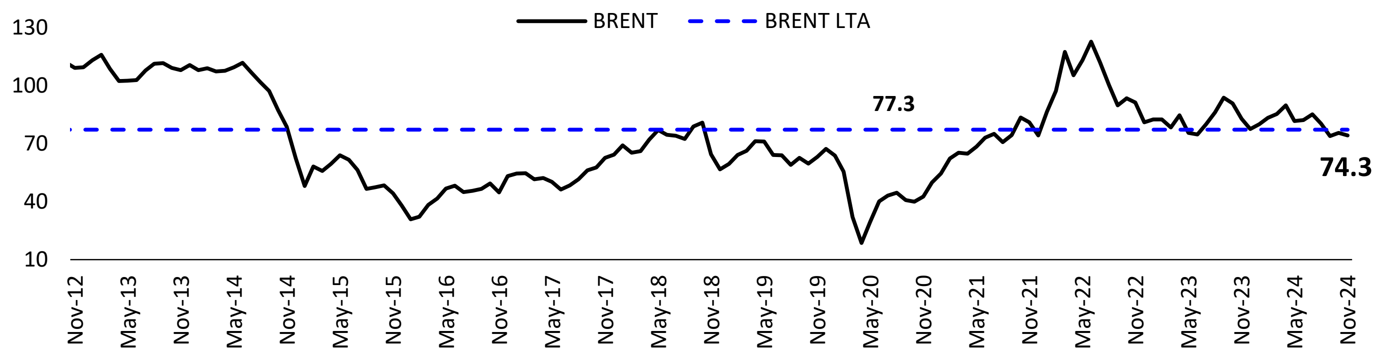
Source: Company, MOFSL

Exhibit 5: SG GRM – historical trend (USD/bbl)



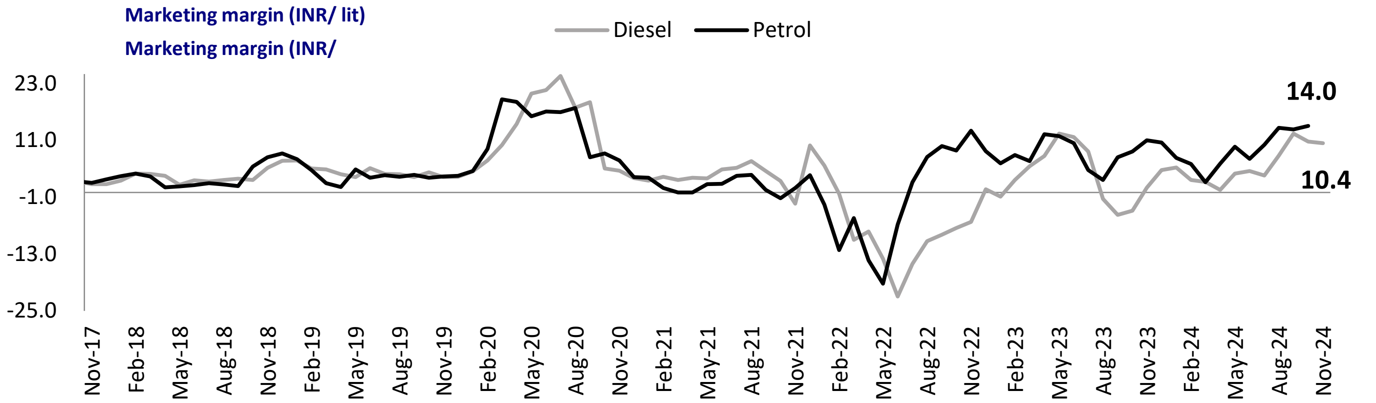
Source: Reuters, MOFSL

Exhibit 6: Brent crude – historical trend (USD/bbl)



Source: Reuters, MOFSL

Exhibit 7: Marketing margins for both petrol and diesel have improved recently



Source: Bloomberg, MOFSL

Financials and valuations: HPCL (TP: INR470) BUY

Consolidated - Income Statement					(INR b)
Y/E March	FY23	FY24	FY25E	FY26E	FY27E
Total Income from Operations	**4,407**	**4,339**	**3,942**	**3,767**	**3,854**
Change (%)	26%	-2%	-9%	-4%	2%
EBITDA	**-72**	**249**	**103**	**168**	**181**
Margin (%)	-1.6	5.7	2.6	4.5	4.7
Depreciation	46	56	71	77	83
EBIT	**-118**	**193**	**32**	**92**	**98**
Interest Charges (incld forex)	22	26	25	26	28
Other Income	15	19	22	23	26
PBT bef. JVs/associates EO	**-125**	**187**	**30**	**89**	**96**
EO Items	0	0	0	0	0
JV and Associate Income	25	18	14	18	18
PBT after EO Exp.	**-100**	**205**	**44**	**106**	**114**
Tax Rate (%)	30.1	21.9	25.2	25.2	25.2
Reported PAT	**-70**	**160**	**33**	**80**	**85**
Adjusted PAT	**-70**	**160**	**33**	**80**	**85**
Change (%)	PL	LP	-80%	144%	7%
Margin (%)	-1.6	3.7	0.8	2.1	2.2

Consolidated - Balance Sheet					(INR b)
Y/E March	FY23	FY24	FY25E	FY26E	FY27E
Equity Share Capital	21	21	21	21	21
Total Reserves	301	448	472	529	588
Net Worth	**323**	**469**	**493**	**550**	**610**
Total Loans	671	628	666	706	748
Deferred Tax Liabilities	29	69	69	69	69
Capital Employed	**1,023**	**1,167**	**1,228**	**1,325**	**1,427**
Net Fixed Assets	**681**	**795**	**823**	**846**	**863**
Capital WIP	256	201	251	301	351
Total Investments	**189**	**295**	**295**	**295**	**295**
Curr. Assets, Loans&Adv.	**447**	**489**	**446**	**459**	**499**
Inventory	296	342	311	297	304
Account Receivables	68	93	85	81	83
Cash and Bank Balance	7	5	2	32	64
Cash	5	3	0	30	62
Bank Balance	2	2	2	2	2
Loans and Advances	11	13	13	13	13
Others	64	36	36	36	36
Curr. Liability & Prov.	**591**	**661**	**636**	**625**	**631**
Account Payables	229	273	248	237	243
Other Current Liabilities	334	353	353	353	353
Provisions	28	35	35	35	35
Net Current Assets	**-144**	**-172**	**-190**	**-166**	**-131**
Appl. of Funds	**1,023**	**1,167**	**1,228**	**1,325**	**1,427**

Financials and valuations: HPCL

Ratios					
Y/E March	**FY23**	**FY24**	**FY25E**	**FY26E**	**FY27E**
Basic (INR)					
EPS	**-32.8**	**75.2**	**15.4**	**37.4**	**40.1**
Cash EPS	-11.4	101.5	48.7	73.6	79.1
BV/Share	151.6	220.5	231.8	258.3	286.4
DPS	0.0	21.0	4.0	10.8	12.0
Payout (%)	0.0	27.9	26.3	29.0	29.9
Valuation (x)					
P/E	-12.5	5.5	26.8	11.0	10.3
Cash P/E	-36.1	4.0	8.4	5.6	5.2
P/BV	2.7	1.9	1.8	1.6	1.4
EV/Sales	0.3	0.3	0.4	0.4	0.4
EV/EBITDA	-21.4	6.0	15.0	9.2	8.6
Dividend Yield (%)	0.0	5.1	1.0	2.6	2.9
FCF per share	-60.2	65.3	-3.3	18.4	20.0
Return Ratios (%)					
RoE	-19.0	40.4	6.8	15.3	14.7
RoCE	-7.8	15.9	3.6	7.1	7.1
RoIC	-16.2	24.4	3.5	10.0	10.3
Working Capital Ratios					
Fixed Asset Turnover (x)	4.6	3.9	3.2	2.9	2.7
Asset Turnover (x)	4.3	3.7	3.2	2.8	2.7
Inventory (Days)	24	29	29	29	29
Debtor (Days)	6	8	8	8	8
Creditor (Days)	19	23	23	23	23
Leverage Ratio (x)					
Current Ratio	0.8	0.7	0.7	0.7	0.8
Interest Cover Ratio	-5.4	7.6	1.3	3.5	3.5
Net Debt/Equity	2.1	1.3	1.3	1.2	1.1

Consolidated - Cash Flow Statement					(INR b)
Y/E March	**FY23**	**FY24**	**FY25E**	**FY26E**	**FY27E**
OP/(Loss) before Tax	-100	205	44	106	114
Depreciation	46	56	71	77	83
Interest expense	22	26	25	26	28
Interest income and dividend	-4	-4	0	0	0
Direct Taxes Paid	-2	-3	-11	-27	-29
MI and others	-10	-13	0	0	0
(Inc)/Dec in WC	13	-28	15	7	-3
CF from Operations	**-35**	**239**	**143**	**189**	**193**
(Inc)/Dec in FA	-93	-99	-150	-150	-150
Free Cash Flow	**-128**	**139**	**-7**	**39**	**43**
Others	12	4	0	0	0
CF from Investments	**-114**	**-130**	**-150**	**-150**	**-150**
Inc/(Dec) in Debt	213	-100	38	40	42
Interest Paid	-32	-41	-25	-26	-28
Dividend Paid	-20	-21	-9	-23	-26
CF from Fin. Activity	**151**	**-111**	**5**	**-9**	**-11**
Inc/Dec of Cash	**3**	**-2**	**-3**	**30**	**32**
Opening Balance	2	5	3	0	30
Closing Balance	**5**	**3**	**0**	**30**	**62**

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
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