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December 4, 2024

SECTOR UPDATE

Oil & Gas

Higher OMC profitability in H2FY25 to offset LPG subsidy impact for the year

In the absence of government support as yet, the LPG subsidy continues to weigh heavily on OMCs. We expect subsidy impact to touch ~Rs400bn by FY25. With H1FY25 having already impacted OMCs with Rs 174.9bn, H2FY25 will see an incremental impact of ~Rs225bn. As per our scenario analysis, if government provides 60% of the shortfall, the FY25 EBITDA could significantly surpass consensus estimates. Even in the event of a worst-case scenario of zero government aid, the robust H2FY25 performance driven by strong GRMs and healthy marketing margins could help offset the said impact.

LPG subsidy burden impact on OMCs

The LPG subsidy mechanism in India has long been a cornerstone of the government's efforts to provide affordable cooking gas to households, particularly to rural and economically weaker sections. Under this system, OMCs are reimbursed for a portion of the subsidy cost, with the government covering the rest. However, in recent years, rising global energy prices, higher domestic consumption, and higher extended subsidy for households have sharply escalated subsidy requirements.

The LPG subsidy burden has emerged as a significant issue for OMCs who sustained an impact of Rs 174.9bn in H1FY25 that dented their profitability in the absence of government support. However, based on our calculations, the actual subsidy requirement for FY25 is expected to reach ~Rs400bn, resulting in a further impact of ~Rs225bn in H2FY25. Assuming a distribution of the subsidy burden across IOCL, BPCL, and HPCL in the ratio of 49%/25%/26%, the respective impacts on these companies could be Rs195.7bn, Rs102bn, and Rs102.4bn for FY25 (H1FY25 burden stood at Rs bn 88.7/41.2/45). There is yet no clarity from the government on the earmarked volume of petroleum subsidy.

Following our understanding and analysis, we have tried to estimate the likely government subsidy to OMCs and the amount to be borne by the latter. Given the likelihood of a strong QTD Q3FY25 performance and a better Q4 outlook, the OMCs could report super normal profits which could more than offset most of the LPG subsidy impact.

Scenario analysis: HPCL and BPCL well placed, IOCL could take a hit

If the government provides ~60% (base case) of the requirement, OMCs would need to absorb the remaining ~Rs160bn. Consequently, FY25 EBITDA will be Rs413.2bn for IOCL, Rs286.8bn for BPCL, Rs207.2bn for HPCL, significantly above Bloomberg consensus of Rs404.6bn, Rs243.6bn, Rs149.4bn respectively. If government provides ~80% (Rs320bn) of the shortfall (bull case), the OMCs will have to bear Rs80bn resulting in FY25 EBITDA of Rs452.4bn for IOCL, Rs307.1bn for BPCL, and Rs227.7bn for HPCL, warranting an upward revision in estimates. If we assume dynamics to be fully against OMCs marked by NIL government support (bear case), OMCs will need to bear Rs400bn resulting in FY25 EBITDA of Rs295.9bn for IOCL, Rs225.4bn for BPCL, and Rs145.8bn for HPCL, indicating a downward revision in estimates for IOCL, while keeping other two at par.

Our View

OMCs are likely to make the most of a buoyant H2FY25 to report better performance than their last 5-year averages. We believe HPCL and BPCL could outperform expectations based on our H2 calculations. In a worst-case scenario, of no government support, HPCL and BPCL could report EBITDA as per the consensus expectations, but we foresee a 40% sharing by OMCs which would revise HPCL and BPCL EBITDAs upwards by 39%/18% respectively. We stay bullish on OMCs but prefer HPCL and BPCL over IOCL, given its limited upside potential.

Recommendation table

Stock	Rating	TP (Rs)
HPCL	BUY	475
BPCL	BUY	370
IOCL	NEUTRAL	154

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Exhibit 1: OMCs expected FY25 performance better driven by stronger H2FY25

	Q1FY25			Q2FY25			Q3FY25e			Q4FY25e			FY25e		
	IOCL	BPCL	HPCL	IOCL	BPCL	HPCL	IOCL	BPCL	HPCL	IOCL	BPCL	HPCL	IOCL	BPCL	HPCL
Exchange Rate (USD/INR)	83.4	83.4	83.4	83.8	83.8	83.8	84.5	84.5	84.5	84.5	84.5	84.5	84.0	84.0	84.0
Refining Segment															
Refining Volumes (mmt)	18.2	10.1	5.8	16.7	10.3	6.3	16.3	10.2	6.4	17.9	10.2	6.4	69.1	40.9	24.9
Reported GRMs (USD/bbl)	6.4	7.9	5.0	1.6	4.4	3.1	6.4	6.7	6.1	5.7	6.0	5.4	5.1	6.2	4.9
Opex (USD/bbl)	2.9	2.1	2.3	3.0	2.1	2.4	3.0	2.3	2.5	3.0	2.3	2.5	3.0	2.2	2.4
Reported EBITDA (Rs bn)	**38.5**	**35.8**	**9.5**	**(14.8)**	**14.3**	**2.8**	**34.7**	**27.7**	**14.5**	30.4	23.3	11.7	88.8	101	38.5
Marketing Segment															
Marketing Volumes (mmt)	25.3	13.4	12.6	23.0	12.8	11.6	22.7	13.4	12.6	22.9	13.6	12.6	93.8	53.2	49.5
Marketing Margins (Rs/ltr)															
HSD	3.7	3.7	3.7	6.7	6.7	6.7	9.0	9.0	9.0	7.0	7.0	7.0	6.6	6.6	6.6
MS	5.4	5.4	5.4	9.7	9.7	9.7	10.5	10.5	10.5	8.0	8.0	8.0	8.4	8.4	8.4
Company Blended Gross Mkg margins (Rs/ltr)	4.6	4.4	3.4	6.6	6.4	5.2	6.7	7.2	7.0	5.4	5.7	5.6	5.8	5.9	5.3
Opex & Inv gain/loss (Rs/ltr)	1.3	1.8	1.0	3.2	2.9	1.9	2.0	2.2	1.9	2.0	2.2	1.9	2.1	2.3	1.7
Reported EBITDA (Rs bn)	**99.4**	**40.9**	**36.0**	**89.7**	**52.2**	**45.0**	**123.5**	**77.4**	**74.5**	90.2	55.9	54.2	402.7	226.3	209.7
Refining + Marketing EBITDA	**137.9**	**76.7**	**45.5**	**74.8**	**66.5**	**47.8**	**158.2**	**105.1**	**89.0**	120.6	79.2	65.9	491.6	327.5	248.2
LPG Burden (Rs bn) 100% on OMCs	51.6	20.2	24.4	37.1	21.0	20.6	55.0	31.2	29.5	52.0	29.6	27.9	195.7	102.0	102.4
Company reported EBITDA (Rs bn)	86.3	56.5	21.1	37.7	45.5	27.2	103.2	73.9	59.5	68.6	49.6	38.0	295.9	225.4	145.8
Integrated Margins (USD/bbl)	3.3	3.9	1.9	1.5	3.2	2.5	4.3	5.1	5.0	2.7	3.4	3.2	2.9	3.9	3.2

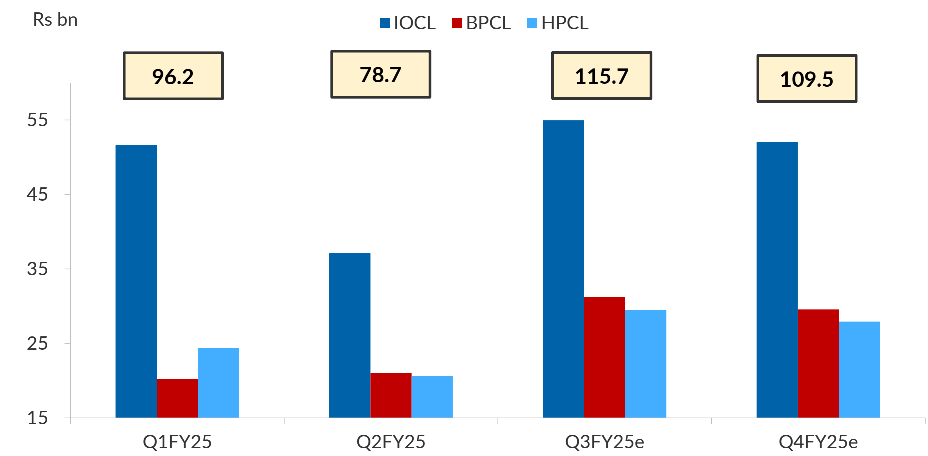
Strong H2FY25 OMCs earnings likely

As per our assumptions for Q3 and Q4FY25, we estimate stronger profitability for OMCs with reported GRMs of USD 6.1-6.7/bbl and USD 5.4-6/bbl respectively, while gross marketing margins of HSD/MS at Rs 9-10.5/ltr and Rs7-8/ltr respectively. From an inventory perspective, the crude inventory levels at the end of the last quarter are flat compared to the average inventory of the current quarter. Consequently, we do not anticipate material inventory gains or losses for either refining or marketing operations during this span.

Exhibit 2: Last 5-year reported EBITDA by the OMCs

FY (Rs bn)	IOCL	BPCL	HPCL
FY20	188.0	66.4	51.2
FY21	380.6	171.3	159.3
FY22	432.4	190.3	101.8
FY23	222.5	109.6	(75.2)
FY24	694.0	441.6	248.4
Average	**383.5**	**195.8**	**97.1**

Exhibit 3: Possible LPG subsidy burden to be borne by the OMCs



Source: Company, Industry, YES Sec

The LPG subsidy burden has emerged as a significant issue for OMCs who had sustained an impact of Rs 174.9bn in H1FY25 impacting their profitability with no support yet from the government. However, based on our calculations, the actual subsidy requirement for FY25 is expected to reach ~Rs400bn, resulting in a further impact of ~Rs225bn in H2FY25.

Exhibit 4: LPG Shortfall filled by Govt. of India

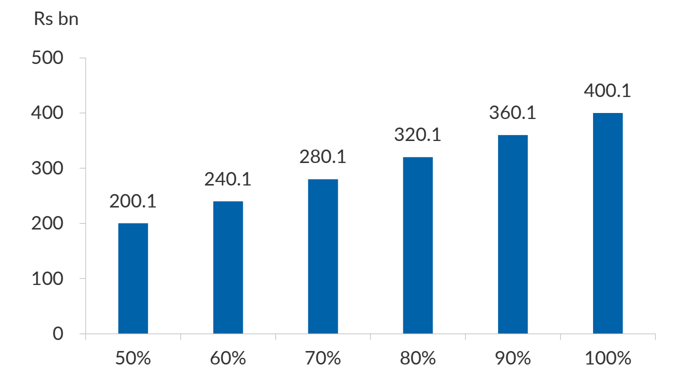
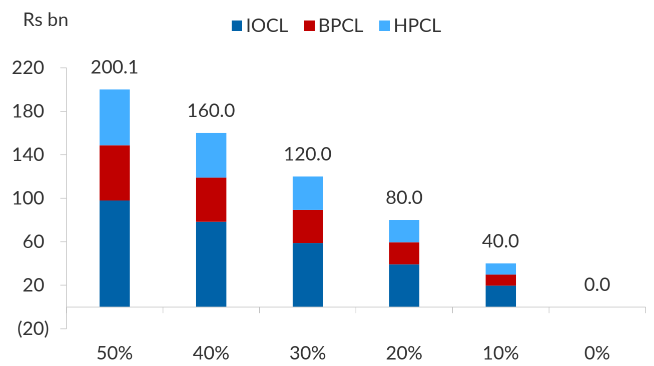


Exhibit 5: LPG Shortfall borne by the OMCs



Source: PPAC, Industry, YES Sec

Assuming a distribution of the subsidy burden across IOCL, BPCL, and HPCL in the ratio of 49%/25%/26%, the respective impacts on these companies could be Rs195.7bn, Rs102bn, and Rs102.4bn for FY25 (H1FY25 burden stood at Rs bn 88.7/41.2/45). There has been no clarity so far from the government on how much petroleum subsidy would be provided on the same.

Exhibit 6: OMCs share of LPG subsidy burden and possible EBITDA

OMCs Share	Total Burden	LPG Subsidy Burden (Rs bn)			EBITDA (Rs bn)		
	(Rs bn)	IOCL	BPCL	HPCL	IOCL	BPCL	HPCL
0%	-	-	-	-	491.6	327.5	248.2
10%	40.0	19.6	10.2	10.3	472.0	317.3	238.0
20%	80.0	39.2	20.3	20.5	452.4	307.1	227.7
30%	120.0	58.7	30.5	30.8	432.8	296.9	217.5
40%	160.0	78.3	40.7	41.0	413.2	286.8	207.2
50%	200.1	97.9	50.9	51.3	393.7	276.6	197.0

The reported EBITDA under various subsidy burden scenarios is expected to reflect a clearer picture of OMCs' operational resilience. Here, we deduce that with even with 40% burden borne by the OMCs, they could still deliver a stronger performance.

Exhibit 7: Scenario Analysis – Base case indicates an upward revision in EBITDA estimates by the Bloomberg consensus for HPCL and BPCL while IOCL at par

Rs bn	Q1FY25			Q2FY25			Q3FY25e			Q4FY25e			FY25e		
	IOCL	BPCL	HPCL	IOCL	BPCL	HPCL	IOCL	BPCL	HPCL	IOCL	BPCL	HPCL	IOCL	BPCL	HPCL
Bear Case - 100% burden borne by the OMCs															
EBITDA	**86**	**57**	**21**	**38**	**45**	**27**	**103**	**74**	**60**	**69**	**50**	**38**	**296**	**225**	**146**
PBT	35	40	5	2	32	8	62	58	42	27	33	20	125	163	75
Adjusted PAT	26	30	4	(10)	24	6	46	43	31	20	25	15	83	122	56
Adjusted EPS	**1.9**	**7.1**	**1.7**	**(0.7)**	**5.6**	**3.0**	**3.3**	**10.1**	**14.7**	**1.4**	**5.8**	**7.2**	**5.9**	**28.6**	**26.5**
Base Case - 40% burden borne by the OMCs															
EBITDA	**86**	**57**	**21**	**38**	**45**	**27**	**103**	**74**	**60**	**69**	**50**	**38**	**296**	**225**	**146**
LPG subsidy from Govt.	-	-	-	-	-	-	-	-	-	117	61	61	117	61	61
Reported EBITDA	**86**	**57**	**21**	**38**	**45**	**27**	**103**	**74**	**60**	**186**	**111**	**99**	**413**	**287**	**207**
PBT	35	40	5	2	32	8	62	58	42	144	95	82	242	224	137
Adjusted PAT	26	30	4	(10)	24	6	46	43	31	137	86	77	200	183	118
Adjusted EPS	**1.9**	**7.1**	**1.7**	**(0.7)**	**5.6**	**3.0**	**3.3**	**10.1**	**14.7**	**9.7**	**20.2**	**36.0**	**14.2**	**42.9**	**55.4**
Bull Case - 20% burden borne by the OMCs															
EBITDA	**86**	**57**	**21**	**38**	**45**	**27**	**103**	**74**	**60**	**69**	**50**	**38**	**296**	**225**	**146**
LPG subsidy from Govt.	-	-	-	-	-	-	-	-	-	157	82	82	157	82	82
Reported EBITDA	**86**	**57**	**21**	**38**	**45**	**27**	**103**	**74**	**60**	**225**	**131**	**120**	**452**	**307**	**228**
PBT	35	40	5	2	32	8	62	58	42	183	106	105	281	236	160
Adjusted PAT	26	30	4	(10)	24	6	46	43	31	177	101	98	239	198	139
Adjusted EPS	**1.9**	**7.1**	**1.7**	**(0.7)**	**5.6**	**3.0**	**3.3**	**10.1**	**14.7**	**12.5**	**23.5**	**45.8**	**16.9**	**46.3**	**65.2**

If the government provides ~60% (base case) of the requirement, then the OMCs would need to absorb the remaining ~Rs160bn. For FY25 this would translate into an EBITDA of Rs413.2bn for IOCL, Rs286.8bn for BPCL, Rs207.2bn for HPCL which itself is significantly above current Bloomberg consensus estimate of Rs404.6bn, Rs243.6bn, Rs149.4bn respectively.

However, if the government provides ~80% (Rs320bn) of the shortfall (bull case), the OMCs will need to bear Rs80bn which would result in FY25 EBITDA of Rs452.4bn for IOCL, Rs307.1bn for BPCL, and Rs227.7bn for HPCL, warranting an upward revision in estimates.

If we believe that the dynamics are fully against the OMCs where the government provides NIL support of the shortfall (bear case), the OMCs will need to bear Rs400bn which would result in FY25 EBITDA of Rs295.9bn for IOCL, Rs225.4bn for BPCL, and Rs145.8bn for HPCL, indicating a downward revision in estimates for IOCL while other two would be at par.

In either case, we expect the government support to be available in Q4FY25 indicating that OMCs might need to continue bearing it entirely in Q3 which would be a drag on margins, however on an annual basis the impact should be rationalized. HPCL should benefit the most from any support given its higher proportion of marketing segment in its overall portfolio

KEY INDUSTRY CHARTS

Exhibit 8: Dubai crude on a sequential declining streak

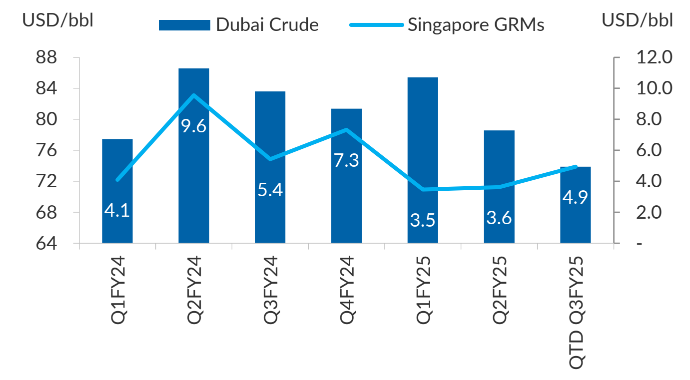
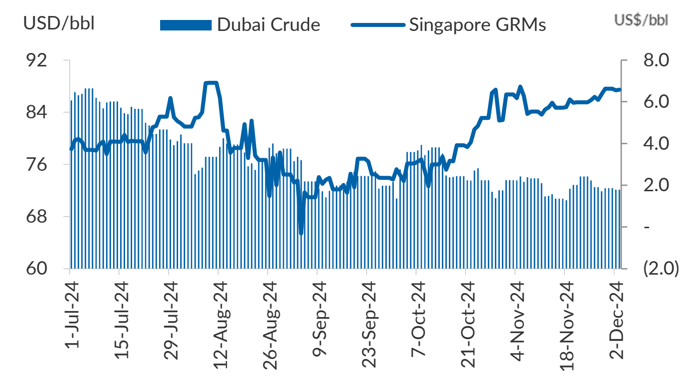


Exhibit 9: Singapore GRMs on an uptrend, at FY25 peak



Source: Industry, Bloomberg, YES Sec

Exhibit 10: MS marketing margins strong

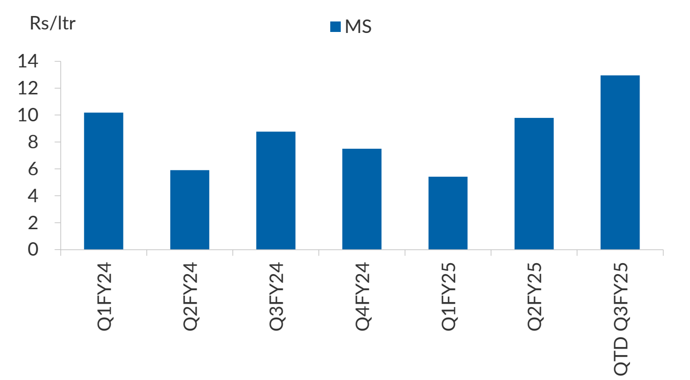
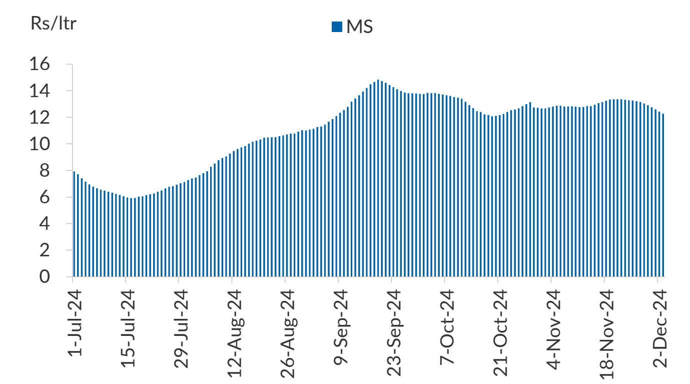


Exhibit 11: MS marketing margins flat over last 2 months



Source: Company, Bloomberg, YES Sec

Note: These MS gross marketing margins does not include the negative impact of ethanol blending which reduces the margins

Exhibit 12: HSD marketing margins improving

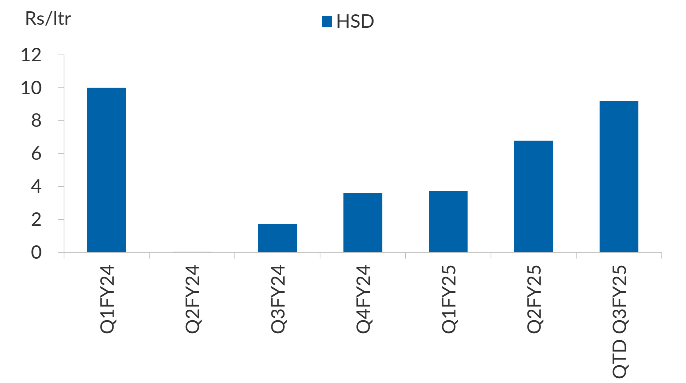
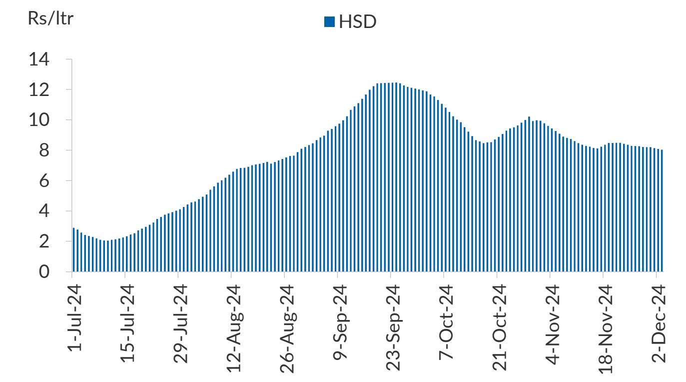


Exhibit 13: HSD marketing margins peaked in Sep'24



Source: Company, Bloomberg, YES Sec

Exhibit 14: Gasoil refining margins stabilizing

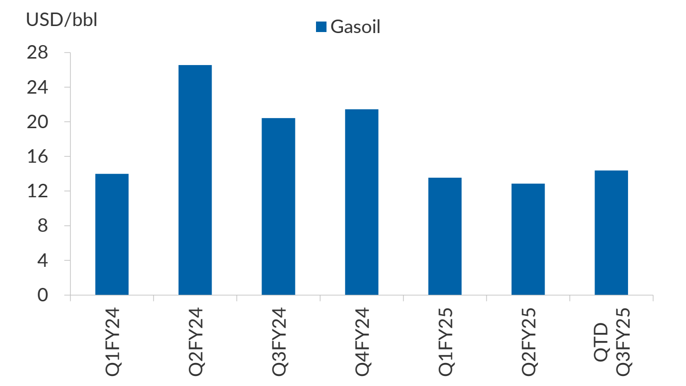
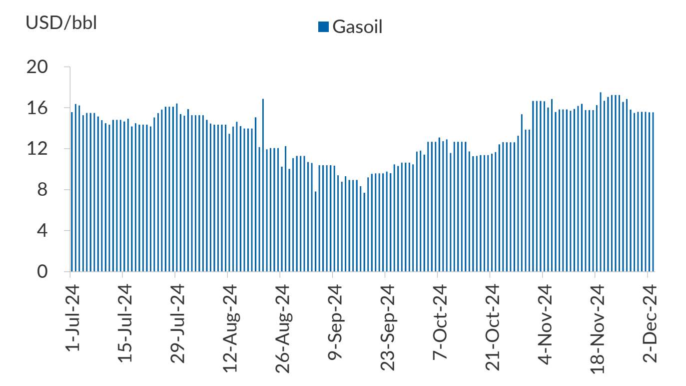


Exhibit 1: Gasoil cracks witnessing sharp recovery from its bottom in Sep'24



Source: Industry, Bloomberg, YES Sec

Exhibit 15: Gasoline cracks declining sequentially

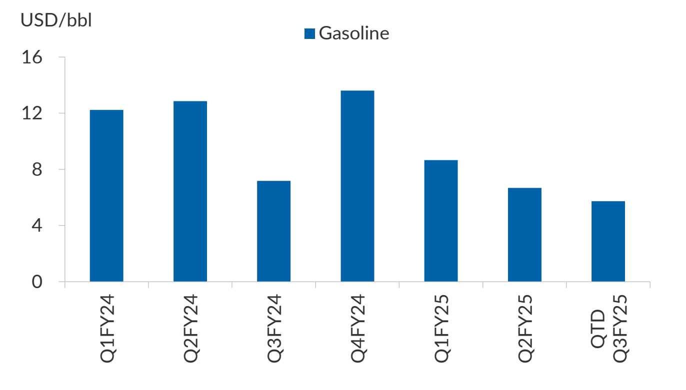
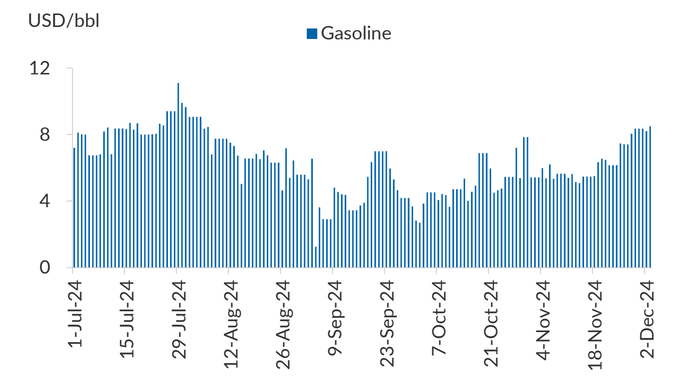


Exhibit 16: Gasoline cracks remain range bound



Source: Industry, Bloomberg, YES Sec

Exhibit 17: Jet Kero cracks stabilizing sequentially

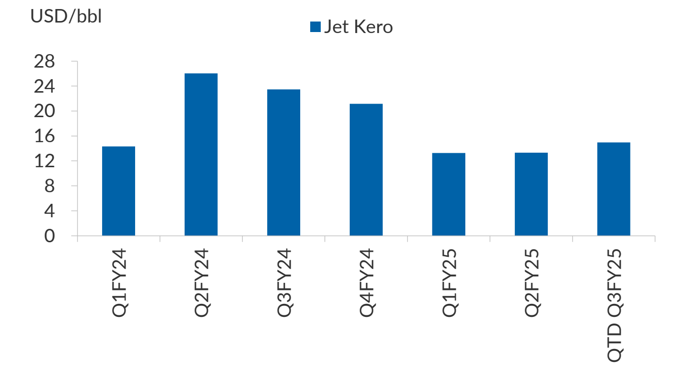
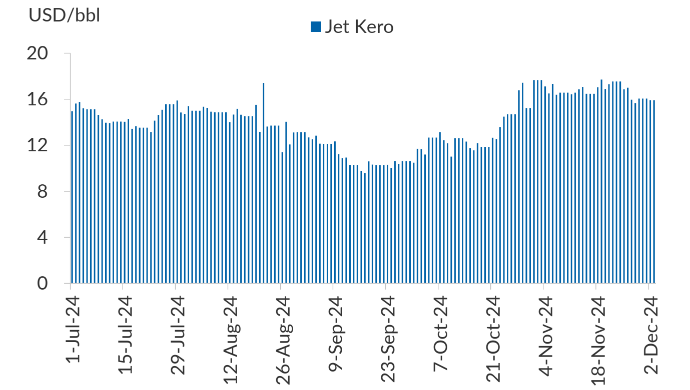


Exhibit 18: Jet Kero cracks recovering since Sep'24



Source: Industry, Bloomberg, YES Sec

Exhibit 19: LPG cracks supporting GRMs

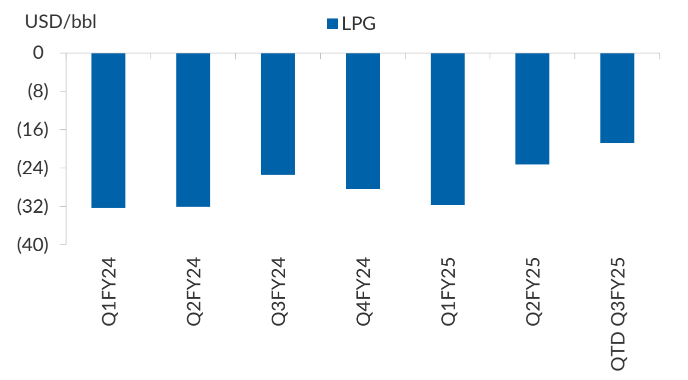
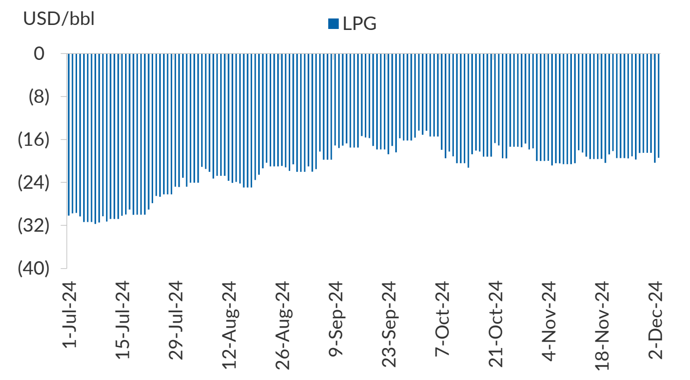


Exhibit 20: Cracks witnessing winter improvement



Source: Industry, Bloomberg, YES Sec

Exhibit 21: Naphtha cracks supporting GRMs

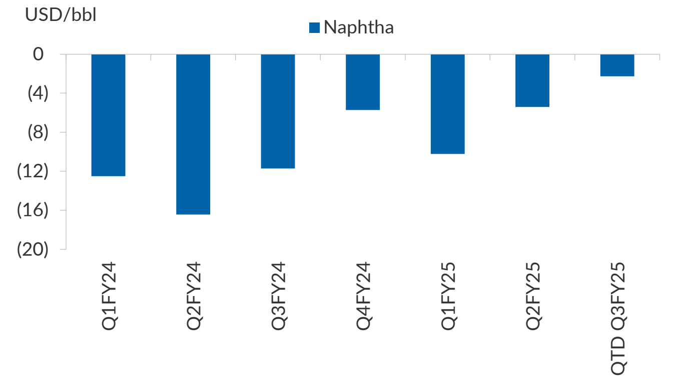
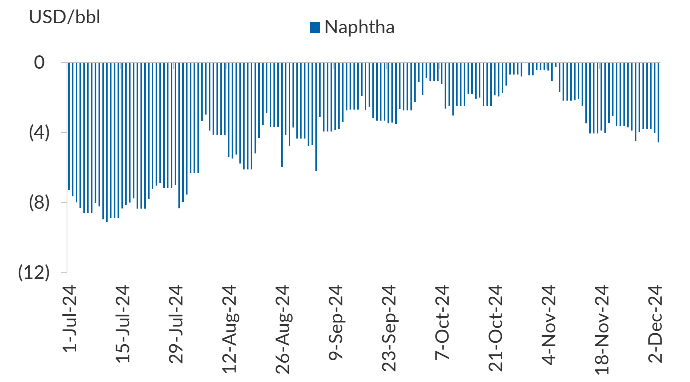


Exhibit 22: Cracks witnessing seasonal improvement



Source: Industry, Bloomberg, YES Sec

Exhibit 23: Fuel oil cracks at recent peak

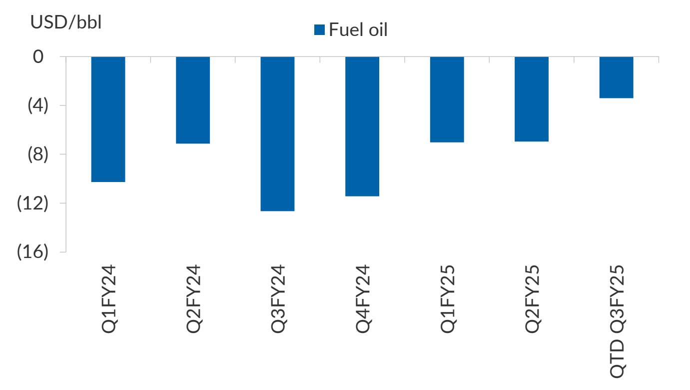
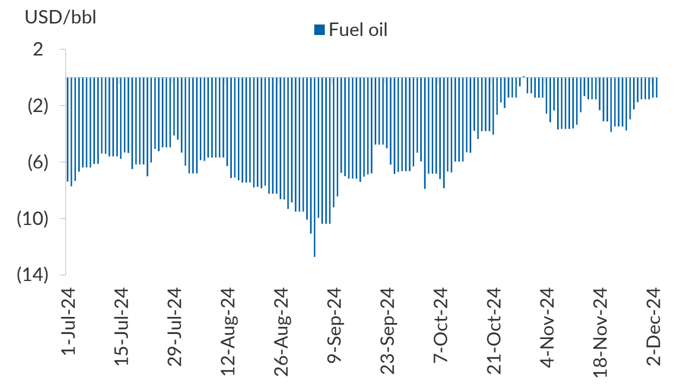


Exhibit 24: Witnessing seasonal improvement



Source: Industry, Bloomberg, YES Sec

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