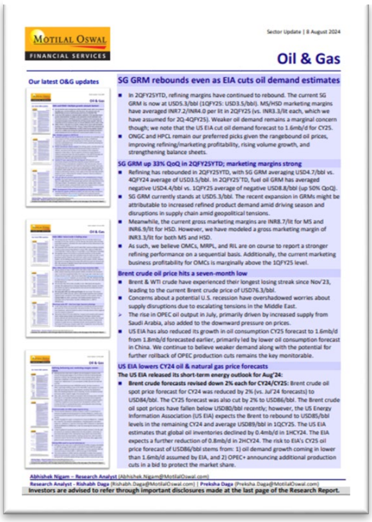
Sector Update | 25 September 2024

Oil & Gas

Our latest O&G updates


Sector Update | 6 August 2024

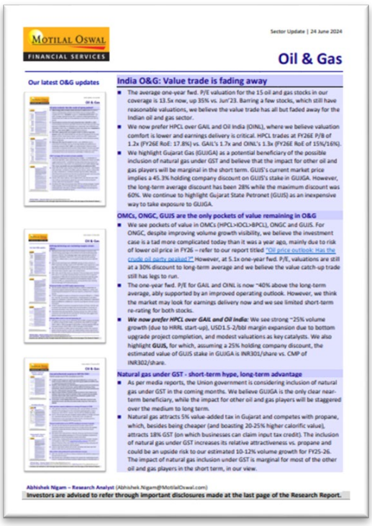
Oil & Gas

SG GRM rebounds even as EIA cuts oil demand estimates


Sector Update | 8 July 2024

Oil & Gas

GAIL and ONGC: Multiple growth catalysts beckon!


Sector Update | 24 June 2024

Oil & Gas

India O&G: Value trade is fading away

Demand a worry, but OMCs poised for another leg up

- **Re-iterate Buy on ONGC and Oil India despite oil price-related risks:** In Jun'24, we highlighted the potential risks to ONGC and Oil India's crude realization assumption of USD 73-74/bbl in our report titled "Oil price outlook: Has the crude oil party peaked?" Since then, the lower crude price momentum has led to corrections of 9% for ONGC and 18% for Oil India over the past four weeks. The International Energy Agency (IEA) has continued to moderate its demand assumptions for both CY24 and CY25, even as supply risks continue to mount. However, following the recent corrections, **we believe that both ONGC and OINL are now pricing in the realization-related risks. Hence, we reiterate our BUY rating on both these stocks.**
- **Refining margin weak but likely to bottom out:** The Singapore GRM in 1HFY25YTD has averaged only USD3.6/bbl, reflecting the effects of a subdued oil demand environment. However, key product inventories globally remain at the lower to mid-range of the last five years. We anticipate limited downside for refining margins from current levels as we approach the seasonally stronger winter months.
- **Marketing margin outlook remains robust; OMC profitability likely to remain strong:** Against the backdrop of weak crude oil prices and a range-bound refining GRM environment, the outlook for marketing margins remains strong. We believe the risk of a substantial retail price cut for MS/HSD before the upcoming key state elections is overstated. Instead, the central government may urge individual states to reduce state taxes to provide relief to consumers. While OMCs appear to be trading at the higher end of the historical range, street earnings estimates are building in only INR3-4/lit marketing margin (current margins are above INR10/lit).

Demand and OPEC+ spare capacity multi-year overhangs

- In its latest monthly oil market report, IEA reiterated that: 1) the oil demand outlook remains soft at 900/950kb per day in CY24/CY25; and 2) oil supply is set to rise 2.1mb/d in CY25, assuming voluntary cuts remain in place. IEA increased its OPEC+ supply growth marginally by 140kb/d for CY25.
- **Demand estimate dips marginally:** IEA has reduced its global oil demand estimate to 900/950kb per day in CY24/CY25 (marginally below the previous estimate). According to the IEA, global oil demand growth continues to slow down, with an increase of 800kb/d in 1HCY24, amid muted demand from China.
- **The persistent weakness in oil demand**, as per the IEA, is due to a contraction in Chinese consumption, an expanding EV fleet, and an improvement in vehicle efficiency. Crude oil imports hit a 22-month low in Jul'24, as demand for industrial fuels and petrochemical feedstock was weak.
- **Key OPEC players raise production in Aug'24:** According to IEA, Iran, Kuwait, Saudi Arabia, and the UAE increased their oil production by ~1.5-2.0% each MoM in Aug'24, leading to 300kb/d increase in oil production and an equivalent reduction in spare capacity. Kuwait, the UAE, and Saudi Arabia together still account for 77% of the OPEC+ spare capacity. With the reversal of voluntary cuts from Dec'24, these four countries together shall add ~1.8mb/d oil production over the current levels by Dec'25.

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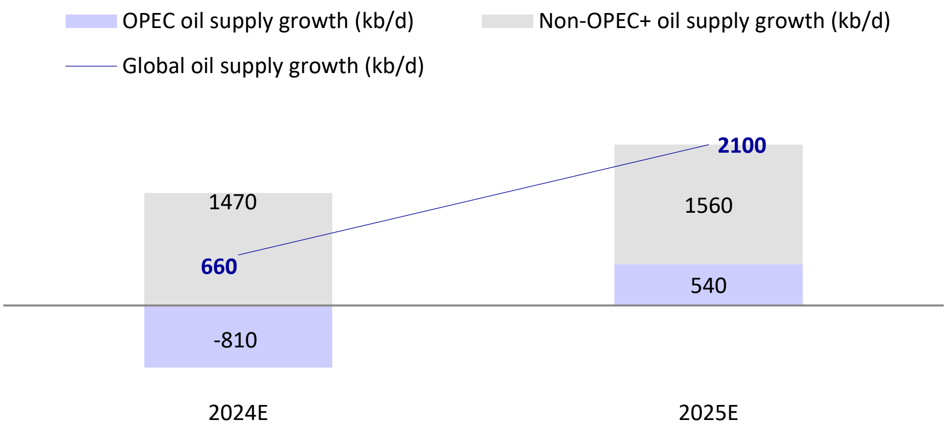
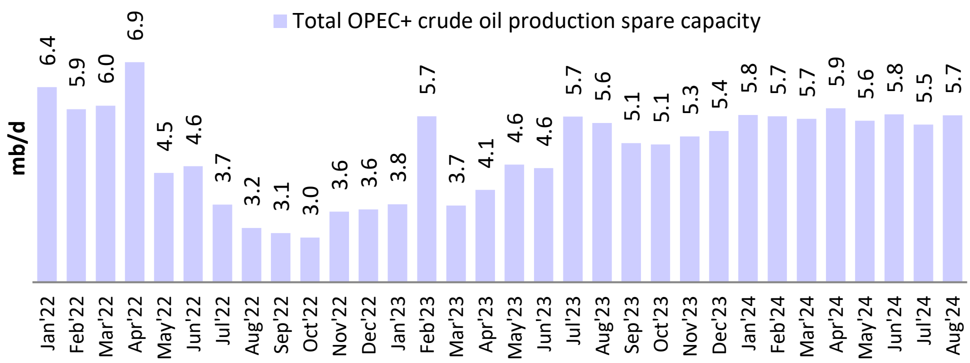
- **Non-OPEC supply remains robust:** The IEA expects global oil supply to report a lower-than-estimated increase of 660kb/d for CY24 (vs. 730kb/d rise estimated previously). This reduction is primarily attributable to outages in Libya and the US Gulf. OPEC+ production is projected to decline 810kb/d in CY24 (vs. 760kb/d decline estimated previously). In CY25, global supply is estimated to rise 2.1md/d (+1.9mb/d est. in Aug'24), as non-OPEC+ output is expected to rise 1.6mb/d.
- **Our oil price assumption down 12% vs. the US EIA:** We are modeling oil prices of USD75/bbl in both FY25 and FY26, but we believe risks to a lower oil price curve continue to mount given the strong non-OPEC supply response in CY25 and beyond.

Exhibit 1: Global oil supply to increase 660kb/d in CY24E and 2.1mb/d in CY25E



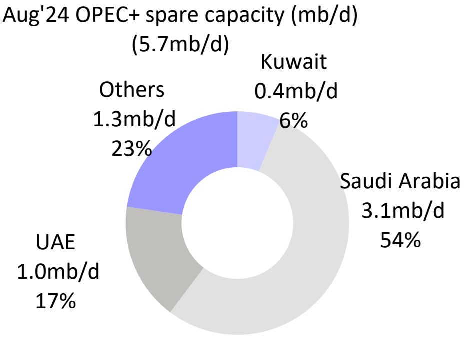
Source: IEA, MOFSL

Exhibit 2: OPEC's surplus crude oil production capacity (mb/d)



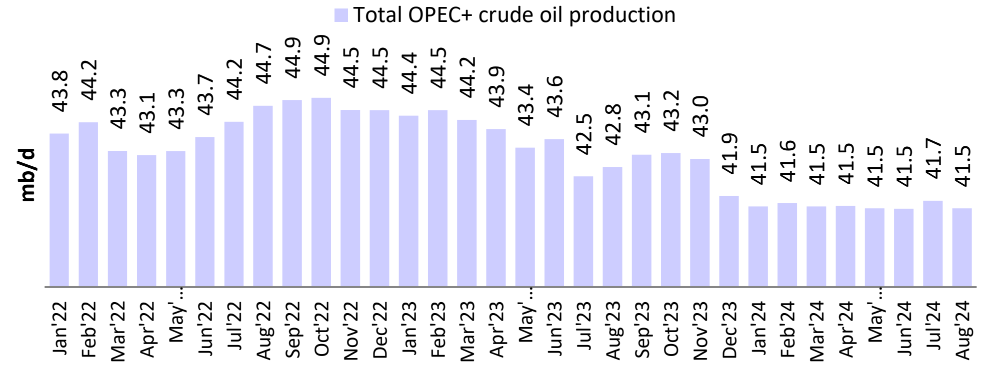
Source: IEA, MOFSL

Exhibit 3: OPEC+ crude production – spare capacity break-up in Aug'24 (mb/d)



Source: IEA, MOFSL

Exhibit 4: OPEC+ crude oil production (mb/d)

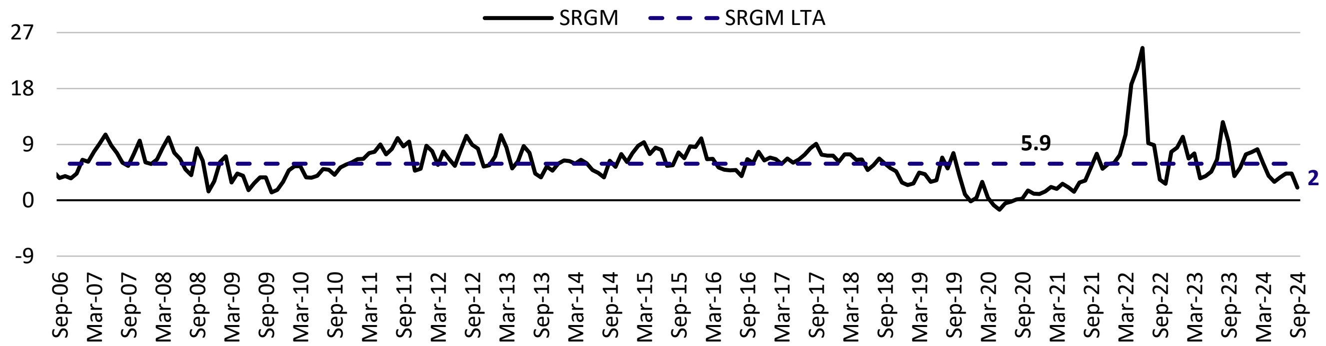


Source: IEA, MOFSL

SG GRM contracts 53% MoM in Sep'24YTD; marketing margin strong

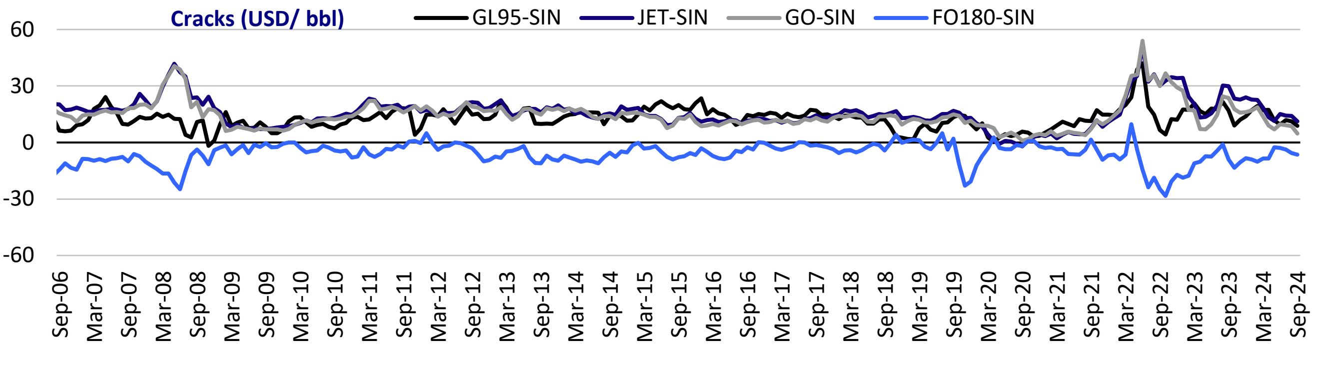
- Refining GRM has contracted 53% MoM in Sep'24YTD, with SG GRM averaging USD2/bbl vs. average of USD4.3/bbl in Aug'24. Gasoline/Jet Oil/Diesel/Fuel Oil cracks have declined 22%/21%/45%/16% MoM during the period. SG GRM currently stands at USD3.2/bbl.
  - SG GRM has averaged USD3.6/bbl in 2QFY25YTD, similar on a QoQ basis. However, fuel oil GRM has averaged negative USD5.3/bbl vs. average of negative USD8.8/bbl (up 38% QoQ) in 1QFY25.
- Meanwhile, the current gross marketing margins are INR12.9/lit for MS and INR12.2/lit for HSD. However, we have modeled gross marketing margins of INR3.3/lit for both MS and HSD.
  - MS and HSD's marketing margins have averaged INR9.5 and INR7.0 per lit in 2QFY25YTD, up 130% and 58% QoQ, respectively.

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



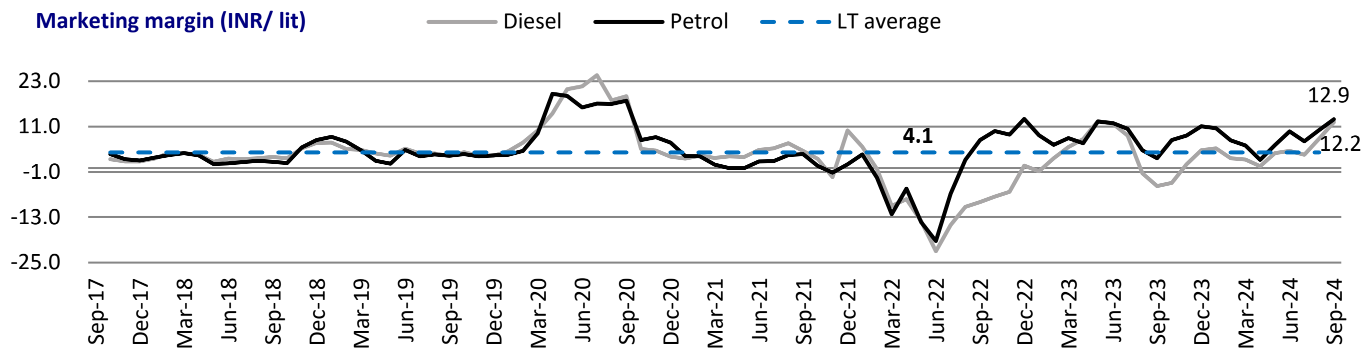
Source: Reuters, MOFSL

Exhibit 6: Various product cracks have declined recently (USD/bbl)



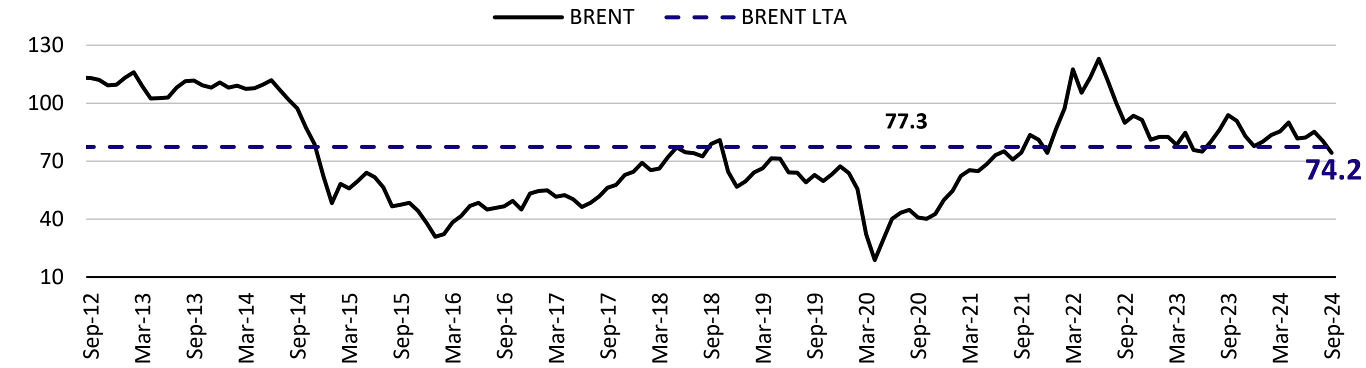
Source: Reuters, MOFSL

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



Source: Bloomberg, MOFSL

Exhibit 8: Brent crude – historical trend (USD/bbl)

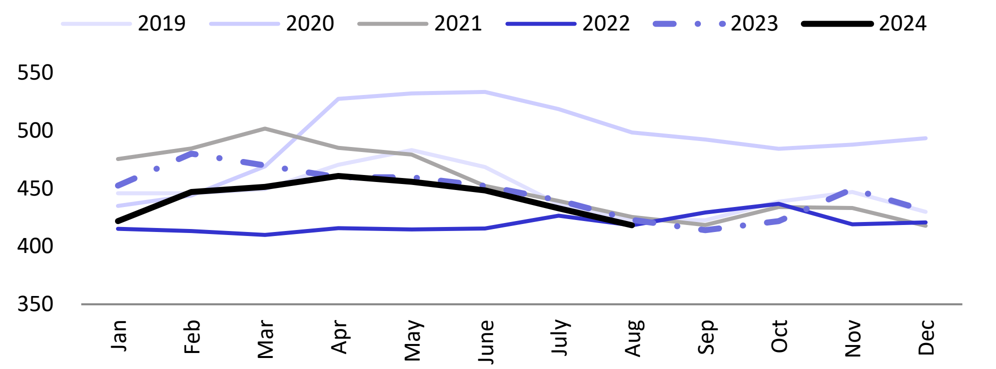


Source: Reuters, MOFSL

Support to crude prices and refining GRMs from moderate inventory levels

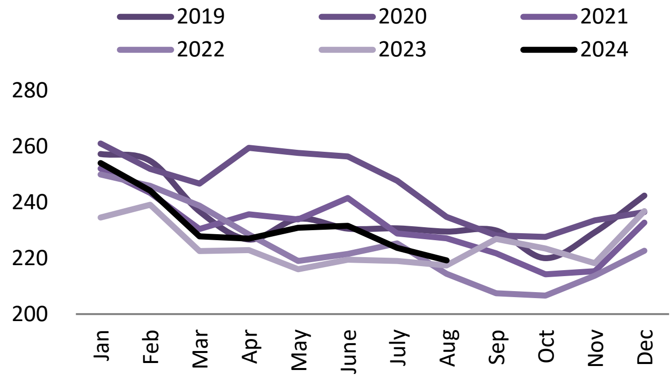
- In Jul'24, global oil inventories decreased by 47.1mb (+ 26.2mb in Jun'24). Total OECD stocks reduced counter-seasonally by 12.3mb, below the five-year average. IEA also stated that preliminary data indicates ongoing stock reductions in Aug'24 as well.
- US crude and gasoline inventories have declined since the past 3-4 months and are now at the lower end of the six-year inventory band (Aug'24-end).
  - Although the US gasoil inventories have marginally increased recently, they still stand on the lower end of the six-year inventory band.
- In Asia, Singapore light and middle distillate inventories, however, are in the middle of the six-year inventory band, indicating a limited downside for refining margins from current levels as we approach the winter season.

Exhibit 9: The US crude inventory levels (million barrels)



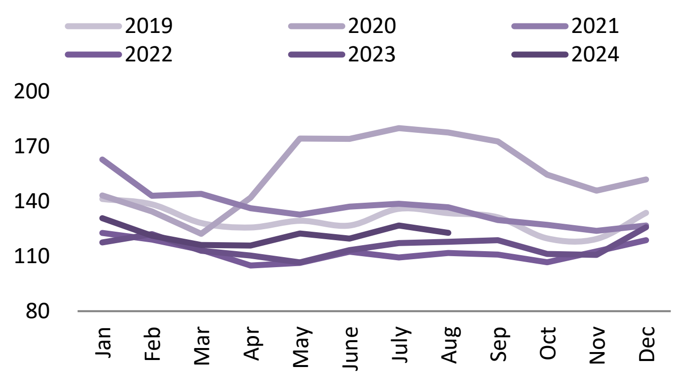
Source: Bloomberg

Exhibit 10: The US gasoline inventory (mb)



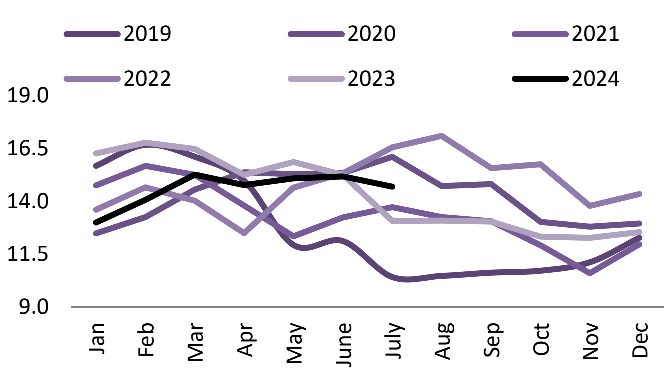
Source: Bloomberg

Exhibit 11: The US gasoil inventory (mb)



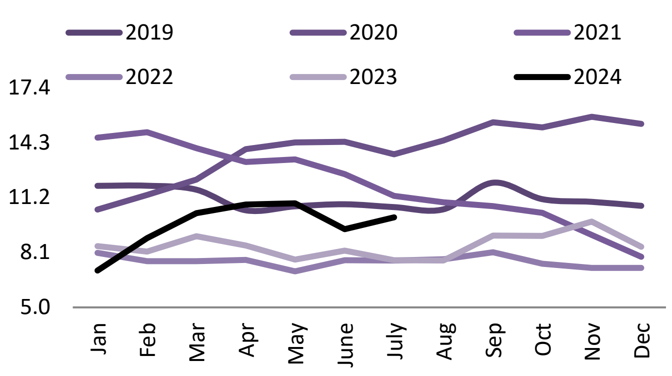
Source: Bloomberg

Exhibit 12: Singapore light distillate inventory (mb)



Source: Bloomberg

Exhibit 13: Singapore middle distillate inventory (mb)



Source: Bloomberg

Risk of MS/HSD price cuts might be overstated

- With strong marketing segment margins, the market is again concerned if OMCs will be pushed to cut retail prices of MS/HSD. We, however, believe this is over-estimated as: 1) the Central government undertook only a marginal price cut before elections that has not had any serious impact on OMCs' profitability until now, and 2) the recent trend has been that individual states going into elections have cut taxes rather than a pan-India retail price cut.
- PSU OMCs had also cut petrol and diesel prices by INR2/lit each on 14th Mar'24, just before the general election. Later, on 28th Jun'24, the Maharashtra government had announced a reduction in diesel tax to 21% from 24% in the Mumbai region, resulting in a price drop of INR2/lit. Additionally, the tax on petrol was lowered to 25% from 26%, leading to a decrease of INR0.65/lit in petrol prices across Mumbai, Navi Mumbai, and Thane.

Upcoming Lok Sabha elections in India

State Name	End of current tenure	Election year
Haryana	4th Nov'24	2024
Maharashtra	26th Nov'24	2024
Jharkhand	05th Jan'25	2025
Delhi	23rd Feb'25	2025

LPG under-recovery levels have largely remained same QoQ

- In the 1QFY25 earnings call, BPCL had guided for LPG under-recovery of INR6b per month. Prices for propane/butane averaged INR585/INR568 per ton in 2QFY25YTD, leading to under-recovery estimates of INR5.4b/INR5.2b/INR8.7b per month for HPCL/BPCL/IOCL.
- Every USD100/ton change in propane price leads to an additional 1.2x under-recovery of HPCL, BPCL, and IOCL.
- Note that we have already accounted for this under-recovery in our earnings estimates (to be on the conservative side). We continue to believe that the losses will likely be recovered from the government later in 2HFY25. As such, there is an upside risk to our FY25 PAT estimates for all three OMCs.

Valuation and view – HPCL, GAIL, and OINL remain our top picks

- **HPCL** remains our preferred pick among the three OMCs. We believe that a combination of stable crude oil prices and refining GRMs presents the potential for OMCs to achieve supernormal profits, which are not currently reflected in street estimates. We model a marketing margin of INR3.3/lit for both MS and HSD in FY25-26E, while current gross marketing margins are INR12.9/lit for MS and INR12.2/lit for HSD. We see the following as major catalysts for the stock: 1) demerger and potential listing of the lubricant business, 2) commissioning of its bottom upgrade unit in Oct'24 (leading to ~USD 2/bbl higher GRMs), and 3) start of its Rajasthan refinery in 4QFY25-end.
- HPCL currently trades at 1.5x FY26E P/B, which we believe offers a reasonable margin of safety as we estimate FY26E RoE of 18.3%. Our SoTP-based TP includes:
  - The standalone refining and marketing business at 6.7x FY26 EV/EBITDA;
  - INR33/share as potential value unlocking from de-merger of the lubricant business;
  - HMEL at 8x P/E based on its FY24 PAT (HPCL's share), deriving a value of INR35/share; and
  - Chhara Terminal at 1x P/B, and HPCL's HRRL stake at 0.5x of HPCL's equity investment in the project to date. MRPL stake is valued at MOFSL's TP.

  Accordingly, we arrive at our TP of INR460. Reiterate BUY.

HPCL's SoTP-based valuation

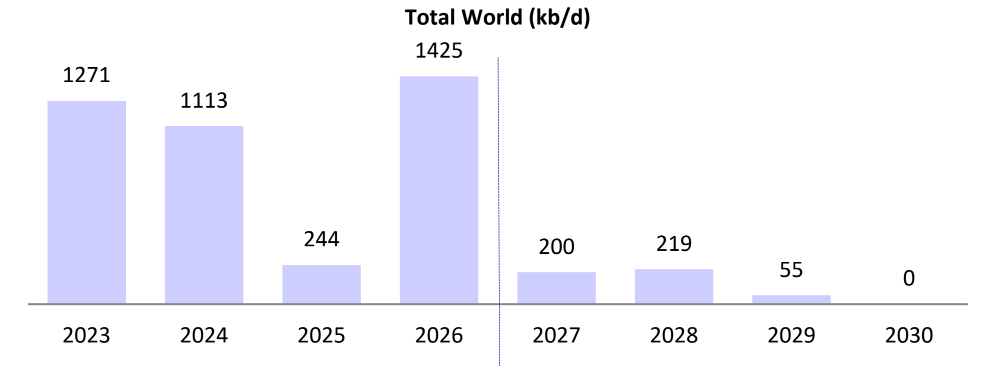
Particularvs	Earning metric		Valuation metric	Multiple	Amount (INR m)
HPCL standalone	FY26E EBITDA	1,90,887	EV/EBITDA	6.7	12,76,652
(-) Standalone FY26E net debt					5,85,492
Standalone market cap					6,91,160
+ Lubricant business – value unlocking	FY24 EBITDA	10,000	EV/EBITDA	7.0	70,000
+ MRPL	MOFSL TP	50,504			50,504
+ HMEL	FY24 PAT	9,310	P/E	8.0	74,480
+ Chhara terminal	Book Value	12,232	P/B	1.0	12,232
+ HRRL	Equity invested to date		P/B	0.5	80,000
SoTP					9,78,375
(/) shares outstanding					2,128
TP (INR/share)					460

- **GAIL: We reiterate our BUY rating on GAIL with a TP of INR275/share.** During FY24-26E, we are modeling an 11% CAGR in PAT driven by:
  - Rising natural gas transmission volumes to 142mmscmd in FY26 from 120mmscmd in FY24;

- Substantial improvement in petchem segment's profitability over 2HFY25- FY26 as new petchem capacity will be operational and low inventories globally will drive re-stocking demand, thus improving spreads; and
- Healthy trading segment profitability with guided EBIT at INR40-45b.
  We expect GAIL's RoE to improve to ~15% in FY26 from 9.5% in FY23, with healthy FCF generation of INR46b in FY26 (vs. -INR45.3b in FY23), which we believe can drive a re-rating for the stock. **Reiterate BUY**.

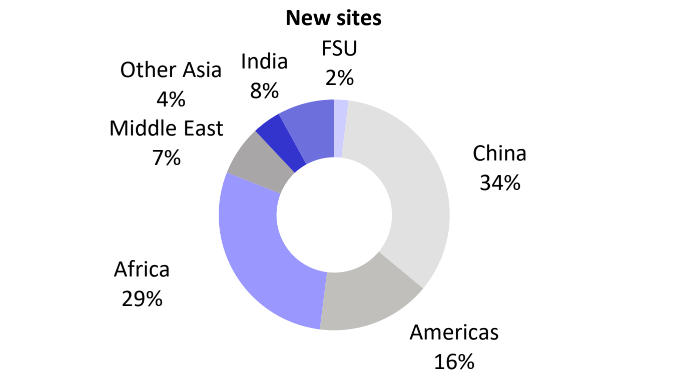
- **OINL:** Production growth guidance remains robust, with drilling activity and development wells in old areas contributing to this growth. OINL is also applying new technologies to grow production. Capacity expansion for NRL (from 3mmt to 9mmt) would also be completed by Dec'25E, which will drive further growth.
- OINL remains a strong conviction at 1.7x FY26E P/B (standalone) valuation. It is a unique play that is likely to benefit from the strong multi-year uptrend in both upstream and refining segments. The stock currently trades at a P/E multiple of 10.5x FY26E EPS and 7.8x FY26E EV/EBITDA. We value the stock at 10x FY26E standalone adj. EPS and add investments to arrive at our TP of INR740. **Reiterate BUY.**

Exhibit 14: World's net refining capacity additions and expansions (3.3mb/d), 2023-30



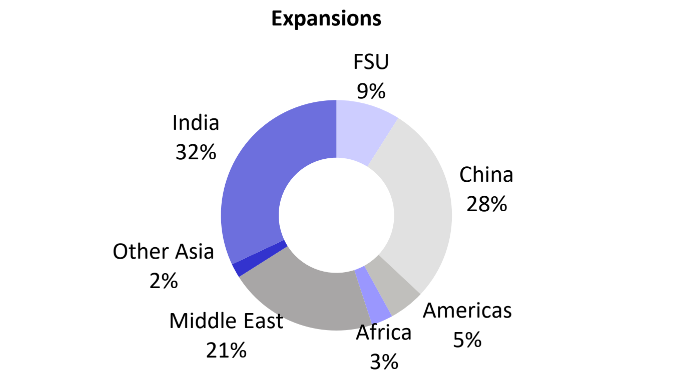
Source: IEA, MOFSL

Exhibit 15: Additions in CDU capacity by region, 2023-30



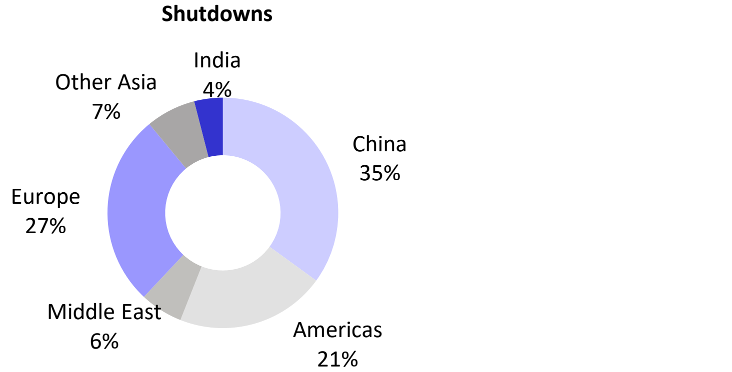
Source: IEA, MOFSL

Exhibit 15: Expansions in CDU capacity by region, 2023-30



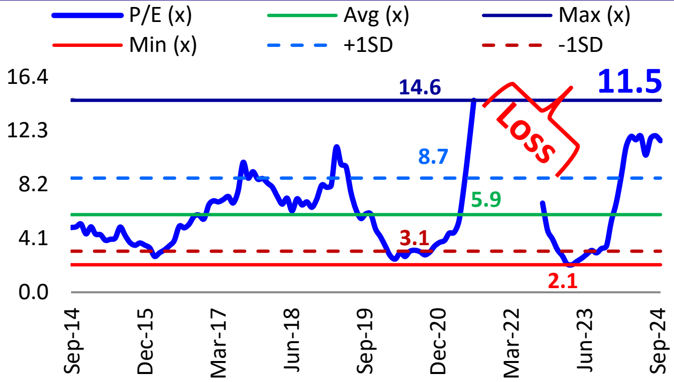
Source: IEA, MOFSL

Exhibit 16: Shutdowns in CDU capacity by region, 2023-30



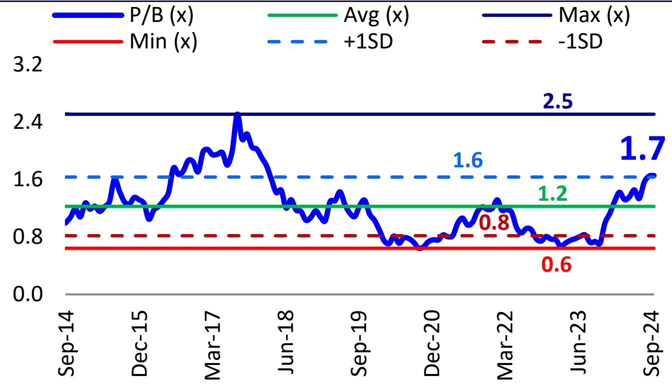
Source: IEA, MOFSL

Exhibit 17: One-year forward P/E ratio – HPCL



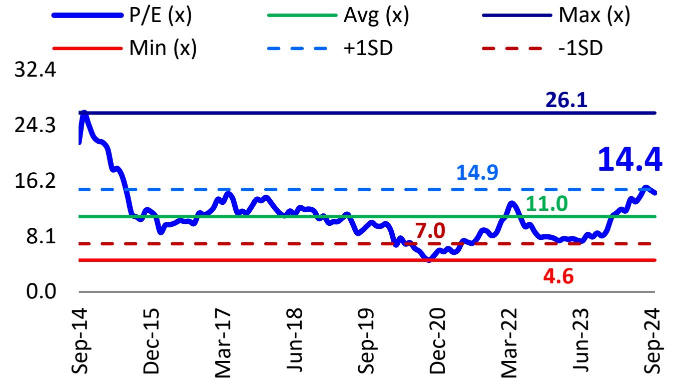
Source: Company, MOFSL

Exhibit 18: One-year forward P/B ratio – HPCL



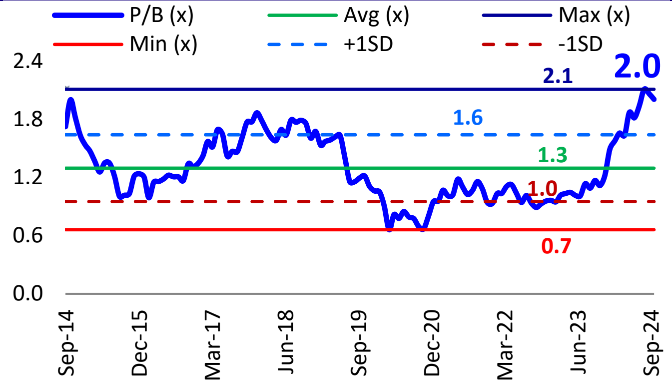
Source: Company, MOFSL

Exhibit 19: One-year forward P/E ratio – GAIL



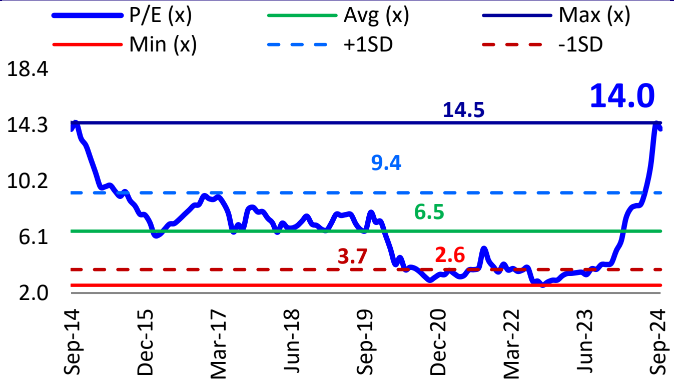
Source: Company, MOFSL

Exhibit 20: One-year forward P/B ratio – GAIL



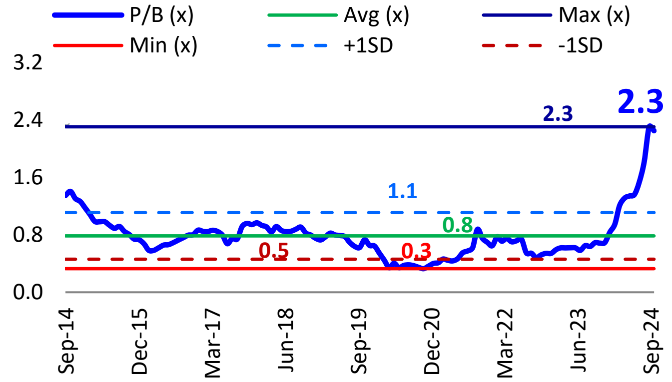
Source: Company, MOFSL

Exhibit 21: One-year forward P/E ratio – OINL



Source: Company, MOFSL

Exhibit 22: One-year forward P/B ratio – OINL



Source: Company, MOFSL

HPCL: Financial summary and assumptions – BUY (TP: INR460)

Financials & Valuations								(INR b)
Y/E March	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25E**	**FY26E**
Sales	2,755	2,691	2,332	3,499	4,407	4,339	4,063	3,962
EBITDA	115	57	160	102	-72	249	131	192
Adj. PAT	67	36	107	73	-70	160	57	100
Adj. EPS (INR)	31	17	50	34	-33	75	27	47
EPS Gr. (%)	-7	-46	193	-32	PL	LP	-64	76
BV/Sh.(INR)	143	146	179	195	152	220	240	274
Ratios								
Net D:E	0.8	1.3	1.1	1.1	2.1	1.3	1.3	1.1
RoE (%)	23.9	11.9	30.9	18.4	-19.0	40.4	11.6	18.3
RoCE (%)	12.9	12.0	14.9	8.3	-7.8	15.9	5.5	8.5
Payout (%)	43.0	76.0	30.3	27.2	0.0	27.9	26.7	28.4
Valuations								
P/E (x)	13.2	24.3	8.3	12.1	-12.7	5.5	15.6	8.9
P/BV (x)	2.9	2.9	2.3	2.1	2.7	1.9	1.7	1.5
EV/EBITDA (x)	9.9	22.6	8.2	13.0	-21.5	6.1	11.7	8.0
Div. Yield (%)	2.5	1.6	3.6	2.2	0.0	5.0	1.7	3.2
FCF Yield (%)	-3.1	-9.4	7.0	4.3	-14.5	15.7	1.4	6.4

Key Assumptions

Particulars	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Exchange Rate (INR/USD)	70.0	70.9	74.3	74.5	80.4	82.8	84.0	85.0
Brent Crude (USD/bbl)	70.1	61.2	44.4	80.5	96.1	83.0	78.7	75.0
Market Sales (MMT)	38.7	39.6	36.6	39.1	43.5	46.8	48.7	50.6
YoY (%)	*5*	*2*	*(8)*	*7*	*11*	*8*	*4*	*4*
GRM (USD/bbl)	5.0	1.0	3.9	7.2	12.1	9.1	7.4	8.1
Singapore GRM (USD/bbl)	4.9	3.2	0.5	5.0	10.7	6.6	5.5	6.0
Prem/(disc) (USD/bbl)	*0*	*(2)*	*3*	*2*	*1*	*2*	*1.9*	*2.1*
Total Refinery throughput (MMT)	18.4	17.2	16.4	14.0	19.1	22.3	23.0	23.0
YoY (%)	*1%*	*-7%*	*-4%*	*-15%*	*37%*	*17%*	*3%*	*0%*
Refining capacity utilization (%)	117%	109%	104%	88%	85%	91%	94%	94%
Blended marketing margin incld inventory (INR/lit)	4.3	4.0	6.3	4.3	(0.8)	5.4	3.6	4.5
Consolidated EPS	**31.4**	**17.1**	**50.1**	**34.3**	**-32.8**	**75.2**	**26.7**	**47.0**

Source: Company, MOFSL

GAIL: Financial summary and assumptions – BUY (TP: INR275)

Financial & Valuation Summary								(INR b)
Y/E March	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25E**	**FY26E**
Sales	751.3	718.8	567.4	916.5	1,443.0	1,306.4	1,382.5	1,399.9
EBITDA	95.3	83.7	64.5	138.3	67.0	134.8	146.2	160.7
Adj. PAT	63.3	74.2	49.0	102.9	53.0	90.2	100.5	111.5
Adj. EPS (INR)	9.6	11.3	7.4	15.6	8.1	13.7	15.3	17.0
EPS Gr. (%)	33.6	17.3	-34.0	110.1	-48.5	70.1	11.5	10.9
BV/Sh.(INR)	68.1	73.0	77.1	89.5	93.5	101.8	110.9	121.1
Ratios								
Net D:E	0.0	0.1	0.1	0.1	0.2	0.2	0.2	0.2
RoE (%)	14.3	15.0	10.8	20.3	9.5	15.0	15.0	15.2
RoCE (%)	13.1	12.6	9.0	17.0	7.9	11.9	11.7	11.7
Payout (%)	34.7	51.3	45.0	21.3	49.6	40.1	40.1	40.1
Valuations								
P/E (x)	23.4	20.0	30.3	14.4	28.0	16.4	14.7	13.3
P/BV (x)	3.3	3.1	2.9	2.5	2.4	2.2	2.0	1.9
EV/EBITDA (x)	4.5	10.5	12.2	6.4	16.1	9.5	8.6	7.7
Div. Yield (%)	1.2	1.9	1.5	1.5	1.8	2.4	2.7	3.0
FCF Yield (%)	0.5	1.0	2.1	2.0	-3.1	3.2	2.4	3.1

OINL: Financial summary and assumptions – BUY (TP: INR740)

Financials & Valuation								INR b
Y/E march	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Sales	137.3	121.3	86.2	145.3	232.7	221.3	236.3	251.0
EBITDA	54.8	43.7	12.7	53.7	96.8	92.6	111.1	126.1
Adj. PAT	36.2	25.8	21.9	38.9	68.1	79.1	79.2	90.0
Adj. EPS (INR)	22.2	15.9	13.5	23.9	41.9	48.7	48.7	55.3
EPS Gr. (%)	35.6	-28.6	-15.2	77.5	75.2	16.2	42.6	13.6
BV/Sh.(INR)	170.6	149.9	161.1	183.8	211.3	271.3	305.0	343.2
Ratios								
Net D:E	0.0	0.2	0.6	0.4	0.3	0.2	0.1	0.1
RoE (%)	9.3	9.9	6.9	13.9	21.2	14.1	16.9	17.1
RoCE (%)	6.8	3.6	-1.6	6.8	13.5	11.6	11.1	11.6
Payout (%)	51.7	53.5	37.5	47.8	39.8	30.8	30.8	30.8
Valuations								
P/E (x)	26.0	36.4	43.0	24.2	13.8	11.9	11.9	10.5
P/BV (x)	3.4	3.9	3.6	3.1	2.7	2.1	1.9	1.7
EV/EBITDA (x)	17.4	22.7	86.0	19.6	10.7	11.1	9.1	7.8
Div. Yield (%)	1.2	1.2	0.6	1.6	2.9	1.8	2.6	2.9
FCF Yield (%)	2.7	2.7	-0.8	3.4	4.5	4.0	5.4	6.2

Key Assumptions - OINL

Particulars	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E
Exchange Rate (INR/USD)	64.5	64.5	74.3	74.5	80.4	80.4	84.0	85.0
APM Gas Price (USD/mmbtu)	3.5	3.8	2.2	2.6	7.3	6.5	6.7	7.0
Brent Crude Price (USD/bbl)	70.1	61.2	44.4	80.5	96.1	83.0	78.7	75.0
Production Details								
Oil (mmt)	3.32	3.13	2.96	3.01	3.18	3.36	3.53	3.70
Gas (bcm)	2.72	2.77	2.48	2.89	3.18	3.18	3.66	4.21
Total (mmtoe)	**6.05**	**5.90**	**5.44**	**5.90**	**6.36**	**6.54**	**7.19**	**7.91**
Subsidy Sharing (INRb)	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Oil Price Realization (USD/bbl)								
Net	**68.5**	**60.8**	**44.3**	**78.8**	**85.2**	**75.7**	**73.0**	**73.0**
Change (%)	*23%*	*-11%*	*-27%*	*78%*	*8%*	*-11%*	*-4%*	*0%*
EPS (INR/sh.)	**22.2**	**15.9**	**13.5**	**23.9**	**41.9**	**48.7**	**48.7**	**55.3**

Source: Company, MOFSL

N O T E S

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
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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