Oil & Gas

Our latest O&G updates

Pockets of value re-emerging

- In Jun'24, we had highlighted that valuations for O&G stocks had surged and the value trade was fading away. In the last seven months, valuations have corrected sharply, with the average **one-year fwd. P/E for O&G stocks (excl. RIL) at 7.7x**, **down 34% vs. Jun'24** (and below 10-year mean now).
- We see a **limited risk of sharp earnings downgrades** to FY26 numbers based on the following factors: 1) Even the most bearish crude oil price estimates of USD60/bbl imply 9.6%/11.9% FY26E ROE for ONGC (SA)/OINL; 2) Marketing margins in our model for MS/HSD are already at a 45%-65% discount to prevailing margins; and 3) The bulk of APM de-allocation shock for CGDs is behind now. INR depreciation is a risk for OMCs, but it is largely offset by lower crude price risk in 2HCY25. Dividend yields for OMCs, ONGC and GAIL are now in the attractive 4-6% range and close to the 10-year average.
- **GAIL** now trades at 8.5x FY27E PE with a 4.4% FY26 dividend yield. We believe strong marketing demand, steady transmission volume growth, transmission tariff hikes in 1QFY26, and the start of petchem facilities in 2HFY26 are key catalysts.
- **HPCL** continues to enjoy strong marketing business momentum, with the commissioning of the bottom-upgrade project slated in 4QFY25.
- **BPCL:** Lastly, we highlight BPCL (Neutral) has corrected 32% in the past five months and now trades at mean – 1 SD (on 1 yr. fwd. PB basis) with a ~6% FY26E dividend yield. BPCL now trades at par with HPCL vs. a historical average premium of 50% (1y fwd. P/B basis).

After recent corrections, pockets of value are re-emerging

- In Jun'24, in our report titled "Value trade is fading away," we had highlighted elevated valuations in the O&G sector as the average one-year fwd. P/E for the 15 O&G stocks (incl. RIL) under our coverage was up 76% vs. Jun'23. For O&G stocks (excl. RIL) under our coverage, the average one-year fwd. P/E was up a staggering 155% YoY in Jun'24.
- In the last seven months, after widespread selloffs in the energy space, valuations have corrected sharply. The average one-year fwd. P/E for O&G stocks (excl. RIL) stands at **7.7x**, **down 34% vs. Jun'24** (10y LTA one-year fwd. P/E valuation is **8.5x**).
- The current valuations are still far off from the 10-year trough levels, though we think earnings should largely hold up (and stocks are unlikely to move toward 10 yr. low valuations), as 1) even the most bearish crude oil price forecasts in CY25/CY26 are above USD 60/bbl; 2) we are building in gross marketing margins on MS/HSD of INR3.3/lit; actual margins have sustained and could come in higher than these numbers; and 3) the bulk of APM de-allocation shock for CGDs is behind now.

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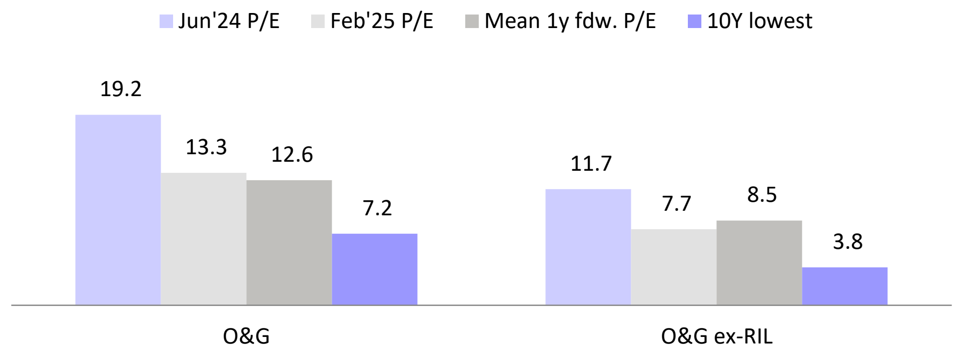
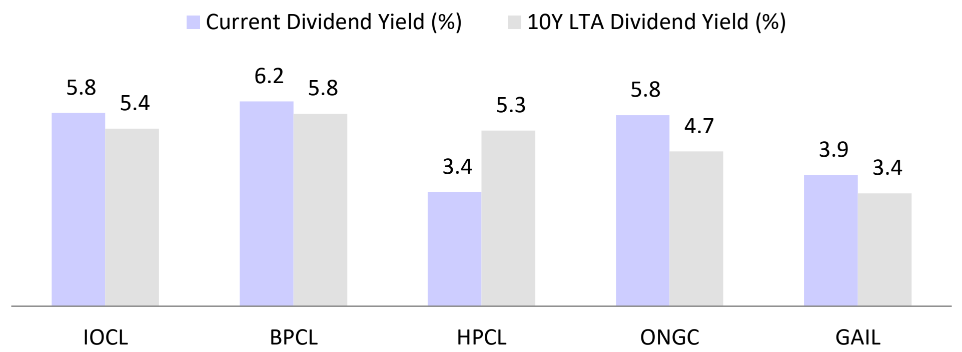
Exhibit 1: Valuations have corrected over the past seven and half months



Source: Company, MOFSL

- Since Jun'24, O&G stocks have declined 6%-49% — OMCs down 6%-28%, upstream entities down 13%-19%, CGDs down 11%-33%, gas utilities down 6%-23%, and RIL down 16%.
- Given the sharp de-rating, dividend yields are now at attractive levels and have risen to ~6% for IOCL/BPCL and ~4-5% for ONGC and GAIL (slightly above the historical average).

Exhibit 2: Dividend Yield (%) - O&G stocks



Source: Bloomberg, MOFSL

Oil prices: Looking beyond the immediate strength

- US EIA forecasts Brent crude oil prices to average **USD74/bbl** in CY25, down 8% YoY, and to further decline by 11% YoY to **USD66/bbl** in CY26.
- While there has been some upward pressure on crude oil prices in Jan'25 (averaging USD79/bbl), US EIA anticipates that crude oil prices will decline from mid-CY25 through the end of CY26, as global oil production grows faster than oil demand.
- Production growth will be driven by the unwinding of spare capacity by OPEC+ starting in 2QCY25 and a sequential rise in production by non-OPEC+. US EIA believes that this production growth, coupled with relatively weak growth in oil demand, will cause global oil inventories to accumulate from mid-CY25 through CY26. Global inventories will increase by an average of 0.9mb/d in 2HCY25 and by 1mb/d in CY26. Increasing inventories will put further downward pressure on prices.
- We had first highlighted the rising pressure on crude oil prices in Jun'24 (Has the crude oil party peaked?) and continue to believe that Brent oil prices will face strong headwinds in 2HCY25 and beyond.

Exhibit 3: US EIA short-term energy outlook – Feb'25 forecast

Feb 25 forecasts	2024	2025	2026	2025/24	2026/25
Global oil consumption increase (mb/d)		1.40	1.00		-29%
Brent crude oil spot price (USD/bbl)	81.00	74.00	66.00	-9%	-11%
U.S. crude oil production (mb/d)	13.20	13.60	13.70	3%	1%
Natural gas price at Henry Hub (USD/mmbtu)	2.20	3.80	4.20	73%	11%
U.S. liquefied natural gas gross exports (bcf/d)	12.00	14.00	16.00	17%	14%

Source: U.S. EIA STEO, MOFSL

	Change vs previous forecast		
	2024	2025	2026
Global oil consumption increase (mb/d)		8%	-9%
Brent crude oil spot price (USD/bbl)	0%	0%	0%
U.S. crude oil production (mb/d)	0%	1%	1%
Natural gas price at Henry Hub (USD/mmbtu)	0%	23%	5%
U.S. liquefied natural gas gross exports (bcf/d)	0%	0%	0%

Source: U.S. EIA STEO, MOFSL

Jan 25 forecasts	2024	2025	2026	2025/24	2026/25
Global oil consumption increase (mb/d)		1.30	1.10		-15%
Brent crude oil spot price (USD/bbl)	81.00	74.00	66.00	-9%	-11%
U.S. crude oil production (mb/d)	13.20	13.50	13.60	2%	1%
Natural gas price at Henry Hub (USD/mmbtu)	2.20	3.10	4.00	41%	29%
U.S. liquefied natural gas gross exports (bcf/d)	12.00	14.00	16.00	17%	14%

Source: U.S. EIA STEO, MOFSL

OMCs: Forex is a risk but likely to be offset by pressure on crude prices

- MS/HSD marketing margins have averaged INR10/INR6.5 per lit in 4QFY25, with the exchange rate averaging INR86.2/USD. The current MS/HSD marketing margins are INR9.1/INR6.6 per lit. We estimate that for every INR1/USD currency depreciation, MS/HSD gross marketing margins are impacted by INR0.5/INR0.6 per lit (6%/13% vs. current levels).
- Although forex risk persists, we believe it is more than compensated by uncertainties surrounding the crude oil price outlook. We estimate every USD1/bbl change in global MS/HSD prices affects MS/HSD gross marketing margins by INR0.5/INR0.5 per lit (6%/12% vs. current levels).
- We (and most global agencies) are forecasting crude prices to average USD70/bbl in CY25, thus providing upside risks to our gross marketing margin estimate of INR3.3/ltr for MS/HSD. On balance, we believe earnings momentum for OMCs should remain robust in FY26.
- In our models, we assume an exchange rate of INR86/USD in FY26 and INR86.2/USD in FY27 (in line with current exchange rate). Further, we assume crude prices to average USD70/bbl in FY26/FY27.

Exhibit 4: MS/HSD marketing margin sensitivity to exchange rate depreciation

Particulars	Base case	Scenario	Change	% Change
Exchange rate (INR/USD)	86.5	87.5	1.0	1%
Marketing margin (INR/lit)				
MS	9.5	9.0	(0.5)	-6%
HSD	4.7	4.1	(0.6)	-13%

Exhibit 5: MS/HSD marketing margin sensitivity to change in global MS/HSD prices

Particulars	Base case	Scenario	Change	% Change
Average global price				
MS	95.2	94.2	(1.0)	-1%
HSD	84.9	83.9	(1.0)	-1%
Marketing margin (INR/lit)				
MS	9.5	10.1	0.5	6%
HSD	4.7	5.2	0.5	12%

LPG prices are peaking, under-recoveries set to fall

- LPG under-recovery was a key concern for OMCs during 9MFY25, with combined under-recovery for OMCs amounting to INR291.6b (INR143.3/INR72.3b/INR76b for IOCL/BPCL/HPCL).
- As per media reports, OMCs may get INR200b-INR250b as compensation against LPG losses. While, no support was provided in the Union Budget, 2025, we still believe that OMCs might get compensated. In CY22, the government had announced a compensation of INR220b for OMCs for a cumulative loss of INR280b they incurred.
  - Assuming INR200b compensation is received by OMCs in 4Q, INR7/INR12/INR25 would be added to FY25E BVPS of IOCL/BPCL/HPCL.

Exhibit 6: Impact of LPG under-recovery compensation on BVPS of OMCs

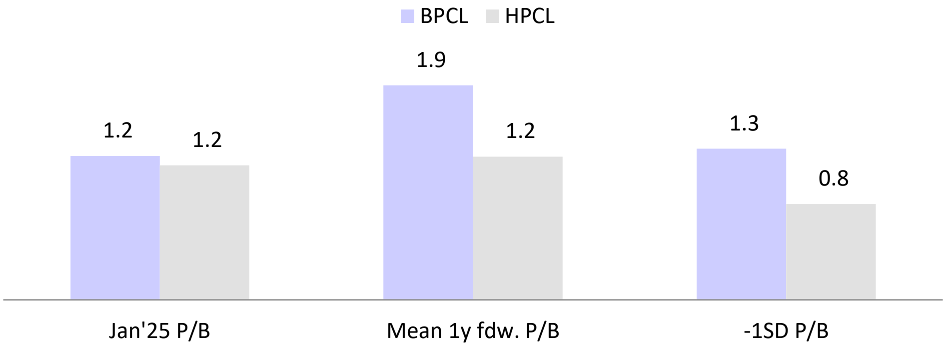
Particulars	IOCL	BPCL	HPCL	Total
9MFY25 LPG under-recovery (INR b)	143	72	76	292
LPG under-recovery %	49%	25%	26%	
Compensation (INR b)	98	50	52	200
Increase in FY25E BVPS	**7**	**12**	**24**	
Increase in FY25E BVPS (%)	**5%**	**6%**	**10%**	

- In 4QFY25, even if LPG prices rise by USD100/t from the current levels (not our base case), we estimate the impact on FY25E BVPS at only INR1-INR3 for OMCs.
  - As per our estimate, LPG under-recovery per 14.2kg cylinder stood at INR176 in 3QFY25. With average propane prices stable QoQ so far in 4QFY25 at USD635/ton, we estimate LPG under-recovery to also remain stable in 4Q.
  - Beyond 4Q, we believe that propane prices should start correcting, leading to higher earnings momentum for OMCs.

BPCL: Preferred Neutral-rated stock; at discount vs. premium to HPCL

- We have BPCL, PLNG and IGL as Neutral rated stocks in our coverage. The three stocks have delivered a return of -10% to +58% in the last two years.
- BPCL remains our preferred Neutral-rated stock. It now trades at par with HPCL (on 1-yr fwd. P/B basis) vs. a historical premium of 50%. The current valuation at 1.2x P/B is also marginally below its mean – 1 S.D. The dividend yield in FY27E is attractive at ~6%; we assume ~50% payout here and we think the payout ratio is unlikely to be lowered materially. While the commencement of a new capex cycle means cash flows and the balance sheet will face some stress, we do highlight healthy marketing business momentum and attractive valuations.

Exhibit 7: BPCL trades at par with HPCL vs. historical average premium of 50% (P/B basis)

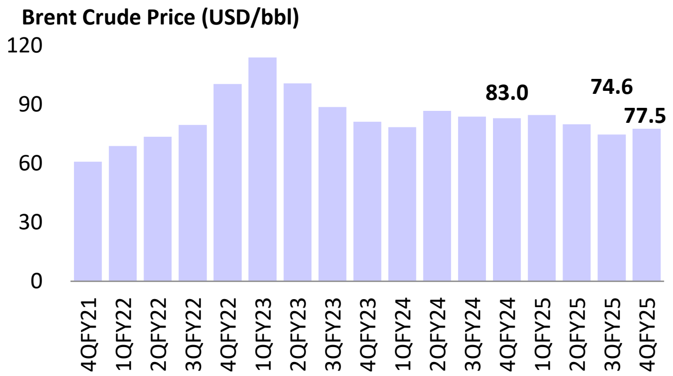


Source: Bloomberg, MOFSL

Our top picks: HPCL and GAIL

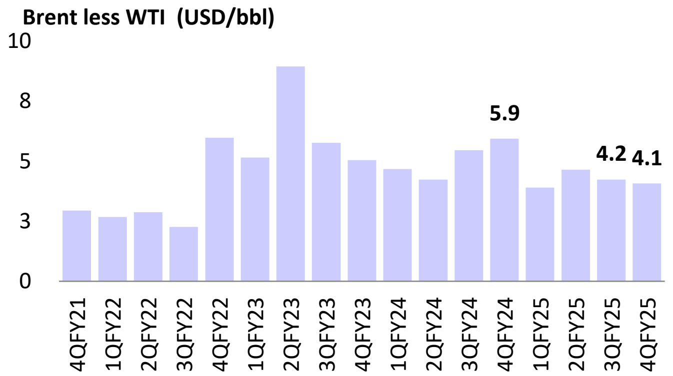
- **HPCL** remains our preferred pick among the three OMCs. We model a marketing margin of INR3.3/lit for both MS and HSD in FY26/FY27, while the current MS and HSD marketing margins are INR9.1/lit and INR6.6/lit, respectively. We view the following as key catalysts for the stock: 1) the de-merger and potential listing of the lubricant business, 2) the commissioning of its bottom-upgrade unit in 4QFY25, 3) the start of its Rajasthan refinery in CY25, and 4) LPG under-recovery compensation.
- HPCL currently trades at 1.3x FY26E P/B, which we believe offers a reasonable margin of safety as we estimate FY26E RoE of 17.3%.
- Our SoTP-based TP includes:
  - The standalone refining and marketing business at 6.5x Dec'26E EBITDA.
  - INR38/sh as potential value unlocking from the de-merger of the lubricant business.
  - HMEL at 8x P/E is based on its FY24 PAT (HPCL's share), deriving a value of INR35/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; MRPL's stake is valued at MOFSL's TP.
  - All these lead to a **revised TP of INR490**. **Reiterate BUY.**
- **GAIL:** We **reiterate our BUY rating** on GAIL with a TP of INR255. During FY24-27, we estimate a 15% CAGR in PAT driven by:
  - an increase in natural gas transmission volumes to 154mmscmd in FY27 from 120mmscmd in FY24;
  - substantial improvement in petchem segment's profitability over 2HFY25- FY27 as the new petchem capacity will be operational and spreads are bottoming out;
  - healthy trading segment's profitability with guided EBIT of at least INR45b.
- We expect GAIL's RoE to improve to ~16% in FY26 from 9.5% in FY23, with a healthy FCF generation of INR81b in FY26 (vs. -INR45.3b in FY23), which we believe can support its valuations.
- Our SoTP-based TP includes:
  - the gas transmission business at 9x FY27E EBITDA of INR95b,
  - LPG transmission business at 8x FY27E EBITDA of INR5b,
  - gas trading business at 6x FY27E EBITDA of INR55b,
  - petrochemical business at 7x FY27E EBITDA of INR28b, and
  - LPG business at 6x FY27E EBITDA of INR19b.
  - Adding the value of listed and unlisted investments of INR267b and adjusting FY27E ND of INR132b, we arrive at our revised TP of INR255.

Exhibit 8: Brent Crude Price (USD/bbl)



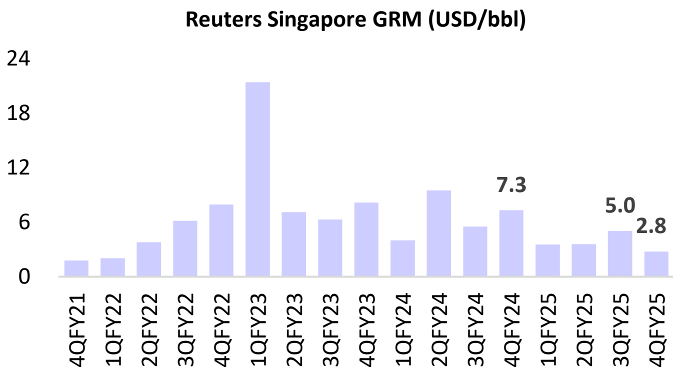
Source: Reuters, MOFSL

Exhibit 9: Brent less WTI (USD/bbl)



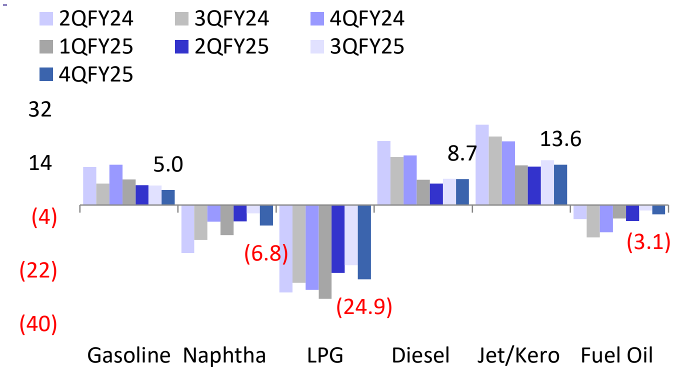
Source: Reuters, MOFSL

Exhibit 10: Singapore GRM (USD/bbl)



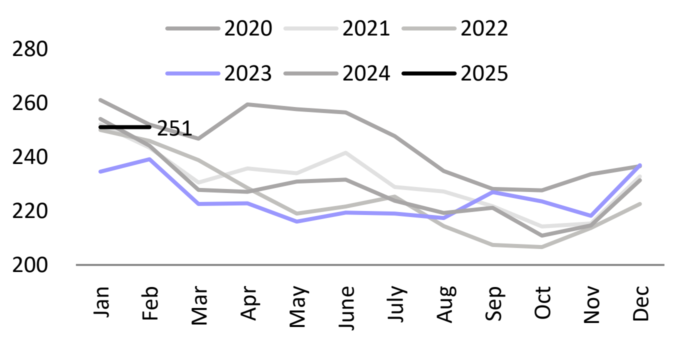
Source: Reuters, MOFSL

Exhibit 11: Various product cracks over Dubai crude (USD/bbl)



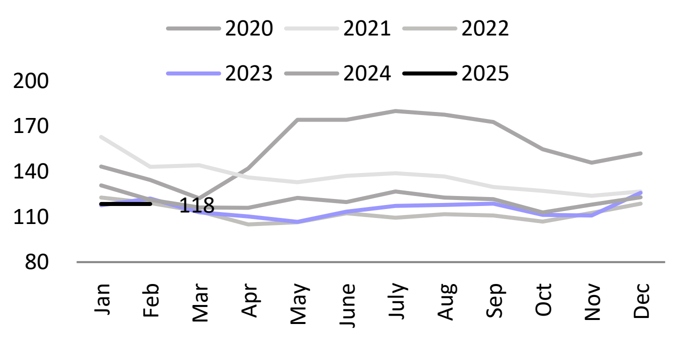
Source: Reuters, MOFSL

Exhibit 12: US gasoline inventory (mb)



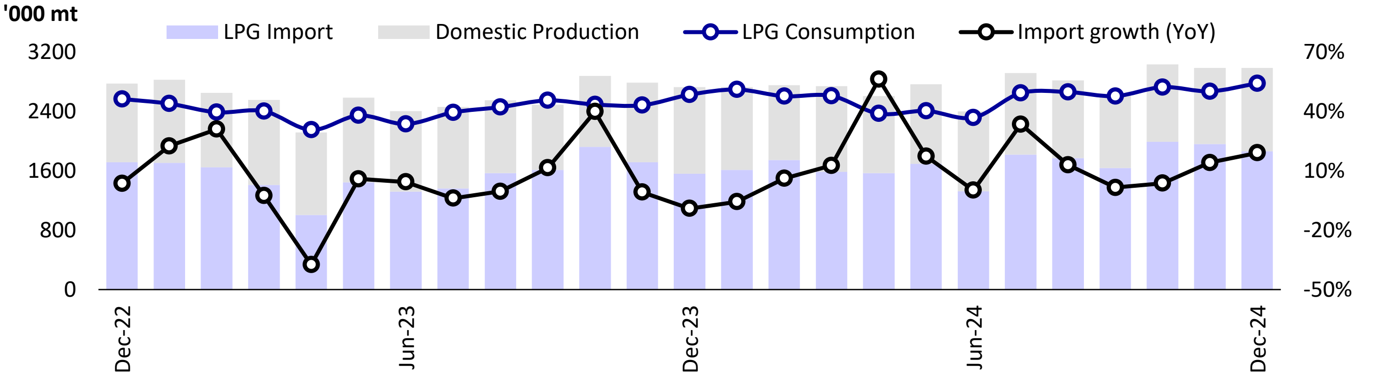
Source: Reuters, MOFSL

Exhibit 13: US gasoil inventory (mb)



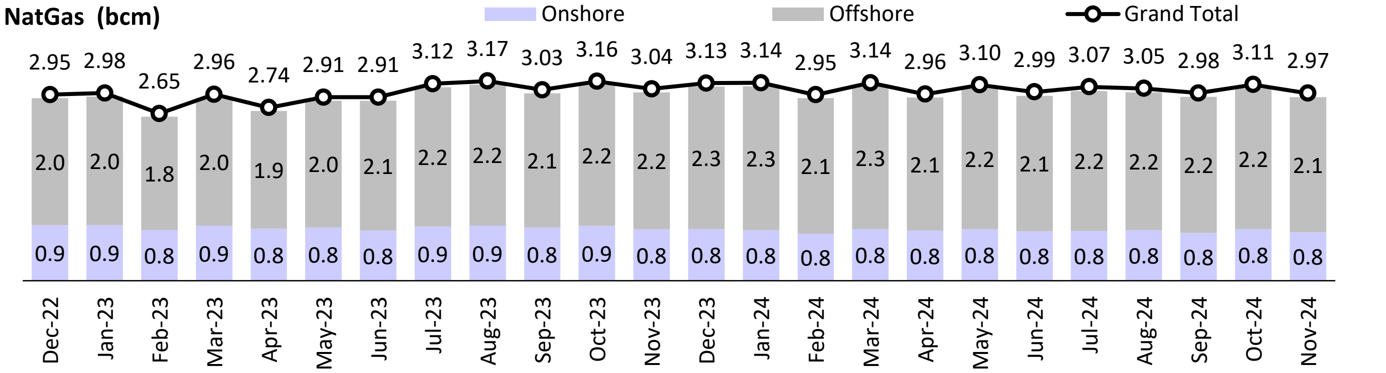
Source: Reuters, MOFSL

Exhibit 14: LPG import, production and consumption trend



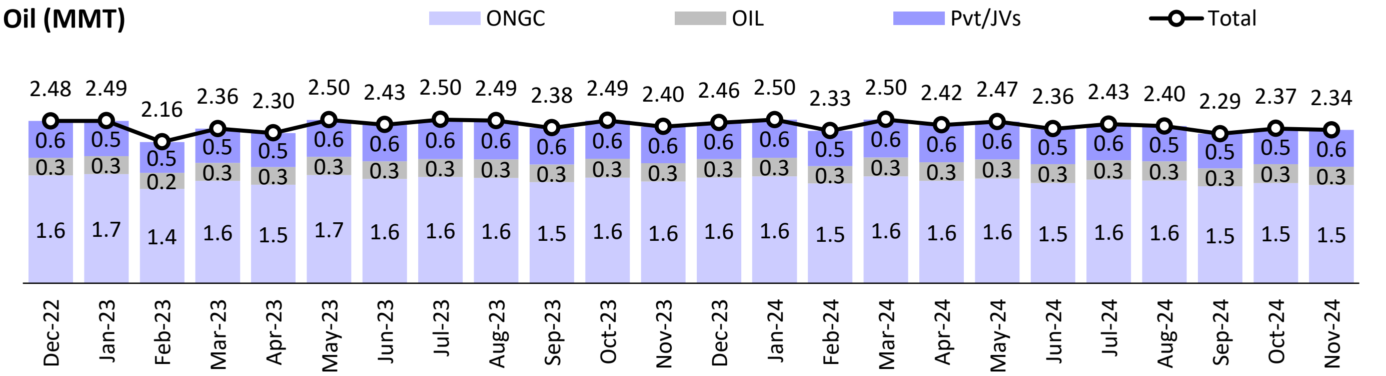
Source: PPAC, MOFSL

Exhibit 15: India's Natural Gas production



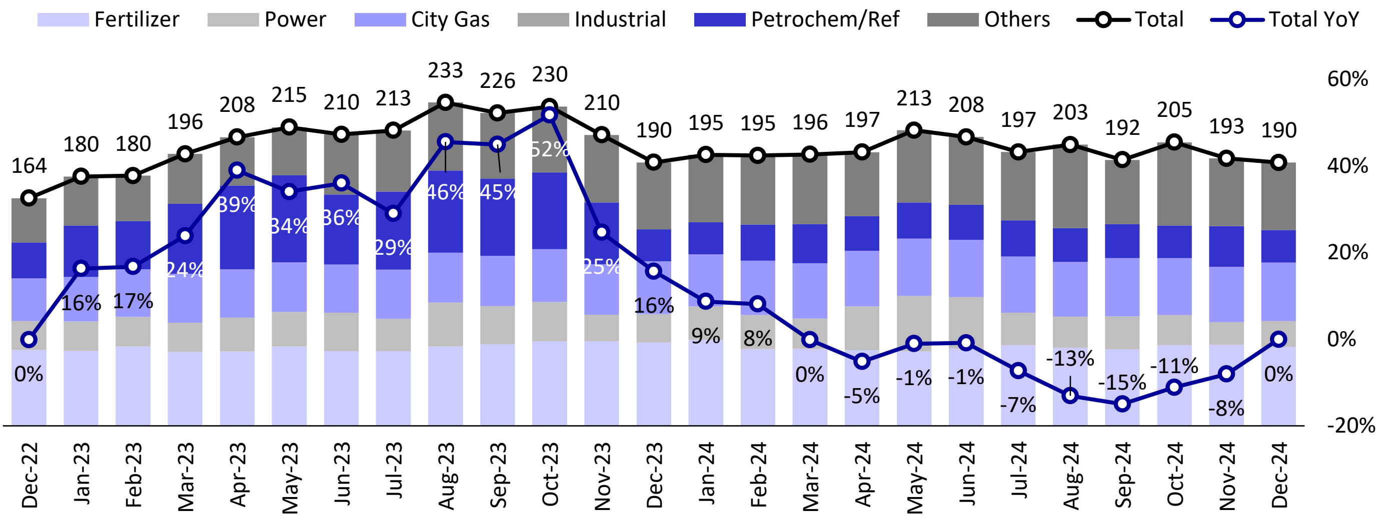
Source: PPAC, MOFSL

Exhibit 16: India's Crude Oil production



Source: PPAC, MOFSL

Exhibit 17: Sector-wise Natural Gas consumption in India (mmscmd)



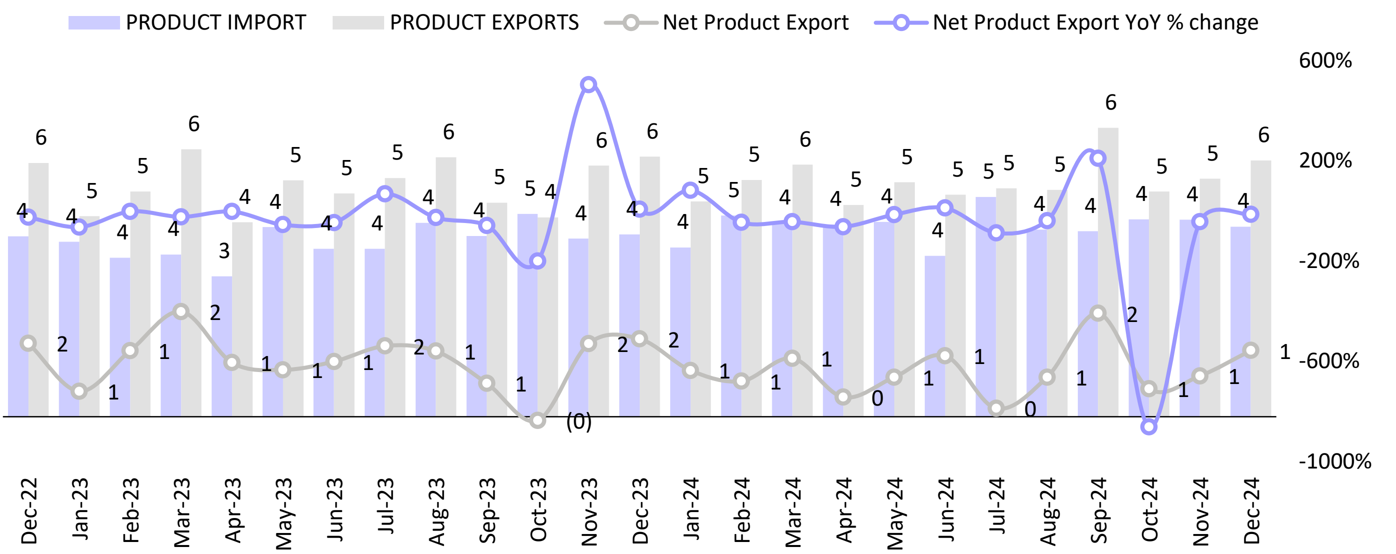
Source: PPAC, MOFSL

Exhibit 18: Sector-wise Domestic Gas vs LNG consumption in India (mmscmd)

	Domestic Gas			LNG			Total		
	Dec-24	**Dec-23**	**Nov-24**	**Dec-24**	**Dec-23**	**Nov-24**	**Dec-24**	**Dec-23**	**Nov-24**
Fertilizer	8.6	8.1	8.5	48.3	52.1	50.0	57.0	60.2	58.5
Power	15.4	17.1	14.6	3.1	3.3	1.6	18.5	20.4	16.3
City Gas	24.0	28.0	25.9	18.3	10.2	14.0	42.2	38.1	39.9
Industrial	-	-	-	-	-	-	-	-	-
Petrochem/Ref	8.2	8.5	10.4	15.4	14.5	18.8	23.5	23.0	29.2
Others	37.0	38.1	37.2	11.6	10.1	11.7	48.6	48.3	48.9
Total	**93.2**	**99.8**	**96.6**	**96.6**	**90.1**	**96.2**	**189.8**	**189.9**	**192.9**

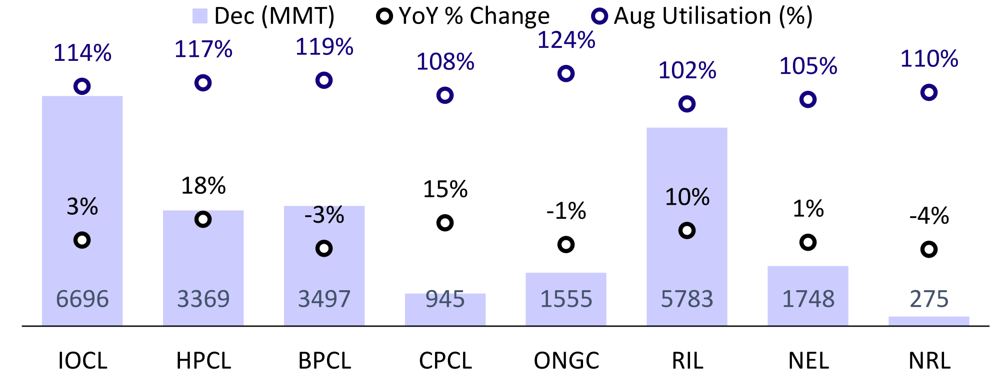
Source: PPAC, MOFSL

Exhibit 19: Refined products' import and export (mmt)



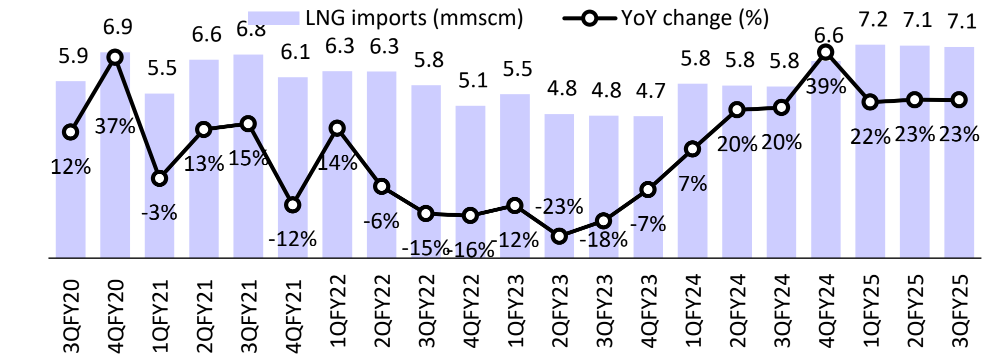
Source: PPAC, MOFSL

Exhibit 20: Throughput & Capacity Utilization – India Refiners



Source: PPAC, MOFSL

Exhibit 21: India's LNG import trend



Source: PPAC, MOFSL

Financials and valuations: HPCL (Target Price: INR490) BUY

Financial Snapshot (IN

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Sales	2,755	2,691	2,332	3,499	4,407	4,339	4,150	3,584	3,675
EBITDA	115	57	160	102	-72	249	147	188	202
Adj. PAT	67	36	107	73	-70	160	66	96	99
Adj. EPS (INR)	31	17	50	34	-33	75	31	45	46
EPS Gr. (%)	-7	-46	193	-32	PL	LP	-59	46	3
BV/Sh.(INR)	143	146	179	195	152	220	244	278	313
Ratios									
Net D:E	0.8	1.3	1.1	1.1	2.1	1.3	1.2	1.1	0.9
RoE (%)	23.9	11.9	30.9	18.4	-19.0	40.4	13.3	17.3	15.7
RoCE (%)	12.9	12.0	14.9	8.3	-7.8	15.9	6.5	8.2	8.2
Payout (%)	43.0	76.0	30.3	27.2	0.0	27.9	25.0	23.9	25.2
Valuations									
P/E (x)	10.2	18.7	6.4	9.3	-9.8	4.3	10.3	7.1	6.9
P/BV (x)	2.2	2.2	1.8	1.6	2.1	1.5	1.3	1.2	1.0
EV/EBITDA (x)	8.1	18.9	6.9	11.0	-18.7	5.2	9.0	7.0	6.5
Div. Yield (%)	3.3	2.0	4.7	2.9	0.0	6.6	2.4	3.4	3.7
FCF Yield (%)	-4.0	-12.2	9.1	5.6	-18.8	20.4	2.7	10.3	8.2

Key Assumptions- HPCL

Particulars	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Exchange Rate (INR/USD)	70.0	70.9	74.3	74.5	80.4	82.8	84.2	86.0	86.2
Brent Crude (USD/bbl)	70.1	61.2	44.4	80.5	96.1	83.0	78.4	70.0	70.0
Market Sales (MMT)	38.7	39.6	36.6	39.1	43.5	46.8	49.6	51.6	53.7
YoY (%)	*5*	*2*	*(8)*	*7*	*11*	*8*	*6*	*4*	*4*
GRM (USD/bbl)	5.0	1.0	3.9	7.2	12.1	9.1	4.9	6.1	6.3
Singapore GRM (USD/bbl)	4.9	3.2	0.5	5.0	10.7	6.6	4.4	5.5	5.5
Prem/(disc) (USD/bbl)	*0*	*(2)*	*3*	*2*	*1*	*2*	*0.5*	*0.6*	*0.8*
Total Refinery throughput (MMT)	18.4	17.2	16.4	14.0	19.1	22.3	25.0	25.9	25.9
YoY (%)	*1%*	*-7%*	*-4%*	*-15%*	*37%*	*17%*	*12%*	*4%*	*0%*
Refining capacity utilization (%)	117%	109%	104%	88%	85%	91%	102%	106%	106%
Blended marketing margin incld inventory (INR/lit)	4.3	4.0	6.3	4.3	(0.8)	5.5	4.2	4.5	4.5
Consolidated EPS	**31.4**	**17.1**	**50.1**	**34.3**	**-32.8**	**75.2**	**31.0**	**45.1**	**46.4**

Financials and valuations: GAIL (Target Price: INR255) BUY

Financial Snapshot									(INR b)
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Sales	751.3	718.8	567.4	916.5	1,443.0	1,306.4	1,337.4	1,488.3	1,599.4
EBITDA	95.3	83.7	64.5	138.3	67.0	134.8	141.5	169.8	184.3
Adj. PAT	63.3	74.2	49.0	102.9	53.0	90.2	89.1	119.2	129.7
Adj. EPS (INR)	9.6	11.3	7.4	15.6	8.1	13.7	13.6	18.1	19.7
EPS Gr. (%)	33.6	17.3	-34.0	110.1	-48.5	70.1	-1.2	33.8	8.8
BV/Sh.(INR)	68.1	73.0	77.1	89.5	93.5	101.8	113.6	124.4	136.3
Ratios									
Net D:E	0.0	0.1	0.1	0.1	0.2	0.2	0.2	0.1	0.1
RoE (%)	14.3	15.0	10.8	20.3	9.5	15.0	9.5	15.8	15.6
RoCE (%)	13.1	12.6	9.0	17.0	7.9	11.9	9.4	12.3	12.2
Payout (%)	34.7	51.3	45.0	21.3	49.6	40.1	31.5	40.1	40.1
Valuations									
P/E (x)	17.4	14.8	22.4	10.7	20.7	12.2	12.3	9.2	8.5
P/BV (x)	2.5	2.3	2.2	1.9	1.8	1.6	1.5	1.3	1.2
EV/EBITDA (x)	3.3	7.8	9.1	4.7	12.0	7.1	6.4	5.2	4.6
Div. Yield (%)	1.6	2.6	2.0	2.0	2.4	3.3	3.2	4.4	4.7
FCF Yield (%)	0.6	1.3	2.8	2.8	-4.1	4.4	5.3	7.3	8.4

NOTES

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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