Nayara Energy

Company Update

September 14, 2021

PSU OMC dominance to sustain

Quick Pointers:

- Private sector competition to increase in lucrative fuel marketing segment. However, OMCs with ~90% share are best placed and will rule the roost.
- With refineries in Gujarat, private retailers will predominantly target adjoining markets and highways given limitation in setting up oil marketing infrastructure.

Nayara Energy Limited (NEL; erstwhile Essar Oil) FY21 Annual Report throws interesting light on the fuel retailing Industry in India. With 6,059 retail outlets as on FY21 end, NEL is India's largest private fuel retailer with 6.1% market share. It's FY21 retail volumes were up 3% YoY vs 9%YoY industry degrowth due to pandemic and segment EBIDTA was at $410mn. Nayara plans to increase the retail store count to 7,600 over next three years. We believe, despite rising competition from private players, Oil Marketing Companies (OMCs) with over 90% of India's retail infrastructure will continue to dominate the B2C space. The private players will target highways and markets closer to Gujarat given the proximity to their refineries. We remain positive on OMCs given favorable risk-reward and maintain HPCL as top pick among peers.

Background: Nayara Energy Ltd (NEL), erstwhile Essar Oil refinery operates India's second largest single site refinery with 20MTPA capacity. Currently Rosneft has 49.13% stake while another 49.13% stake is held by Trafigura and UCP Investment group. They acquired the stake from Ruia's for USD12.9bn in FY18.

Key highlights from the Annual Report and its impact:

Retail competition is heating up, but OMCs dominate: Lured by steady improvement in fuel retailing margins to Rs4-5/litre for petrol and diesel currently vis-à-vis ~Rs3.5/litre in FY19, post fuel deregulation in FY15, private players have gradually expanded their network. NEL accounted for 78% of total private retailers store count of 7,743 as on FY21 end while OMCs dominate with 90% (69,351) Source (PPAC). Private sector share has steadily increased with retail count and petrol and diesel volume sold accounted for 10.2%/11.5% in FY21 vis-à-vis only 2%/1% in FY15.

Private sector is more focused on B2B segment in diesel: Sharp increase in fuel share is also because private sector focused on competitive B2B business especially in diesel where non transport demand including mobile towers, railways, mining industry etc. accounted for 26.5% (Source: PPAC). However, the B2B space is typically a lower margin segment compared to B2C. Nonetheless, for petrol, demand is predominantly for transport sector.

However, with refineries based out of Gujarat and limitations on setting up oil terminals and pipelines across India, we expect the private competitors to target highways and markets adjoining Gujarat for their growth.

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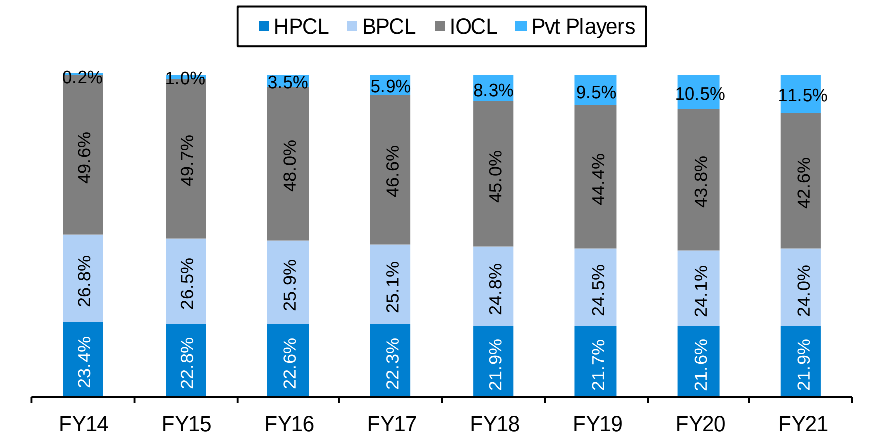
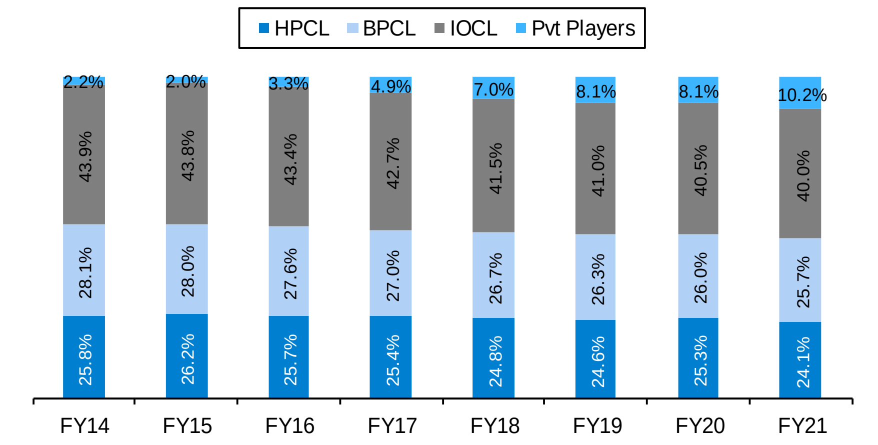
Marketing profits make up for weak refining performance- NEL's focused expansion in priority markets led to volume growth of 3% YoY in FY21 despite pandemic lockdown while industry degrew 9%. FY21 retail EBIDTA was at $410mn (Rs30.5bn). Led by focus on B2B customers, NEL's diesel sales were up 28.5% vs industry decline of 21.3%. The company steadily increased their retail network count from 3,499 in FY17 to 6,059 currently and plans to increase network to 7,600 over next three years. NEL also plans to automate the entire network by FY22 end vs 61% as on FY21 end.

Exhibit 1: Private sector share in diesel sales have increased to 11.5%



Source: PPAC, PL

Exhibit 2: Petrol sales of private players were at 10.2% in FY21



Source: PPAC, PL

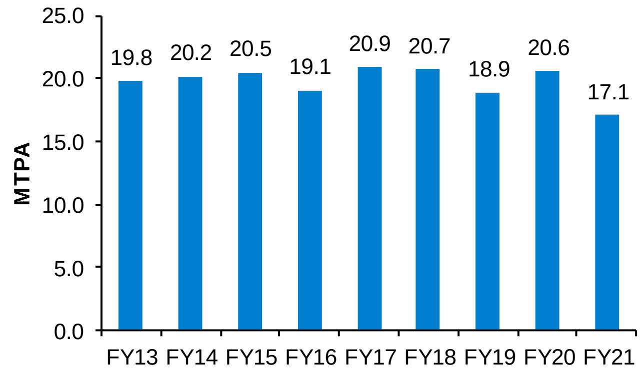
Aggressive expansion to continue by private and OMCs

Going forward, RIL-BP plans to set up 4,000 retail outlets over next five years from current ~1,400. The Oil Marketing Companies (OMCs) will continue their retail ramp up; they added 7,600 stores in FY21. However, as road network expands there will be more opportunity for players to target the off highway infrastructure for future growth. Also, limited government led pricing interventions will lead to more competition in fuel retailing. We have modelled marketing margins of Rs4-4.5/litre for FY22/23E for the OMCs.

Refining segment lags

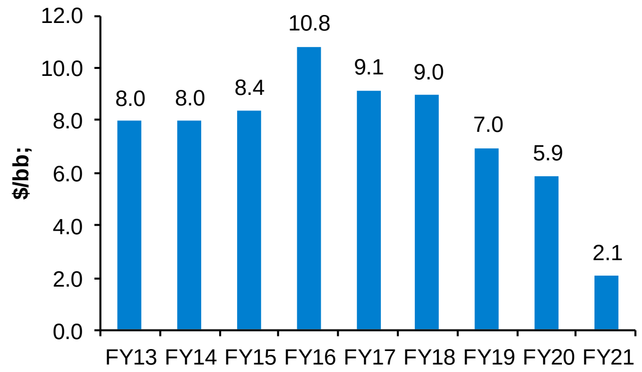
Weak spreads, volumes drag refining performance: NEL is one of the most modern refinery with complexity index of 11.8. FY21 refining segment was hit by lower volumes (17.1MTPA vs 20.6 last year) and weak spreads and we calculate FY21 EBIDTA loss at $51mn. FY21 refining margins were not shared, but factoring in USD2.5/bbl as operating cost, we calculate GRMs at USD2.1/bbl. This is against USD5.9/bbl in FY20 and USD9.0/bbl in FY18.

Exhibit 3: FY21 throughput was lower due to pandemic



Source: Company, PL

Exhibit 4: GRMs have come off due to weak spreads



Source: Company, PL; FY21 GRMs is our estimate

For FY21, NEL managed to secure over 60% of its Ultra Heavy crude despite declining availability vis-a-vis 84% heavy crude diet in FY20. Unfavorable crude mix also impacted margins of the company.

NEL management remains hopeful of refining margins improving going ahead as less complex refineries of 3.6mbpd global capacity will be permanently shut, off which 1.7mbpd closure is likely by CY21 end.

Entering the petrochemicals space for future growth

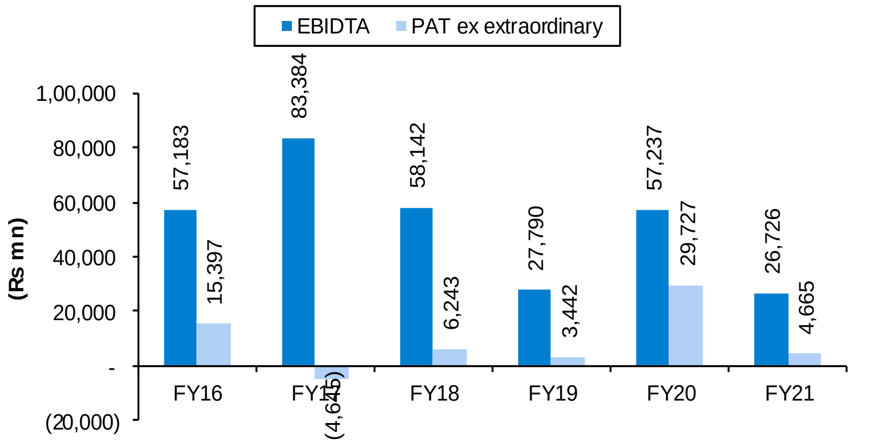
NEL plans to set up 0.45MTPA Polypropylene (PP) project and the company plans to revamp existing Fluid Catalytic Cracker (FCC) and Liquefied Petroleum Gas (LPG) Treatment Units, a new Propylene Recovery Unit (PRU) and new Polypropylene Unit (PP). These Revamp units provide the required amount of propylene rich feedstock. The PRU unit will recover propylene from propylene rich gas streams, while the PP unit will convert propylene into polypropylene, the final product. Media reports suggests that company has secured a term loan of Rs40.1bn for the project.

For the second phase the company plans to set up petrochemical derivatives project by setting up world scale steam cracker. Given the scale, the company plans to set up partnership with other players. Company aims to complete Front End Engineering Design (FEED) activities at the beginning of FY22.

Financials

Pandemic, lower spreads impact profits: NEL's FY21 was hit by lockdown which hit refining profits. Operating profits were down to Rs26.7bn (-53%YoY) while PBT loss was at Rs2.7bn vis-à-vis gains of Rs14.5bn. PAT was at Rs4.7bn due to deferred tax write back vs Rs29.7bn in FY20. NEL's operating profits have come down from FY17 levels of Rs83.3bn and were impacted by weak refining margins.

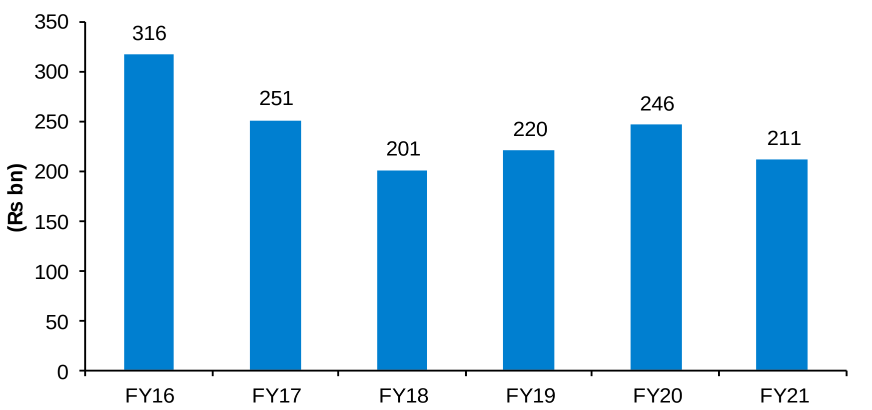
Exhibit 5: NEL's performance has been hit by weak refining margins



Source: Company, PL

Net debt down to Rs211bn: NEL's FY21 net debt was at Rs211bn vs Rs246bn in FY20 and has come off from FY16 levels of Rs316bn. Net debt is likely to increase going forward as company expands its petrochemical footprint.

Exhibit 6: NEL's net debt has come off from FY16 highs



Source: Company, PL

Exhibit 7: NEL key financial highlights

(Rs mn)	FY16	FY17	FY18	FY19	FY20	FY21
Revenue	525,969	608,691	708,650	856,762	855,799	627,410
EBIDTA	57,183	83,384	58,142	27,790	57,237	26,726
PBT	30,385	4,898	9,487	5,386	14,501	(2,755)
PAT	15,397	(4,645)	6,243	3,442	29,727	4,665

Source: PL, Company

Exhibit 8: Valuation Summary

Company Names	S/C	Rating	CMP (Rs)	TP (Rs)	MCap (Rs bn)	Sales (Rs bn)				EBITDA (Rs bn)				PAT (Rs bn)				EPS (Rs)				RoE (%)				PE (x)			
						FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY23E
BPCL	S	BUY	490	581	1,025.4	2,845.7	2,301.6	2,719.7	3,224.1	83.5	213.0	133.4	169.2	36.7	120.5	88.3	121.4	18.6	57.6	42.2	58.0	9.7	26.8	15.4	18.9	26.3	8.5	11.6	8.4
HPCL	S	BUY	276	404	400.4	2,687.7	2,330.0	2,472.2	2,774.4	51.2	159.3	117.8	129.7	38.5	106.6	60.1	67.1	25.2	73.4	41.4	46.2	13.5	32.7	15.6	15.5	10.9	3.8	6.7	6.0
Indian Oil Corporation	S	BUY	116	135	1,068.7	4,843.6	3,639.5	5,084.7	5,618.4	164.0	405.9	339.9	354.5	67.0	193.7	160.1	163.6	7.3	21.1	17.4	17.8	6.4	18.7	13.6	12.8	16.0	5.5	6.7	6.5

Source: Company, PL *S=Standalone / C=Consolidated*

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Aarti Industries	Hold	985	952
2	Bharat Petroleum Corporation	BUY	581	448
3	Burger King India	BUY	250	168
4	GAIL (India)	BUY	184	143
5	Gujarat Gas	BUY	896	772
6	Hindustan Petroleum Corporation	BUY	404	265
7	Indian Oil Corporation	BUY	135	106
8	Indraprastha Gas	BUY	662	535
9	Mahanagar Gas	BUY	1,370	1,109
10	NOCIL	BUY	393	283
11	Oil & Natural Gas Corporation	BUY	155	116
12	Oil India	BUY	328	167
13	Petronet LNG	BUY	351	215
14	Reliance Industries	BUY	2,416	2,106

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Reduce : -5% to -15%
Sell : < -15%
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