Prabhudas Lilladher
POWERING YOUR FINANCIAL GROWTH

Oil & Gas

Sector Update

November 30, 2023

OMCs - richly valued

Companies covered in the report

Name of the Company	Recommendation
Indian Oil Corporation	Reduce (Downgrade)
Bharat Petroleum Corp.	Reduce (Downgrade)
Hindustan Petroleum	Sell (Downgrade)

Stock Performance (%)

	1M	6M	12M
Nifty	**5.5**	**8.1**	**7.9**
Indian Oil Corporation	24.9	20.5	44.2
Bharat Petroleum	28.0	18.5	26.4
Hindustan Petroleum	40.6	32.9	43.6

Interesting Read


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Oil & Gas

Sector Update

November 23, 2023

Weak petrochemical cycle expected in 2024

Companies covered in the report

Name of the Company	Recommendation
Reliance Ind.	Accumulate (Rev. from BUY)
GAIL (India)	BUY (No Change)
Indian Oil Corporation	HOLD (No Change)

Stock Performance (%)

	1M	6M	12M
Nifty	1.4	8.1	6.6
Reliance Industries	3.9	6.8	2.2
Gail (India)	(1.0)	16.4	35.9
IOC	11.1	9.0	34.8

Interesting Read

Quick Pointers:

- China added 2.75 mmtpa of new PE capacities in 2022, while the country announced 4.15 mmtpa of new PP capacities in 2023.
- China's net PP imports fell sharply from 6.1 mmt in 2020 to 3.2 mmt in 2022; similarly PE imports fell from 18.9 mmt to 13.4 mmt in the same period.

Chinese refiners have been increasing their petrochemical capacities to (1) diversify from transportation fuels like petrol & diesel (whose demand is expected to decline with anticipated pick up in EV) and (2) reduce dependency on imports. Increase in capacities would lead to supply glut, amidst lack of commensurate global demand. We expect Reliance Industries (RIL), GAIL India (GAIL) and Indian Oil Corporation's (IOCL) petrochemical margins to remain suppressed in the near to medium term. Accordingly, we downgrade our rating on RIL to 'Accumulate' from Buy with SOTP based TP of Rs2,618 (unchanged, valuing the standalone business at 7.5x FY26 EV/EBITDA, Jio at 15x FY26 EV/EBITDA and Retail at 37x FY26 EV/EBITDA). We maintain 'Buy' rating on GAIL, driven by strong transmission and trading segments with TP of Rs161 (earlier Rs139) based on 10x FY26 EPS of 12.7 and value of listed and unlisted investments at Rs24. For IOCL, we maintain 'Hold' rating with TP of Rs94 (unchanged) based on 0.7x FY26 P/BV.

Global petrochemicals demand: Global PP demand for FY23 is projected at ~90 mmt, out of which China accounts for 40%. Similarly, global demand for PE is projected at ~118 mmt, out of which China accounts for 34%. Current PE/PP spreads are at lower end of last decade and are expected to remain weak going ahead too.

Surplus supply from China: China, the world's largest producer and consumer of petrochemicals has been adding new petchem capacities and improving its self-sufficiency. About 1.4 mmt of new PE capacities (most of which are for HDPE) are expected to come online in 2023, up 8.5% YoY. China's net imports of PP have fallen from 26.7% in 2013 to a mere 10.7% in 2023. HDPE imports have halved from 52% to 25.4% during the same period. LDPE and LLDPE imports have declined from 56.7%/44.6% in 2019 to 48.3%/35.4%in 2023, respectively. Thus, China has reduced its reliance on imports. Along with this, demand concerns too persist in Europe on the back of high inflation and interest rates. This has led to suppressed product margins.

Indian petchem companies' margins to remain weak: The above macro developments are likely to impact the Indian petrochemical sector. Reliance has announced expansion plans across its petrochemical value chain by CY26. IOCL is planning to enhance its petrochemical capacity from 4.1 mmtpa to 15 mmtpa by FY30 (link). GAIL is setting up a 500 KTA PP plant based on PDH technology at Usar, Maharashtra to be commissioned by 2025 and another 60 KTA PP plant is also being set up at PATA petchem complex, to be commissioned by 2024. Petchem margins have been suppressed since the beginning of 2023 and we expect RIL, GAIL and IOCL's petchem margins to remain weak going into 2024 too, on the back of production capacities exceeding demand.

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November 23, 2023 1

Quick Pointers

- Gross marketing margins have risen in Q3TD, however any spike in benchmark prices may impact these margins.
- Singapore GRM at US$4.5/bbl in Q3TD.

Oil marketing companies like Indian Oil Corporation (IOCL), Bharat Petroleum Corporation (BPCL) and Hindustan Petroleum Corporation (HPCL) are likely to witness a strong Q3 performance on back of improvement in gross marketing margins on petrol and diesel. Singapore GRM for Q3TD stands at US$4.5/bbl, while gross marketing margins (GMMs) on petrol and diesel are at Rs8.2/(-0.6)/ltr. IOCL/BPCL/HPCL have historically traded at long term P/BV of 1/1.3/0.8x respectively (we exclude the period between 2014-18, during which the OMCs enjoyed higher valuations due to twin benefits of deregulation and benign oil prices) and are currently trading at 0.9/1.3/1.1x FY24 P/BV. We downgrade our rating from 'HOLD' to 'REDUCE' on IOCL with a TP of Rs94 based on 0.7x FY26 P/BV. We downgrade our rating on BPCL from 'HOLD' to 'REDUCE' with TP of Rs365 based on 1xFY26 P/BV. Similarly, on HPCL we downgrade our rating from 'HOLD' to 'SELL' with a TP of Rs272 based on 0.7x FY26 P/BV.

GRMs soften in Q3-TD: Average petrol cracks which were at US$13.5/bbl in Q2 softened to US$4/bbl in October but have risen to US$8.2/bbl in November. On the other hand, diesel cracks which were at an average of US$26.6/bbl in Q2 fell to US$22.8/bbl in October and US$19.8/bbl in November. This led to softening of Singapore GRM from US$9.6/bbl in Q2 to US$3.8/bbl in October and US$5.3/bbl in November. Over a longer period, we expect Singapore GRM to stabilize at US$6/bbl and OMCs also to broadly report in line with the same.

Gross marketing margins moderate: Average gross GMMs on petrol and diesel in Q2 were Rs7.6/1/ltr. Gross margins on diesel which were negative in Aug-Oct turned positive in November. GMM on petrol stands at Rs8.2/ltr in Q3-TD while there is a gross marketing loss of Rs 0.6/ltr on diesel. In the week ended 28th November, GMMs on petrol diesel stood at Rs9.7/4.7/ltr. However, sustainability of higher-than-normalized GMMs is questionable in light of the upcoming elections.

Valuations stretched: IOCL has historically traded at an average P/BV of 1x and is currently trading at 0.9x. The company has been generating free cash flows and is hence trading at a higher valuation. BPCL has historically traded at a higher P/BV due to investments across its upstream segment. We assign ~25% discount to its long term P/BV of 1.3x on account of no significant development in its E&P assets. HPCL's long term average P/BV stands at 0.8x and is currently trading at 1.1x. HPCL has been reporting lower GRMs than the other two companies since FY22 due to ongoing expansion/upgradation at Vizag. We expect this to continue for another 1-1.5years till Vizag refinery stabilizes. We expect its net debt to rise from Rs664bn in FY23 to Rs694bn in FY26E due to ongoing projects.

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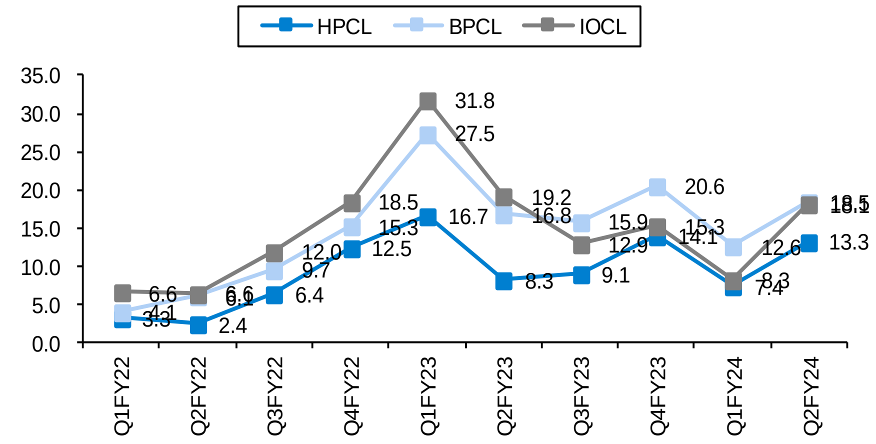
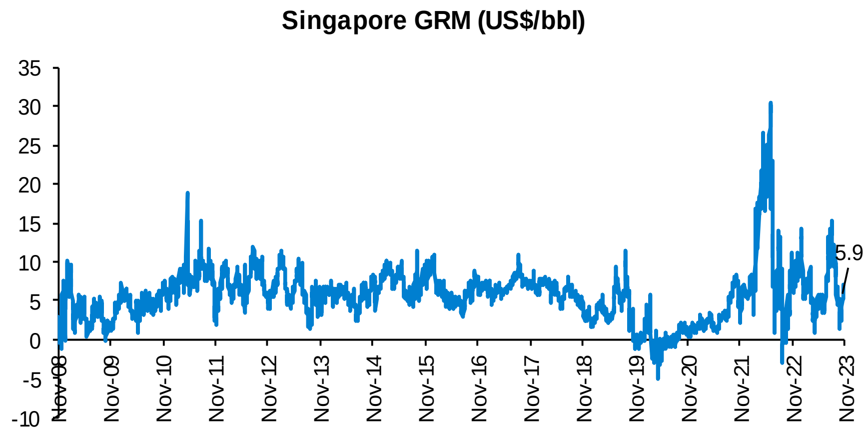
Exhibit 1: HPCL has been reporting lower GRMs since FY22



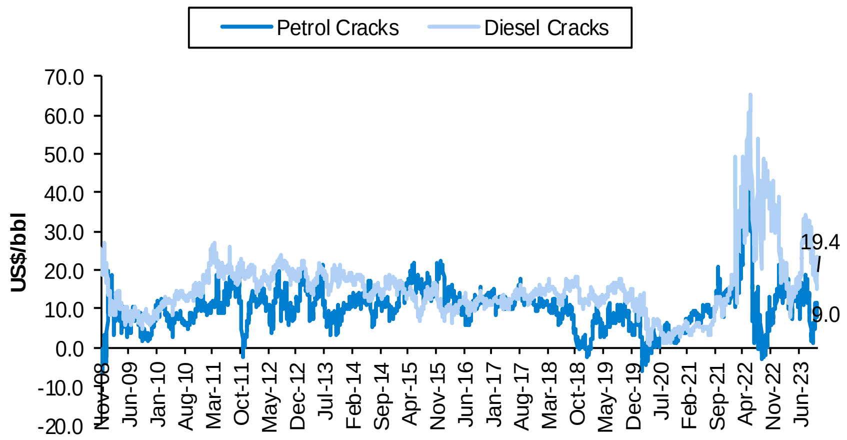
Source: Company, PL

Exhibit 2: Singapore GRM softens on account of demand concerns



Source: PL, Industry

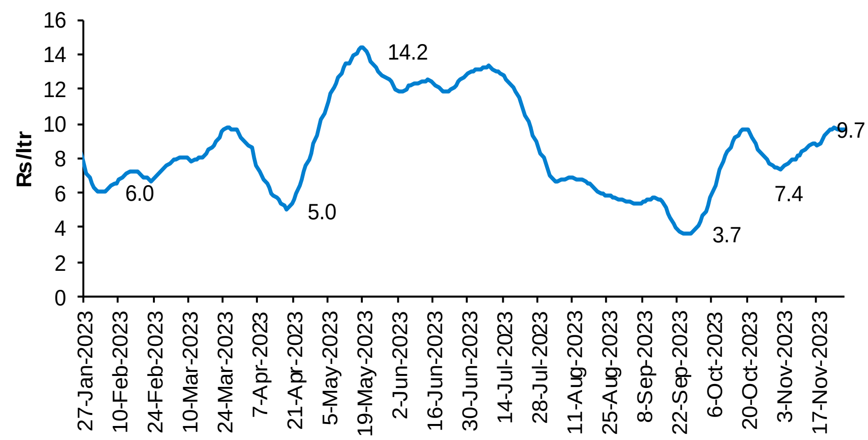
Exhibit 3: Average diesel cracks have weakened to ~US$20/bbl in November



Source: Industry, PL

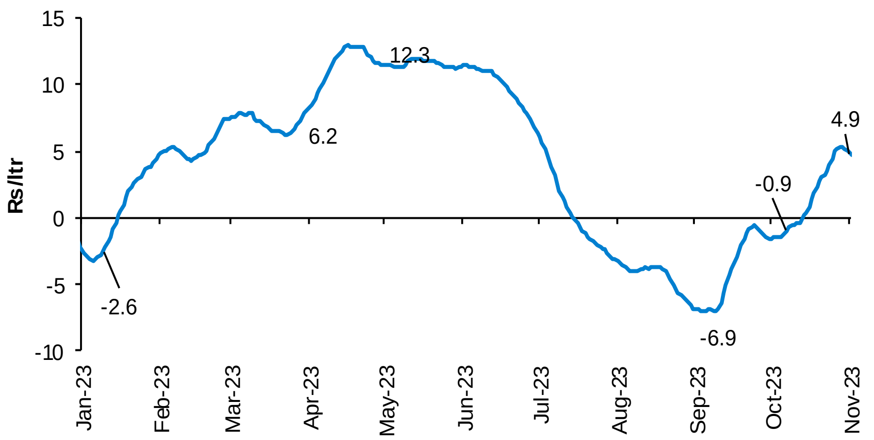
Oil prices fell during the 2008 recession. Lower oil prices and deregulation of diesel led to high valuation between 2014-2018 and we excluded this period for our analysis.

Exhibit 4: Average GMMs on petrol in Nov came in at Rs8.7/ltr



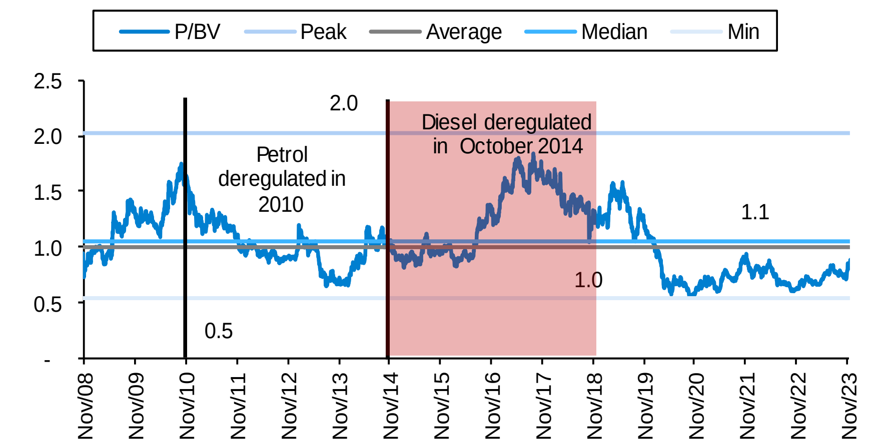
Source: PL, Industry

Exhibit 5: Average GMMs on diesel in Nov stand at Rs2.3/ltr



Source: PL, Industry

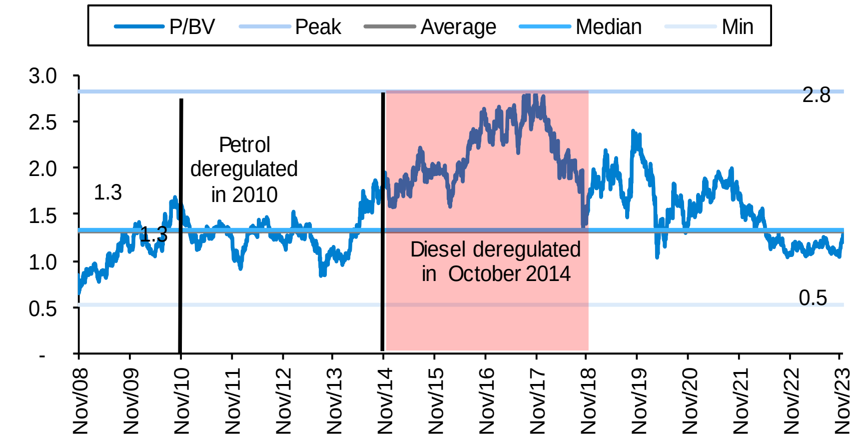
Exhibit 6: IOCL currently trades at 0.9x FY24 P/BV



Source: Company, PL

Brent prices were at low levels during the 2008 recession. Deregulation of diesel combined with low oil prices led to high valuation in 2014-2018, which have been excluded for our analysis.

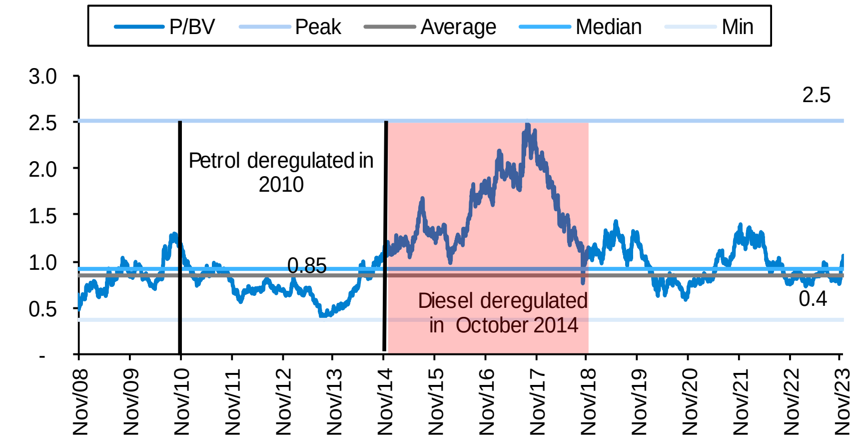
Exhibit 7: BPCL currently trading around its long term P/BV of 1.3x



Source: Company, PL

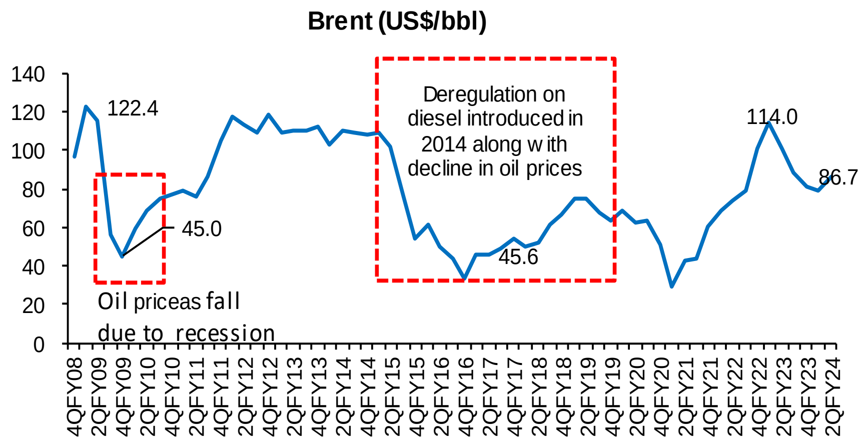
Oil prices fell during the 2008 recession. Benign oil prices combined with deregulation led to higher valuation during 2014-2018, which we have excluded for our analysis.

Exhibit 8: HPCL currently trades above its long term P/BV of 0.8x



Source: Company, PL

Exhibit 9: Period between 2014-18 excluded in our valuations



Source: PL, Industry

Exhibit 10: Valuation Table

Company	P/BV (x)			EPS (Rs)			RoE (%)			RoCE (%)			EV/EBITDA (x)		
	FY24E	FY25E	FY26E	FY24E	FY24E	FY25E	FY26E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
IOCL	0.9	0.9	0.8	26.7	14.8	14.4	24.6	12.2	11.1	16.4	8.1	7.1	4.3	6.3	6.2
BPCL	1.4	1.3	1.2	104.9	46.2	45.1	37.6	14.5	13.0	24.4	8.8	8.3	4.0	7.7	7.5
HPCL	1.1	1.0	0.9	107.6	57.5	54.8	40.3	17.6	14.9	17.5	7.9	6.9	4.8	7.5	7.5

Source: PL

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Aarti Industries	Accumulate	584	510
2	Bayer Cropscience	Accumulate	5,920	5,193
3	Bharat Petroleum Corporation	Hold	365	347
4	Bharti Airtel	Accumulate	993	924
5	Clean Science and Technology	Hold	1,368	1,374
6	Deepak Nitrite	Reduce	1,935	2,076
7	Dhanuka Agritech	BUY	1,060	883
8	Fine Organic Industries	Hold	4,252	4,250
9	GAIL (India)	BUY	151	124
10	Godrej Agrovet	Hold	420	515
11	Gujarat Fluorochemicals	Reduce	2,413	2,780
12	Gujarat Gas	Accumulate	477	419
13	Gujarat State Petronet	BUY	328	273
14	Hindustan Petroleum Corporation	Hold	272	279
15	Indian Oil Corporation	Hold	94	101
16	Indraprastha Gas	Hold	406	390
17	Insecticides India	Accumulate	600	519
18	Jubilant Ingrevia	Hold	433	412
19	Laxmi Organic Industries	Reduce	220	254
20	Mahanagar Gas	Hold	1,065	1,015
21	Mangalore Refinery & Petrochemicals	Hold	94	96
22	Navin Fluorine International	BUY	4,007	3,430
23	NOCIL	Hold	226	216
24	Oil & Natural Gas Corporation	BUY	237	196
25	Oil India	BUY	368	302
26	P.I. Industries	BUY	4,600	3,648
27	Petronet LNG	Hold	208	196
28	Rallis India	Reduce	190	217
29	Reliance Industries	Accumulate	2,618	2,388

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Buy : > 15%
Accumulate : 5% to 15%
Hold : +5% to -5%
Reduce : -5% to -15%
Sell : < -15%
Not Rated (NR) : No specific call on the stock
Under Review (UR) : Rating likely to change shortly

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