OIL & GAS

05 July 2021

OMCs: Prefer HPCL over BPCL and IOCL

- **Positive view on oil marketing companies with earnings supported by post-Covid recovery, potential BPCL divestment**
- **Prefer HPCL over IOCL with the former geared to deliver earnings growth over FY23-FY24 driven by Vizag expansion and upgrade**
- **Downgrade BPCL to HOLD from BUY on fair valuation**

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Recommendation snapshot

Ticker	Price	Target	Rating
BPCL IN	460	518	HOLD
HPCL IN	304	368	BUY
IOCL IN	109	135	BUY

Price & Target in Rupees | Price as of 5 Jul 2021

Positive view on OMCs: Given our expectation of gradual improvement in refining margin and marketing margin holding up, we have a positive view on oil marketing companies (OMC). Potential BPCL divestment could establish a value for the marketing business. While OMCs are exposed to climate related risks, their valuations provide comfort.

Recovery in refining margin likely to be gradual: To achieve sustainable utilisation above 80%, IEA estimates that 6mbpd of closures are needed to offset the planned addition of 8.5mbpd till 2026. So far, only 3.6mbpd of closures have been announced. In the interim, we see only a gradual improvement of US$ 3.5/bbl in benchmark refining margin over the next three years to US$ 3.8/bbl by FY24.

Marketing margin to hold up; expect crude to retract to US$ 65 by year-end: Crude price has surged to US$ 75/bbl with recovery in demand running ahead of release of supply. However, any sustainable upside will be capped by higher OPEC spare capacity at 5mbpd even after end of CY21 (vs. the average of 2.3mbpd over the last decade) and potential ramp-up of US production. We consider US$ 65/bbl a more sustainable level, which meets the financial needs of OPEC and also keeps investments in US liquids production in check.

Downgrade BPCL to HOLD: At our estimates, we believe the current market price reflects a fair value for BPCL's business and a portion of control premium. Our new Mar'22 TP of Rs 518 (Rs 480 earlier) is based on 6x FY23E EV/EBITDA for the refining/marketing business, control premium at 20% of core equity value and stakes in listed entities at market price with no holding discount. We do not see a strong case for a higher control premium given growing global concerns with scope 3 emission.

Prefer HPCL over IOCL: We maintain BUY on HPCL (TP: Rs 368 vs. Rs 440 earlier) and IOCL (TP: Rs 135 vs. Rs 170) with potential upsides of 21% and 24% respectively. We prefer HPCL as earnings growth driven by completion of Vizag expansion and the residue upgrade project over FY22/FY23 would be a key catalyst. While IOCL is on a larger expansion drive, its key projects are due for completion only in FY24 and beyond.

Contents

Investment thesis: Oil marketing companies (OMC)

We have a positive view on OMCs given our expectation of gradual improvement in refining margin and marketing margin holding up. Potential divestment of BPCL will help establish a value for the marketing business in an attractive growth market like India.

Divestment to establish valuation benchmark for marketing business

Completion of the proposed divestment transaction in BPCL will set a credible benchmark for valuing the oil marketing business in India. It will also help increase private sector share of the refining products market from 12% currently to close to 45%, thereby raising the sustainability of market-determined pricing.

Building in only a gradual recovery in refining margin

The refining sector is undergoing a structural challenge as it adjusts to a new climate of declining transport fuel demand due to changing vehicle technologies (e.g. the rise of electric vehicles (EV) and tightening of emission norms. A third wave of refinery closures is underway, with 3.6mbpd of plant shutdowns announced. This is still well below the 6mbpd of closures required to allow refining utilisation to move above 80%. (Source: Oil 2021, Analysis and forecast to 2026, IEA, Paris)

We believe that the refining margin of OMCs has bottomed out and we expect gradual recovery over the next 2-3 years with improvement in demand, reduction in inventory overhang and shuttering of capacities. That said, we do not see the possibility of a super-cycle unless refining utilisation climbs sustainably beyond 80%. There may be intermittent supply tightness as closures could precede planned capacity additions.

Fig 1 – Crude and Refining margin forecasts

(US$/bbl)	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Brent	49.9	57.9	70.8	60.9	45.8	67.5	65.0	65.0
Singapore Dubai Refining Margin	3.7	6.4	5.1	2.8	0.3	1.8	3.3	3.8
Sweet-Sour spread	2.1	1.6	1.0	0.6	0.1	0.6	1.0	1.5

Source: Bloomberg, BOBCAPS Research,

Marketing margin to hold up as crude likely reverts to US$ 65/bbl

While Indian oil marketing businesses face challenges maintaining margins in an environment of higher oil prices, we believe marketing margins will hold firm as crude price likely reverts to a more sustainable level of US$ 65/bbl. Though crude has spiked to US$ 75/bbl, we expect downward pressure from the gradual restoration of OPEC+ production and increase in US output.

We consider the level of US$ 65/bbl as a compromise between meeting OPEC financial needs and avoiding a sharp rise in US liquids production. Although under-investment in crude production could tighten the market in the longer run, we expect OPEC spare capacity to remain significantly above the historical average over the next 2-3 years.

Increase in Iran production has a potential to further loosen crude market. If sanctions on Iran are lifted, an additional 1.4mbpd of supply could be brought to market in relatively short order as per the IEA's assessment. The key risk would be that OPEC+ countries may not cut back production in response to increasing Iranian output.

Diversification into gas distribution and EV charging still early-stage

OMCs are building up gas distribution networks and exploring the set-up of electric vehicle (EV) charging stations to latch onto the use of new energy as it becomes available. However, these investments in the gas economy through stakes in city gas distribution (CGD) and CNG stations are still at an early stage and are yet to reach the critical mass necessary to serve as a material valuation driver.

OMCs need to accelerate pace of transition to new energy environment

While domestic OMCs may face the impact of the ongoing energy transition later than their counterparts in the developed world, they are not fully immune to this risk. It is true that OMCs in India have access to growing local fuel demand to support economic growth, which is still far from reaching its peak. And this thinking is also visible in planning by the global refining industry. As per IEA, emerging economies is likely to account for all the growth in refining activity over the next five years.

However, energy transition could happen at a faster pace than expected. OMCs have started responding to the threat by expanding and upgrading refineries and increasing petrochemical integration to bolster their competitive position. But the pace of transition remains slow. As an example, IOCL is currently looking to increase petrochemical integration to 14-15% by 2030. This may not suffice to meet the challenge posed to refiners over the next decade. As the balance of volume and value growth shifts from oil to chemicals, the second-generation integrated sites with >40% chemicals output could capture a larger share of value available for the industry.

We estimate India's petrochemical demand at ~45mtpa growing at ~5%, which is hardly a meaningful opportunity for Indian refiners carrying 265mtpa of capacity. However, this does present a substantial market for the first mover if other competitors don't follow suit. In our view, petrochemical demand could grow by ~25mtpa to 70mtpa by 2030 (against existing petrol and diesel consumption of ~116mtpa).

While the earnings momentum for Indian refiners may sustain beyond that of global peers as the country will take far longer to transition to a full EV landscape, we expect their valuation multiples will likely start moderating much sooner, given decreasing interest from global investors, particularly long-only funds. Refiners who make the early transition to O2C and capture chemical demand will likely limit derating of multiples. However, Indian OMCs already trade at a valuation discount to their global refining and petrochemical peers, providing comfort. Refer to our India Strategy report **Climate Action – Clean your way up** dated 9 Jun 2021, by our Head of Research Kumar Manish, for further details.

Key risks

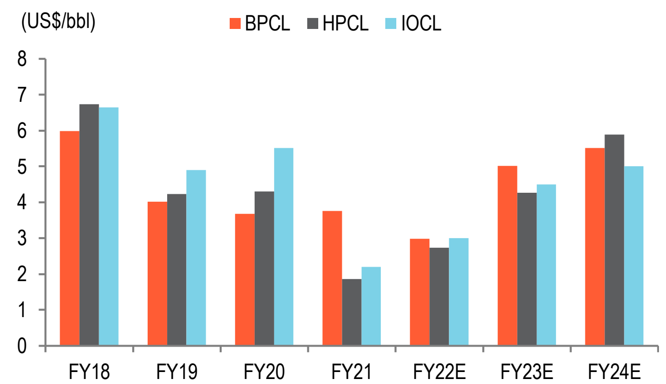
The marketing business can benefit from growth in petroleum demand and healthy average margins. However, if OMCs are unable to manage sustainable marketing margins over the cycle, the investment case for them could weaken and valuations could correct sharply.

Delay in divestment is a risk to our thesis and could impact further recovery in valuation multiples. While the government is pursuing closure of BPCL's divestment this fiscal, there are still several issues which have the potential to delay divestment, among them being the open offer triggered by the transaction for stakes in PLNG and IGL.

Underlying earnings to be supported by post Covid recovery

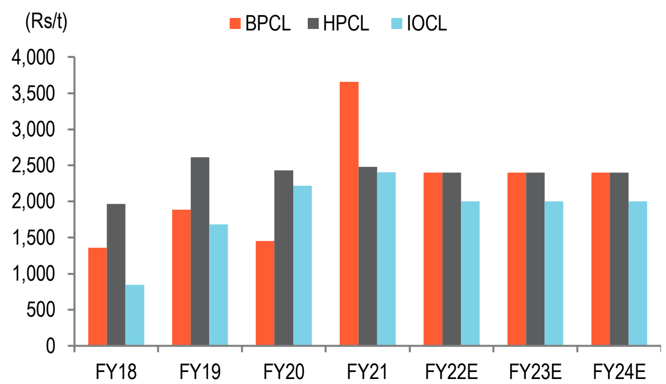
We expect a 34% YoY decrease in FY22 EBITDA for OMCs collectively (vs. consensus estimate of -23%) in the absence of material inventory gains and normalization of marketing margins. As against, we see improvement in underlying earnings supported by improvement in refining margin and healthy marketing margins closer to historical averages. For FY23 and FY24, we model for 27% and 13% growth in EBITDA respectively (vs. 13% and 7% for consensus), driven by recovery in refining margins, higher marketing volumes and completion of investment projects. We expect HPCL to outperform its OMC peers on EBITDA growth over FY22-FY24 as it delivers on expansion and upgrades at the Mumbai and Vizag refineries.

Fig 2 – Refining margin forecasts



Source: Company, BOBCAPS Research

Fig 3 – Marketing margin forecasts



Source: Company, BOBCAPS Research

Fig 4 – Earnings forecasts

Company	Actual	New			Consensus			Delta (%)		
	FY21	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
EBITDA (Rs bn)										
BPCL	213	128	176	197	154	174	173	(16.8)	1.3	13.8
HPCL	149	93	118	145	113	135	121	(17.6)	(12.6)	20.3
IOCL	417	294	360	395	333	367	428	(11.8)	(1.9)	(7.6)
OMCs	**779**	**515**	**654**	**738**	**600**	**676**	**722**	**(14.2)**	**(3.2)**	**2.2**
EBITDA growth (%)										
BPCL	-	(39.9)	37.8	11.9	(27.8)	13.2	(0.4)	-	-	-
HPCL	-	(37.6)	26.3	23.6	(24.2)	19.1	(10.3)	-	-	-
IOCL	-	(29.5)	22.7	9.7	(20.1)	10.3	16.5	-	-	-
OMCs	**-**	(33.9)	27.1	12.8	(23.0)	12.7	6.8	**-**	**-**	**-**
Adj PAT (Rs bn)										
BPCL	121	70	102	116	85	100	86	(18.4)	1.5	34.7
HPCL	104	61	83	106	67	79	66	(8.3)	4.4	60.5
IOCL	216	131	170	181	158	180	194	(16.8)	(5.6)	(6.6)
OMCs	**441**	**262**	**355**	**403**	**310**	**360**	**346**	**(15.4)**	**(1.4)**	**16.5**

Source: Company, Bloomberg, BOBCAPS Research

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Prefer HPCL amongst OMCs

OMC valuations have recovered from the recent lows in Oct'20. With progress on the divestment process, BPCL's stock has also rebounded and now adequately reflects the underlying value of its refining and marketing businesses and also a portion of the acquisition premium that bidders may be willing to pay for a controlling stake. We thus downgrade BPCL to HOLD from BUY with a potential upside of 13% at our revised Mar'22 TP of Rs 518.

We assume the control premium at 20% of equity value for core businesses and do not apply any discount on BPCL's stakes in Indraprastha Gas (IGL), Oil India (OINL), Petronet LNG (PLNG). At this stage, we are not accounting for a higher acquisition premium (more than 20%) given growing global concerns with refiners' scope 3 emission.

Fig 5 – Valuation of OMC stocks

(Rs bn)	New				Old		EBITDA		Net income		P/B (x)		P/E (x)	
	CMP	Rating	Target price	Upside (%)	Rating	Target price	FY22E	FY23E	FY22E	FY23E	FY21A	FY22E	FY22E	FY23E
BPCL	460	HOLD	518	12.7	BUY	480	128	176	70	102	1.8	1.7	13.8	9.4
HPCL	304	BUY	368	20.9	BUY	440	93	118	61	83	1.2	1.1	7.2	5.3
IOCL	109	BUY	135	24.1	BUY	170	294	360	131	170	0.9	0.8	7.6	5.9

Source: Bloomberg, BOBCAPS Research

Despite the recovery, HPCL and IOCL still trade below FY23E EV/EBITDA of 6.0x after adjusting for investments by OMCs. In our FY23 estimates, we account for a ~US$ 3/bbl improvement in refining margin over FY21 and normalised marketing margin.

We maintain our BUY ratings on both HPCL and IOCL. Between the two, we prefer HPCL as its delivery on profit growth over FY22-FY24 will act as a key catalyst. HPCL is targeting to complete major investments at the Mumbai and Vizag refineries and a polymer addition project at its JV refinery at Bhatinda. For IOCL, its expansion projects are geared to deliver profit growth beyond FY23.

Oil and refining margin outlook

Crude oil

We expect Brent crude oil to average US$ 67.5/bbl in FY22 as prices likely ease to ~US$ 65 by the year-end with a rise in OPEC production. Beyond FY22, we assume Brent at US$ 65/bbl, a level we believe will meet the financial needs of OPEC and also keep investments in US liquids production in check.

Fig 6 – Crude price forecasts

(US$/bbl)	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Brent	49.9	57.9	70.8	60.9	45.8	67.5	65.0	65.0

Source: Bloomberg, BOBCAPS Research

Demand to recover to pre-pandemic level by end-FY22

Current forecasts of the EIA, IEA and OPEC suggest that oil demand could rise by 5.4-6.0mbpd in CY21 and by 3.1-3.6mbpd in CY22 after the decline of 8.6-9.3mbpd witnessed in CY20. Assuming sustained economic recovery, demand is expected to touch pre-Covid levels by end-CY22.

Fig 7 – Oil demand forecasts

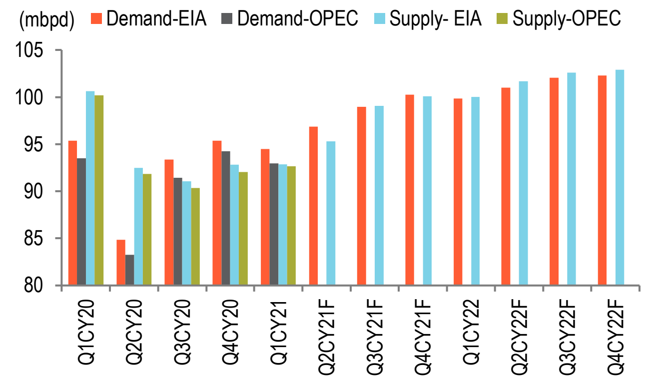
(mbpd)	CY19	CY20	CY21F	CY22F
Oil demand growth				
IEA	-	(8.6)	5.4	3.1
EIA	-	(8.6)	5.4	3.6
OPEC	-	(9.3)	6.0	NA
Oil demand				
IEA	99.6	91.0	96.4	99.5
EIA	100.9	92.3	97.7	101.3
OPEC	100.0	90.6	96.6	NA

Source: EIA, IEA, OPEC, BOBCAPS Research | Note: (1) EIA Short-Term Energy Outlook, Jun-21, (2) IEA (2021) Oil Market Report, Jun-21, IEA, Paris (3) OPEC Monthly Oil Market Report, Jun-21

Near-term support from demand recovery ahead of supply increases…

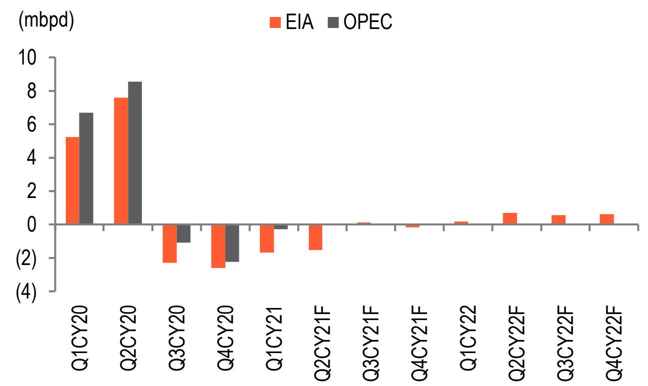
During the first half of CY21, the global oil market was in deficit with OPEC maintaining disciplined production. The deficit stood at ~1.7mbpd in Q1 and 1.5mbpd in Q2. During the second half of the year, oil demand is likely to grow by 3.4mbpd between Q2 and Q4, as per EIA forecasts. As against this, non-OPEC supply is likely to increase by 1.6mbpd. This implies that OPEC could have flexibility to ramp-up production by 3.3mbpd (1.5mbpd to fill the Q2 deficit and another 1.8mbpd to address the incremental demand between Q2 and Q4) while maintaining the global oil market balance.

Fig 8 – Demand and supply growth



Source: EIA, OPEC, BOBCAPS Research

Fig 9 – Global oil stock build/draw



Source: EIA, OPEC, BOBCAPS Research

…but spare OPEC capacity and US production ramp-up to cap upside

Between May and July 2021, OPEC is ramping up production by 2mbpd including a reversal of cuts by Saudi Arabia. Even after this increase, OPEC will have spare capacity of 6.9mbpd or so, significantly higher than the 2.3mbpd average seen over the past decade (2011-20). We therefore believe prices could retract to a more sustainable level of US$ 65/bbl as OPEC boosts output.

From CY22, current forecasts by international market observers indicate world oil supply could grow at a faster rate driven by growth in US liquids production. The expectation is that non-OPEC crude production will also be above pre-pandemic levels by the end of CY22. The range of forecasts for increase in non-OPEC production is summarised in the table.

Fig 10 – Oil supply forecasts

(mbpd)	CY19	CY20	CY21F	CY22F
Non-OPEC oil and OPEC NGL growth				
IEA	-	-	0.7	1.6
EIA	2.0	(2.8)	1.4	3.2
OPEC	2.0	(2.7)	1.0	-
US oil supply YoY growth				
IEA	-	-	-	0.9
EIA	1.6	(0.9)	0.0	1.3
OPEC	0.0	(2.4)	1.5	-
OPEC crude production growth				
EIA	(2.2)	(3.7)	1.3	1.8
OPEC	(2.0)	(3.7)	2.0	-

Source: EIA, IEA, OPEC, BOBCAPS Research | Note: (1) EIA Short-Term Energy Outlook, Jun-21, (2) IEA (2021) Oil Market Report, Jun-21, IEA, Paris (3) OPEC Monthly Oil Market Report, Jun-21

Specifically, for the US,

- EIA expects US crude oil production to increase from 10.9mbpd in Q4CY20 to 11.4mbpd in Q4CY21 and average 11.8mbpd in CY22. Onshore US crude oil production in the Lower-48 states during May'21 averaged 8.9mbpd, and EIA expects production to reach ~9.3mbpd by Dec'21 with further increases into CY22. Since 14 August 2020, the Baker Hughes US oil rig count has more than doubled, reaching 359 rigs as of 2 June 2021 with the increase in oil prices. While it is still below half the 2019 average, higher oil prices could accelerate rig deployment.
- OPEC expects US liquids production to increase from 16.6mbpd in Q1CY21 to 18.5mbpd in Q4CY21, above the 2019 average.

For Russia, EIA expects production of petroleum and other liquids to increase by 0.2mbpd in CY21 and by 0.8mbpd in CY22, reaching an average of 11.5mbpd in CY22.

Iran production increase has potential to further loosen crude market

If sanctions on Iran are lifted, an additional 1.4mbpd of supply could be brought to market in relatively short order as per the IEA's assessment. The key risk would be that OPEC+ countries may not cut back production in response to increasing Iranian output.

Iran will be setting up a new government headed by Ebrahim Raisi around mid-August, following the completion of elections on 18 Jun 2021. In the interim, nuclear negotiations are continuing in Vienna. As per media reports, the official US position is that it will revive the Joint Comprehensive Plan of Action when it is convinced that Iran has reversed the significant expansion of its atomic activities in the past two years. Raisi has said that he will not undermine the talks. Per the media reports, the decision to negotiate in Vienna was made by the Iran's Supreme Leader Ayatollah Ali Khamenei.

Under-investment could risk price spike but spare capacity a cushion

Under-investment in the oil sector with a focus on energy transition could potentially result in inadequate replacement of declining oil barrels. IEA notes that upstream spend declined 30% YoY in CY20 and is likely to rise only marginally in CY21. This could constrain oil supply growth to 5mbpd by 2026 against a need for 10.2mbpd. However, Middle East producers could still bridge the gap from the existing shut-in capacity. IEA estimates effective global spare production capacity (excluding Iran) at 2.4mbpd even by 2026. If Iran is allowed to supply, this could further increase available spare capacity. (Source: Oil 2021 Analysis and Forecast to 2026, IEA, Paris)

While the risk of an upswing in oil price exists, we believe that OPEC spare capacity would weigh on prices in the near-to-medium-term. There is also a possibility that stronger policy action could lower demand.

Refining margin

Refining margin recovery likely to be gradual over medium term

Unlike the quick rebound in crude price, we expect refining margin recovery to be drawn out over 2-3 years. Even thereafter, margins are likely to remain well below the levels seen over FY18-FY19.

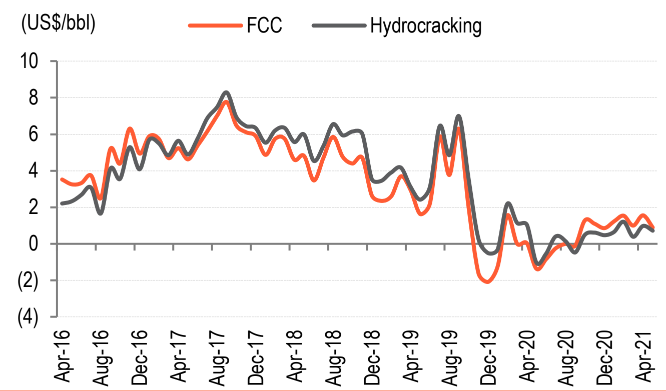
Fig 11 – Refining margin forecasts

(US$/bbl)	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E	FY24E
Singapore Dubai Refining Margin	3.7	6.4	5.1	2.8	0.3	1.8	3.3	3.8
Sweet-Sour Spread	2.1	1.6	1.0	0.6	0.1	0.6	1.0	1.5

Source: Bloomberg, BOBCAPS Research

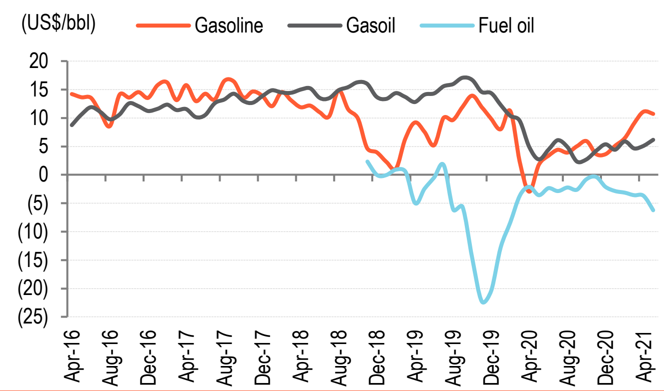
The Asian benchmark refining margin has seen a modest uptick with recoveries in the developed world and particularly improvement in gasoline spreads due to the start of driving season in the US. However, the Asian gasoline crack margin remains muted relative to the US with a decline in demand due to lockdowns amid the second Covid-19 wave. Refining run rates and product supply are also likely to improve as we approach the end of peak refinery turnaround season. This would limit margin upside.

Fig 12 – Singapore Dubai refining margin



Source: Bloomberg, BOBCAPS Research

Fig 13 – Singapore Dubai product crack spread



Source: Bloomberg, BOBCAPS Research

IEA expects global refinery throughput to recover by ~3.7mbpd in CY21, recouping only half of the 7.4mbpd fall seen in 2020. The recovery in throughput is likely to lag demand growth of 5.4-6.0mbpd for refined products due to surplus inventories. In CY22 as well, IEA expects refining throughput to recover by 2.4mbpd against its forecasted demand growth of 3.6mbpd (which is still below the 2017 level). (Source: IEA (2021), Oil Market Report - June 2021, IEA, Paris)

Further, IEA estimates net refining capacity addition of 1.5mbpd over CY21-CY22 with the addition of 3.8mbpd of new capacity partially offset by 2.3mbpd of announced closures or conversions to bio-refineries. This is likely to limit refining utilisation improvement to only 78% and lead to a slower rebound in refining margin over the next 2-3 years unless we see accelerated capacity closures.

Utilisation above 80% still some time away

Looking to 2026, IEA highlights that besides announced closures of 3.6mbpd of capacity, the industry needs to shutter another 2.4mbpd to cross the 80% utilisation rate necessary to earn a mid-cycle margin. Based on the announced projects, planned capacity additions total 8.5mtpa, comprising 6mbpd of greenfield projects and 2.2mbpd of brownfield expansion.

No refining super-cycle yet

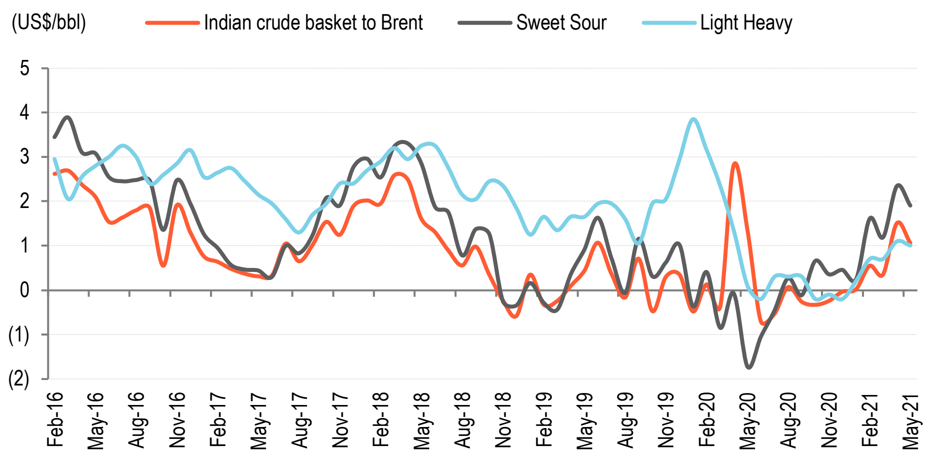
While current shutdown plans will fail to adequately boost utilisation, the refining industry could tighten if closures outweigh the ramp-up in new capacity. However, this impact is likely to be short-lived. Also, refiners are up against the challenge of declining transport fuel consumption. IEA believe a third of oil demand growth over 2019-27 is likely to be met by products bypassing the refinery sector, such as natural gas liquids and biofuels.

Sweet-sour spread to revive with recovery in OPEC production

The sweet-sour spread dipped in 2020 with a sharp cut in OPEC production, resulting in improved availability of sweet crude as a proportion of the global basket. Further, the better performance of light distillate products, specifically gasoline, compared to heavier distillates like fuel oil is still exerting pressure on the sweet-sour differential.

This spread recovered only modestly in Q2CY21. We expect further recovery to tie in with revival in medium-sour OPEC production. The pace at which OPEC+ cuts can be unwound will depend not only on the success in containing the virus and on demand growth but also on the timing of Iranian barrels eventually returning to market.

Fig 14 – Sweet-sour spread



Source: Bloomberg, BOBCAPS Research

Company-wise investment thesis

BPCL – Downgrade to HOLD, TP Rs 518

We downgrade BPCL from BUY to HOLD with an upside of 13% to our target price. At our estimates, we believe the current market price reflects a fair value of business and some portion of control premium to be paid by the buyer at a ~6x EV/EBITDA valuation multiple.

Divestment holds the key

In our view, divestment of the government's 52.98% stake in BPCL will be able to fetch a control premium above fair market value for the existing marketing footprint which carries scope for substantial growth. We currently account for a 20% premium over equity value of the core business for setting our target price. We also account for BPCL's investment in IGL, OINL and PLNG at market value without applying any holding company discount.

We do not believe a control premium above 20% is justified at present. At this stage, three bidders have submitted expressions of interest to buy the government's stake in BPCL. Bidders include Vedanta, Apollo Global Management and Think Tank, the Indian arm of I Squared Capital, as per media reports. Global oil majors have not directly participated in this process yet. Given increasing scrutiny on scope 3 emissions, we may see declining enthusiasm among global oil majors for any significant acquisition of refineries.

In terms of the bid process, as per media reports, BPCL has extended data room access to bidders on 10 April 2021 and was planning to offer meetings with senior management from June. We also understand that the draft sale & purchase agreement, vetted by the competent government authority, has been shared with bidders. Before DIPAM invites financial bids, participants may have to be given an opportunity to physically inspect the facilities. The government is also working on clearing 100% FDI in OMCs.

A key concern related to this divestment transaction is resolution of the open offer requirement upon acquisition of stakes in PLNG and IGL along with BPCL. During the Q4FY21 call, BPCL management mentioned that it does not intend to divest its stakes in PLNG (22.5%) and IGL (12.5%) and was working with the government to find a solution that avoids triggering the open offer requirement for bidders.

HPCL – Maintain BUY, TP Rs 368

We maintain BUY on HPCL with an upside of 21% to our target price. HPCL's stock closed some of its valuation gap with peer BPCL after the announcement of a buyback offer priced at Rs 250/sh in May'21.

Amongst OMCs, HPCL is positioned to deliver profit growth over FY22-FY24 from completion of its large capex investments. While the throughput increase at its Mumbai refinery was implemented in Q1FY22, key catalysts for the stock from hereon are delivery on its Vizag refinery expansion in FY22 and Vizag residue upgrade project in CY22 and Bhatinda Polymer Addition project in FY23 which will aid margins in FY23.

IOCL – Maintain BUY, TP Rs 135

We maintain BUY on IOCL with an upside of 24%. IOCL offers similar upside as HPCL at our target price. However, the valuation gap is unlikely to narrow soon. IOCL faces higher earnings volatility relative to peers due to its need to maintain higher level of inventory for its inland refineries.

IOCL is implementing a substantially larger investment plan than OMC peers with an annual capex outgo of Rs 270bn-280bn. However, most of these projects are still 2-3 years away from bearing fruit and hence profit expansion is likely only over FY24-FY25. At this point, we value IOCL based on FY23E EBITDA and do not capture the benefit of future projects achieving commercial operation beyond this time.

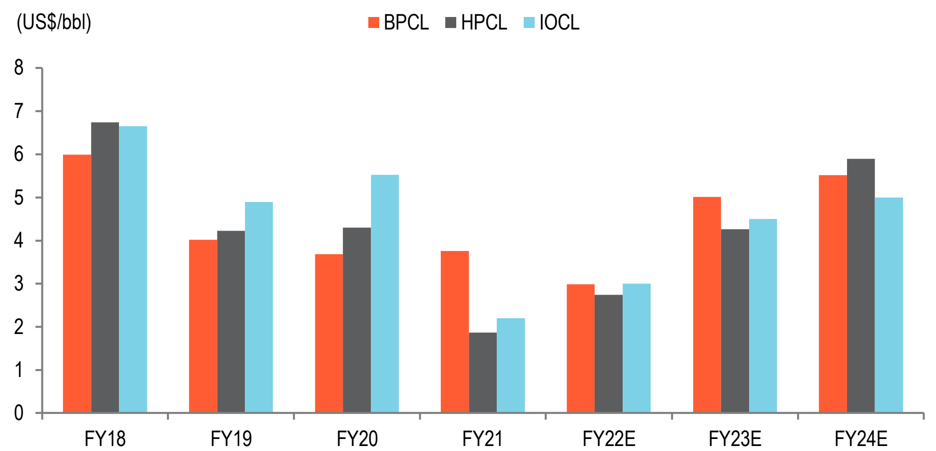
Estimate revision

Refining margin for Indian OMCs

Refining margins in FY21 were supported by inventory gains from a sharp rise in crude prices. Our forecasts have oil prices settling at around US$ 65/bbl over FY22-FY24 and do not assume any inventory gains. We model for gradual improvement in benchmark refining margin by ~US$ 1.5/bbl, US$ 1.5/bbl and US$ 0.5bbl over FY22, FY23 and FY24 respectively, supported by better product cracks and recovery in light-heavy spreads. Additionally, we assume margin upside from completion of specific projects:

- **BPCL:** We factor in an additional US$ 1/bbl of improvement in gross refining margin at Kochi refinery after completion of the PDPC complex in FY22.
- **HPCL:** Vizag refinery margin is projected to expand by US$ 3/bbl over FY24 and FY25 after completion of the bottom-of-the-barrel upgradation project.
- **IOCL:** We are not assuming upsides from expansion projects due in FY24 as we await clearer visibility on their completion.

Fig 15 – Gross refining margin excluding inventory gains

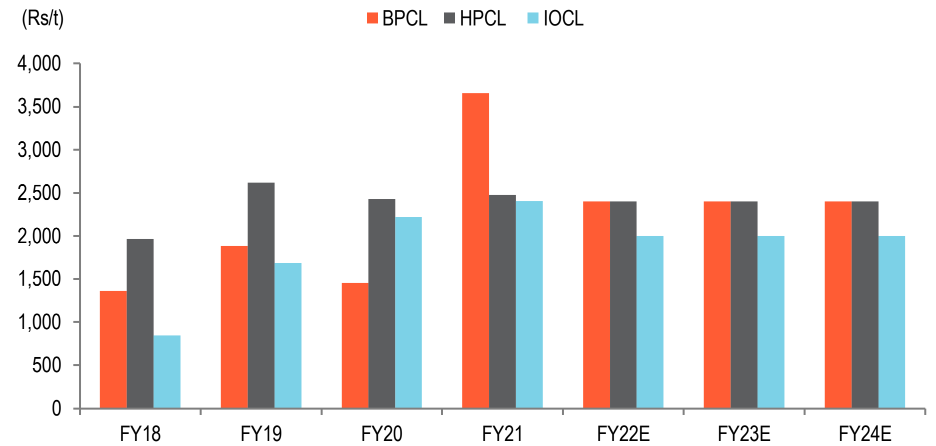


Source: Company, BOBCAPS Research

Marketing margin

FY21 marketing margins were supported by a phase of lower crude oil prices in the first half of the year and by inventory gains during the second half. While oil price has risen to US$ 75/bbl, we expect it to normalise towards US$ 65/bbl with the rise in OPEC as well as US production. Hence, we assume marketing EBITDA margins will normalise at historical levels of Rs2200-2600/t. As IOCL separates its pipeline margin from marketing margin, we pencil in lower marketing EBITDA for the company than that of peers.

Fig 16 – Marketing EBITDA excluding inventory gains



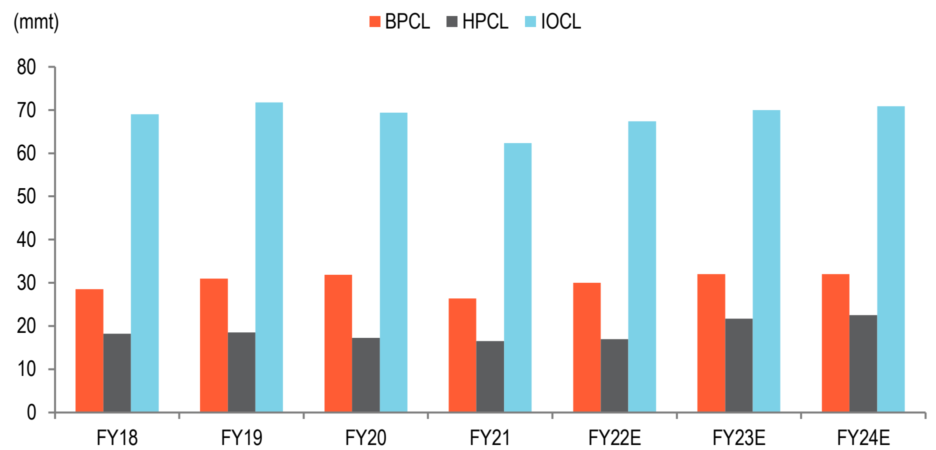
Source: Company, BOBCAPS Research

Refining throughput

We expect sharp recovery in refining throughput in FY22 from muted levels in FY21 supported by post-Covid recovery]

- **BPCL:** Throughput is forecast to recover to pre-pandemic levels at existing refineries.
- **HPCL:** We build in an increase in Mumbai refinery throughput to 9.5mtpa (from 7.5mtpa) after completion of expansion in Q1FY22, along with gradual ramp-up in Vizag refinery throughput by 6mt over FY23 and FY24.
- **IOCL:** We have not factored in upsides from expansion projects due in FY24 as we await clearer visibility on their completion.

Fig 17 – Refining throughput

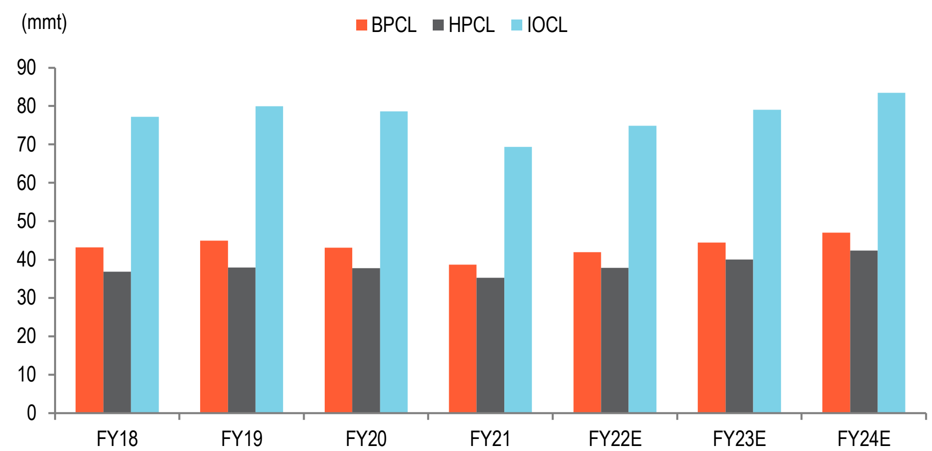


Source: Company, BOBCAPS Research

Marketing throughput

We assume 8-9% YoY growth in sales volumes for all three OMCs in FY22 and normalised annual growth of 5-6% thereafter. We are not factoring in changes in market share.

Fig 18 – Domestic marketing sales



Source: Company, BOBCAPS Research

Earnings forecasts

We expect a 33% YoY decrease in FY22 EBITDA for OMCs collectively (vs. consensus estimate of -23%) in the absence of material inventory gains and our expectation of normalisation of marketing margins. For FY23 and FY24, we model for 26% and 13% growth in EBITDA respectively (vs. 13% and 7% for consensus), driven by recovery in refining margins, higher marketing volumes and completion of investment projects. We believe HPCL will outperform its OMC peers on EBITDA growth over FY22-FY24 as it delivers on expansion and upgrade projects at the Mumbai and Vizag refineries.

Fig 19 – Earnings forecasts

Company	Actual	New			Consensus			Delta (%)		
	FY21	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
EBITDA (Rs bn)										
BPCL	213	128	176	197	154	174	173	(16.8)	1.3	13.8
HPCL	149	93	118	145	113	135	121	(17.6)	(12.6)	20.3
IOCL	417	294	360	395	333	367	428	(11.8)	(1.9)	(7.6)
OMCs	**779**	**515**	**654**	**738**	**600**	**676**	**722**	**(14.2)**	**(3.2)**	**2.2**
EBITDA growth (%)										
BPCL	-	(39.9)	37.8	11.9	(27.8)	13.2	(0.4)	-	-	-
HPCL	-	(37.6)	26.3	23.6	(24.2)	19.1	(10.3)	-	-	-
IOCL	-	(29.5)	22.7	9.7	(20.1)	10.3	16.5	-	-	-
OMCs	**-**	**(33.9)**	**27.1**	**12.8**	**(23.0)**	**12.7**	**6.8**	**-**	**-**	**-**
Adj PAT (Rs bn)										
BPCL	121	70	102	116	85	100	86	(18.4)	1.5	34.7
HPCL	104	61	83	106	67	79	66	(8.3)	4.4	60.5
IOCL	216	131	170	181	158	180	194	(16.8)	(5.6)	(6.6)
OMCs	**441**	**262**	**355**	**403**	**310**	**360**	**346**	**(15.4)**	**(1.4)**	**16.5**

Source: Company, Bloomberg, BOBCAPS Research

BPCL

We estimate 40% YoY contraction in FY22 EBITDA mainly due to the absence of inventory gains. We have baked in an additional US$ 1/bbl of improvement in gross refining margin at Kochi refinery after completion of the PDPC complex in FY22. For FY23 and FY24, we see 38% and 12% growth in EBITDA respectively backed by a recovery in benchmark refining margin and increase in marketing volumes. We account for full consolidation of BORL and removal of NRL from FY22, reflecting the transactions completed by BPCL in FY21.

Our EBITDA forecasts are 17% below consensus for FY22 but 1% and 14% higher for FY23 and FY24 respectively.

Fig 20 – BPCL: Key drivers

Key Drivers	FY21	FY22E	FY23E	FY24E
Refining EBITDA	66	27	70	84
Marketing EBITDA	147	101	107	113
Consolidated EBITDA	213	128	176	197
YoY Growth (%)	-	(39.9)	37.8	11.9
Throughput (mt)	26.4	30	32	32
YoY Growth (%)	(17.3)	13.6	6.7	0.0
Domestic Marketing sales (mt)	38.7	42.0	44.4	47.1
YoY Growth (%)	(10.1)	8.4	5.8	5.9
Ex rate	74.2	75.0	76.5	78.0
Crude price (US$/bbl)	45.8	67.5	65.0	65.0
GRM (US$/bbl)	4.1	3.0	5.0	5.5
Marketing EBITDA (Rs/t)	3,805	2,400	2,400	2,400

Source: Company, BOBCAPS Research

Fig 21 – BPCL: Earnings forecast changes

(Rs bn)	Actuals	New			Consensus			Delta (%)			Old		Change (%)	
	FY21	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY22E	FY23E
Revenue	2,302	3,239	3,304	3,353	2,898	3,197	2,911	11.8	3.4	15.2	2,542	3,140	27.4	5.2
EBITDA	213	128	176	197	154	174	173	(16.8)	1.3	13.8	151	178	(15.4)	(0.9)
Adj Net profit	109	70	102	116	85	100	86	(18.4)	1.5	34.7	85	90	(17.7)	12.7
EPS	52.1	33.3	48.7	55.4	41.2	48.2	42.4	(19.3)	1.0	30.8	43	46	(22.6)	5.9

Source: Company, Bloomberg, BOBCAPS Research

HPCL

We expect EBITDA to decline 38% YoY in FY22 in the absence of inventory gains. Mumbai refinery throughput is forecast to rise to 9.5mtpa (from 7.5mtpa) after expansion ends in Q1FY22, followed by gradual ramp-up in Vizag refinery throughput by 6mt over FY23 and FY24. This together with increase in refining margin aids in 26% and 24% YoY growth in EBITDA for FY23 and FY24 respectively. We pencil in cumulative Vizag refinery margin gains of US$ 2.5/bbl over FY24 and FY25 upon completion of the residual upgrade project.

Our EBITDA forecasts are 18%/13% below consensus for FY22/FY23 but 20% above for FY24. In our view, we have used conservative assumptions for the increase in profits at Vizag refinery from implementation of the expansion project.

Fig 22 – HPCL: Key drivers

Key Drivers	FY21	FY22E	FY23E	FY24E
Refining EBITDA	9	2	21	45
Marketing EBITDA	141	91	96	102
Consolidated EBITDA	149	93	118	146
YoY Growth (%)	-	(37.6)	26.3	24.5
Throughput (mt)	16.5	17.0	21.7	22.5
YoY Growth (%)	(4.1)	2.8	27.6	3.8
Domestic Marketing sales (mt)	35.2	37.9	40.1	42.4
YoY Growth (%)	(6.8)	7.6	5.8	5.8
Ex rate	74.2	75.0	76.5	80.0
Crude price (US$/bbl)	67.5	65.0	65.0	65.0
GRM (US$/bbl)	3.9	2.7	4.3	5.9
Marketing EBITDA (Rs/t)	3,997	2,400	2,400	2,400

Source: Company, BOBCAPS Research

Fig 23 – HPCL: Earnings forecast changes

(Rs bn)	Actuals	New			Consensus			Delta (%)			Old		Change (%)	
	FY21	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY22E	FY23E
Revenue	2,322	3,029	3,194	3,327	2,801	2,942	2,756	8.1	8.5	20.7	2,473	3,218	22.5	(0.7)
EBITDA	149	93	118	145	113	135	121	(17.6)	(12.6)	20.3	152	172	(38.7)	(31.6)
Adj Net profit	104	61	83	106	67	79	66	(8.3)	4.4	60.5	86	103	(28.3)	(19.7)
EPS (Rs)	71.5	42.3	57.1	72.8	45.1	53.1	46.2	(6.4)	7.7	57.8	56.2	67.8	(24.8)	(15.8)

Source: Company, Bloomberg, BOBCAPS Research

IOCL

For IOCL, we see 30% YoY reduction in FY22 EBITDA primarily due to the absence of inventory gains. In FY23 and FY24, we expect 22% and 10% improvement in EBITDA respectively on the back of a better benchmark refining margin, increase in pipeline throughput and higher petrochemical sales volumes.

While IOCL is pursuing a large investment plan of Rs 270bn-280bn annually, most of its expansion projects are targeted for completion in FY24 and beyond. We have not built the same into our estimates as we await visibility on timely implementation. Our EBITDA forecasts are 12%, 2% and 8% below consensus estimates for FY22, FY23 and FY24 respectively.

Fig 24 – IOCL: Key drivers

Key Drivers	FY21	FY22E	FY23E	FY24E
Refining	66	0	59	81
Marketing	215	160	168	177
Petrochemicals	61	61	57	57
Pipeline	57	62	65	67
Others	6	6	7	7
CPCL EBITDA	10	5	5	6
Consolidated EBITDA	**417**	**294**	**360**	**395**
YoY Growth (%)		(29.5)	22.7	9.7
Refining throughput (mt)	62.4	67.4	70.0	70.9
YoY Growth (%)	(10.1)	8.0	3.9	1.3
Domestic Marketing sales (mt)	69.4	74.9	79.0	83.5
YoY Growth (%)	(11.7)	7.9	5.6	5.7
Pipeline throughput (mt)	76.0	85.5	89.1	92.7
YoY Growth (%)	(19.4)	12.5	4.2	4.0
Ex rate	74.2	75.0	76.5	78.0
Crude price (US$/bbl)	67.5	65.0	65.0	65.0
GRM (US$/bbl)	5.6	3.0	4.5	5.0
Marketing EBITDA (Rs/t)	2,927	2,000	2,000	2,000
Petrochemicals EBITDA (US$/t)	303	286	247	229

Source: Company, BOBCAPS Research

Fig 25 – IOCL: Earnings forecasts changes

(Rs bn)	Actuals	New			Consensus			Delta (%)			Old		Change (%)	
	FY21	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY22E	FY23E
Revenue	3,639	5,196	5,291	5,464	4,960	5,322	5,376	4.8	(0.6)	1.6	4,362	5,034	19.1	5.1
EBITDA	417	294	360	395	333	367	428	(11.8)	(1.9)	(7.6)	463	470	(36.5)	(23.3)
Adj Net profit	216	131	170	181	158	180	194	(16.8)	(5.6)	(6.6)	222	222	(40.9)	(23.8)
EPS (Rs)	23.6	14.3	18.5	19.7	16.9	19.4	20.7	(15.3)	(4.7)	(4.9)	24.2	24.2	(40.9)	(23.7)

Source: Company, Bloomberg, BOBCAPS Research

Valuation and Rating

We are positive on OMCs given our expectation of gradual improvement in refining margin and marketing margin holding up. While sustainability of marketing margin is a key risk with the rise in oil prices, we expect crude to retract and remain range bound around US$ 65/bbl. Divestment of BPCL will be a key catalyst for the sector as it will help establish a value for the marketing business in an attractive growth market like India. Within OMCs, we downgrade BPCL to HOLD from BUY as known positives appear priced in, while maintain BUY on HPCL and IOCL.

Fig 26 – OMCs: Valuation and ratings

(Rs bn)	New				Old		EBITDA		Net income		P/B		P/E	
	CMP	Rating	Target price	Upside (%)	Rating	Target price	FY22E	FY23E	FY22E	FY23E	FY21	FY22E	FY22E	FY23E
BPCL	460	HOLD	518	12.7	BUY	480	128	176	70	102	1.8	1.7	13.8	9.4
HPCL	304	BUY	368	20.9	BUY	440	93	118	61	83	1.2	1.1	7.2	5.3
IOCL	109	BUY	135	24.1	BUY	170	294	360	131	170	0.9	0.8	7.6	5.9

Source: BOBCAPS Research

Valuation methodology

We continue to value OMCs using the SOTP method and roll our target prices forward to Mar'22 from Sep'21. We value the core businesses based on the following target multiples:

- **Refining business** at a one-year forward EV/EBITDA multiple of 6x (unchanged). Our target multiple is at a discount to the global peer-set which is valued at an average CY22E/FY23E EV/EBITDA multiple of 7.5-8.1x.

Fig 27 – Global refining valuation snapshot

Company	Bloomberg Code	Maket Cap (US$ bn)	Rating	Price Currency	Current Price	P/E		P/B		EV/EBITDA	
						CY21E/ FY22E	CY22E/ FY23E	CY21E/ FY22E	CY22E/ FY23E	CY21E/ FY22E	CY22E/ FY23E
Phillips 66	PSX US	38.5	N/R	USD	86.66	30.2	12.7	2.0	1.8	13.6	8.3
Valero Energy	VLO US	31.9	N/R	USD	78.58	68.8	13.2	1.8	1.7	11.5	6.4
Marathon Petroleum	MPC US	39.9	N/R	USD	60.96	42.9	17.5	2.4	2.8	9.5	8.0
S-Oil	010950 KS	1.1	N/R	KRW	100,500	11.1	11.7	1.8	1.7	7.1	7.2
SK Innovation	096770 KS	2.2	N/R	KRW	277,500	46.0	22.6	1.6	1.5	11.4	10.6
IRPC	IRPC TB	2.4	N/R	THB	3.9	14.0	17.8	1.0	1.0	7.8	8.5
Thai Oil	TOP TB	3.5	N/R	THB	55.75	16.5	13.9	0.9	0.9	12.5	11.8
Eneos Holdings	5020 JP	13.7	N/R	JPY	463.6	7.2	7.0	0.6	0.6	5.4	5.2
Idemitsu Kosan	5019 JP	7.2	N/R	JPY	2673	7.3	7.4	0.6	0.6	6.7	6.5
Weighted Average	**-**	**140.3**	**-**	**-**	**-**	**38.7**	**13.6**	**1.8**	**1.8**	**10.6**	**7.5**
Simple Average	**-**	**-**	**-**	**-**	**-**	**27.1**	**13.7**	**1.4**	**1.4**	**9.5**	**8.1**
Median	**-**	**-**	**-**	**-**	**-**	**16.5**	**13.2**	**1.6**	**1.5**	**9.5**	**8.0**

Source: Bloomberg, BOBCAPS Research

- **Marketing business** at a one-year forward EV/EBITDA multiple of 6.0x (5x previously), at the same target multiple that we use for valuing the refining business. For OMCs, we believe that marketing business has the potential to offer a stable earnings stream due to its access to domestic growth and potential to capture the marketing of competing energy sources such as biofuels, natural gas and electric charging. Also, we believe market forces have started playing an increasing role in determining the level of earnings for the marketing division, except during times of election. This trend will gain traction as the privatisation of BPCL will increase the share of private players.

- **Petrochemical business** at a one-year forward EV/EBITDA multiple of 6x (from 7x), the same target multiple as the refining business. While improved petrochemical integration can help improve sustainability of earnings, Indian OMCs are at an early stage and are progressing at a slower pace – hence, we do not yet accord a premium over the refining target multiple. Our target multiple is at a discount to the global chemical peer set, which is currently valued at 8.4-9.5x, and reflects limited capture of margins from the chemical chain relative to peers.

Fig 28 – Global petrochemicals valuation snapshot

Company	Bloomberg Code	Maket Cap (US$ bn)	Rating	Price Currency	Current Price	P/E		P/B		EV/EBITDA	
						CY21E	CY22E	CY21E	CY22E	CY21E	CY22E
LG Chem	051910 KS	5.4	N/R	KRW	824,000	20.4	21.7	3.1	2.8	9.3	8.9
Lotte Chemical	011170 KS	0.8	N/R	KRW	273,000	5.6	6.1	0.6	0.6	3.2	3.1
SK Innovation	096770 KS	2.2	N/R	KRW	277,500	46.0	22.6	1.6	1.5	11.4	10.6
S-Oil Corp	010950 KS	1.1	N/R	KRW	100,500	11.1	11.7	1.8	1.7	7.1	7.2
Wanhua Chemical -A	600309 CH	54.7	N/R	CNY	104.09	17.9	16.5	5.5	4.4	12.2	10.9
IRPC	IRPC TB	2.4	N/R	THB	3.9	14.0	17.8	1.0	1.0	7.8	8.5
Formosa Plastics	1301 TT	24.5	N/R	TWD	102	14.0	15.4	1.9	1.8	16.0	19.0
Petronas Chemicals Group Bhd	PCHEM MK	15.6	N/R	MYR	8.01	16.3	16.6	2.0	1.9	8.9	8.3
Indorama Ventures Pcl	IVL TB	7.2	N/R	THB	40.75	15.1	14.2	1.7	1.6	9.0	8.4
Lyondellbasell	LYB US	34.6	N/R	USD	102.42	6.7	7.7	3.0	2.5	5.7	6.1
Dow	DOW US	47.3	N/R	USD	63.54	9.3	11.8	2.9	2.7	5.5	6.0
Weighted Average	**-**	**196.0**	**-**	**-**	**-**	**13.4**	**13.7**	**3.3**	**2.9**	**9.3**	**9.5**
Simple Average	**-**	**-**	**-**	**-**	**-**	**15.6**	**14.0**	**2.2**	**1.9**	**8.7**	**8.8**
Median	**-**	**-**	**-**	**-**	**-**	**14.0**	**14.8**	**1.9**	**1.7**	**8.9**	**8.4**

Source: Bloomberg, BOBCAPS Research | Note: N/R Not Rated

- **Pipeline and other businesses** at a one-year forward EV/EBITDA multiple of 6x (unchanged) – the same target multiple that we use to value refining businesses.

- **Investments and other holdings** at 20% discount to current market price for listed holdings and at book value for other investments.

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BPCL

We downgrade BPCL to HOLD from BUY with a revised TP of Rs 518 (Rs 480 previously) with a potential upside of 13%. As the government is aiming to complete divestment of its stake in BPCL this fiscal, we now add a control premium at 20% of the equity value of core business, believing that the bidder would have to pay a premium to acquire a similar busines footprint in a growth market like India. With divestment on the cards, we do not apply holding discounts to BPCL's investments in PLNG, OINL and IGL.

Fig 29 – BPCL: Valuation summary

	New			Old
Business segments	**EV (Rs bn)**	**Value (Rs/sh)**	**Comments**	**Value (Rs/sh)**
Refining				
Standalone	282	135	6x FY23E EBITDA	36
BORL refinery	136	65	6x FY23E EBITDA	92
Numaligarh	0	0		94
Marketing	640	306	**6x FY23E EBITDA**	**339**
Total core business	**1,058**	**505**		**562**
Less: Net Debt	425	203	Adj for consolidation	157
Equity value of core business	**633**	**302**		**406**
Control premium	127	60	At 20% of equity value of core business	0
Investments	140	67	Investments in PLNG, OINL, IGL @ CMP	53
Total E&P	40	32	At carrying value estimated by BPCL as on FY21	20
Total equity value for BPCL	**940**	**462**		**480**
Target price ex-FY21 dividend (rounded to nearest Rs5)	**-**	**460**		**480**
FY21 dividend due	-	58		-
Target price including FY21 dividend	**-**	**518**		**480**

Source: BOBCAPS Research

HPCL

We retain BUY on HPCL with a reduced TP of Rs 368 (Rs 440 previously), implying a potential upside of 21%. We add value for the Vizag refining expansion being completed in FY23/FY24 by valuing incremental earnings at the target multiple and discounting this back to Mar'22. For Polymer Addition project at Bhatinda refinery as well, we add value for incremental earnings from full ramp-up of project over FY23/24.

Fig 30 – HPCL: Valuation summary

	New			Old
Business segments	**EV (Rs bn)**	**Value (Rs/sh)**	**Comments**	**Value (Rs/sh)**
Refining standalone	175	121	6x FY23E EBITDA plus value of expansions discounted back to FY22	19
Marketing	577	397	6x FY23E EBITDA	516
Refining and marketing	**752**	**518**		**535**
Less: Net Debt	360	248		99
Bhatinda refinery equity value	20	14	6x FY23E EBITDA plus value of expansions discounted back to FY22	0
Equity value of core business	**412**	**284**		**435**
Investment in MRPL and Oil India	16	11	20% discount to CMP	5
Other subsidiaries/ JVs/ Affiliates	75	51	At cost	0
Total equity value for HPCL	**503**	**346**		**440**
Target price excl FY21 dividend rounded to nearest Rs 5	**-**	**345**		**440**
Dividend FY21 (ex-dividend date 8 Jul '21)	**-**	**23**		**-**
Target price incl FY21 dividend	**-**	**368**		**440**

Source: BOBCAPS Research

IOCL

We retain BUY on IOCL with a TP of Rs 135 (Rs 170 previously), carrying a potential upside of 24%. We value IOCL's refining and marketing business at 5.5x, at a small discount to our target multiple of 6.0x for its OMC peers. With inland refineries, IOCL needs to maintain a higher level of inventory for its operations, which tends to increase earnings volatility relative to peers. Expansion projects are not factored in as they are still some time away.

Fig 31 – IOCL: Valuation summary

Business segments	New		Comments	Old
	EV (Rs bn)	Value (Rs/sh)		Value (Rs/sh)
Refining				
Refining	324	35	5.5x FY23E EBITDA	30
Marketing	924	101	5.5x FY23E EBITDA	146
Petrochemicals	342	37	6x FY23E EBITDA	32
Pipeline	387	42	6x FY23E EBITDA	49
Others	40	4	6x FY23E EBITDA	0
Total core business EV	**2,017**	**220**		**257**
Less: Net Debt	956	104		97
Equity value of core business	**1,062**	**116**		**160**
Investments	181	20	Listed holdings at 20% discount to CMP, and others at investment value	10
Total equity value for IOCL	**1,243**	**135**		**170**
Target price rounded to nearest Rs 5	**-**	135		**170**

Source: BOBCAPS Research

Key risks

OMC valuations are highly sensitive to refining and marketing margins. Key downside/upside risks to our estimates for OMCs are as follows:

- A slower/faster recovery in global economies could lead to below/above-expected refining margins and petrochemical spreads. An adverse/favourable change in global demand-supply balance for the refining or petrochemical products chain could also lower/increase margins vs. our current assumptions.
- Oil prices have surged close to US$ 75/bbl levels and expose OMCs to the risk of not fully recovering marketing margins for retail sales of petrol/diesel, especially in the wake of recent sharp hikes in excise duties on these fuels, which would affect the marketing business.
- Market share losses on fuel product sales could result in below-expected volumes and affect marketing business earnings.
- Refiners are exposed to requirement of additional investments to lower their carbon footprint, including potential investment in green hydrogen.

BPCL

- Delay in divestment is a key risk to our estimates. While the government is pursuing closure of BPCL's divestment this fiscal, there are still several issues which have the potential to delay divestment, among them being the open offer triggered by the transaction for stakes in PLNG and IGL.
- BPCL has deferred the implementation of several strategic projects to allow the new management to define the course of action. This has the potential to delay implementation of the next wave of margin enhancement projects.

HPCL

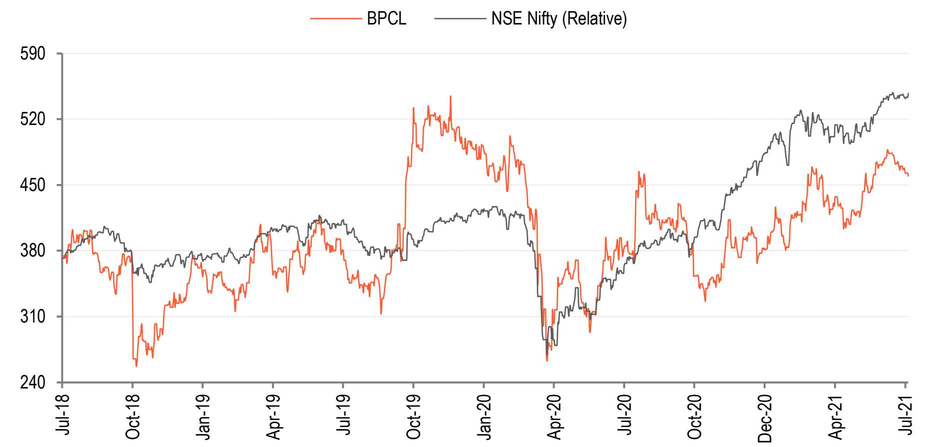
- Delay in implementation of Vizag refinery expansion and residue upgrade projects could impact earnings growth from this refinery.
- Delay in normalisation of heavy-sour spreads could also have an impact on expected earnings growth from Vizag.

IOCL

- IOCL's earnings are exposed to relatively higher volatility considering its higher inventory days than other OMCs.
- Adverse pipeline tariff orders or regulations by PNGRB mandating third-party use of IOCL's pipelines could hurt pipeline business earnings.

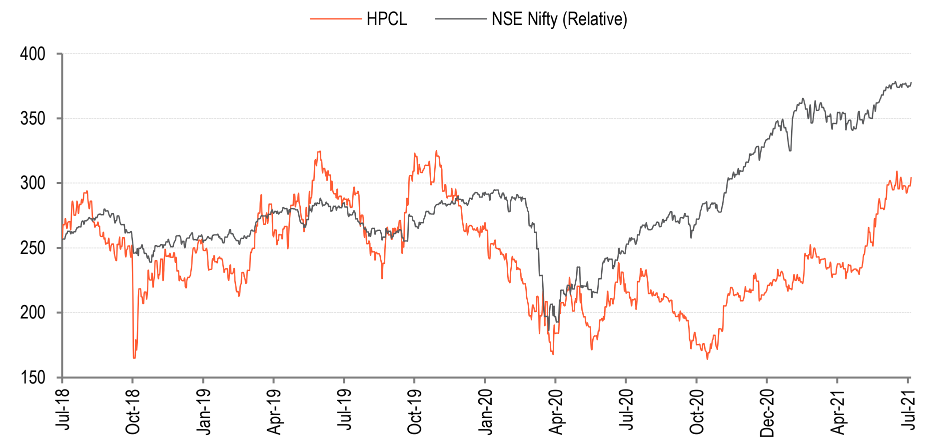
Stock performance

Fig 32 – BPCL



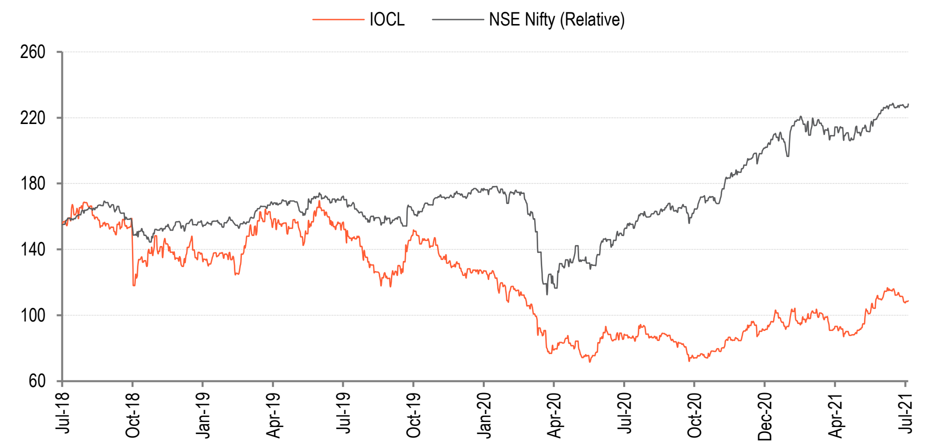
Source: NSE

Fig 33 – HPCL



Source: NSE

Fig 34 – IOCL



Source: NSE

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Financials – BPCL

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	**28,45,719**	**23,01,626**	**32,39,324**	**33,04,436**	**33,52,899**
EBITDA	89,311	2,12,964	1,27,941	1,76,254	1,97,194
Depreciation	(40,801)	(43,342)	(50,490)	(56,679)	(62,522)
EBIT	48,510	1,69,622	77,452	1,19,575	1,34,672
Net interest inc./(exp.)	(26,370)	(17,234)	(19,218)	(19,817)	(17,314)
Other inc./(exp.)	19,293	22,530	29,273	31,032	32,178
Exceptional items	(18,925)	52,658	0	0	0
EBT	41,433	1,74,918	87,507	1,30,789	1,49,536
Income taxes	142	(51,122)	(27,860)	(39,321)	(44,572)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	7,903	14,804	(10,000)	(10,500)	(11,025)
Reported net profit	**14,749**	**1,61,650**	**69,647**	**1,01,968**	**1,15,989**
Adjustments	0	0	0	0	0
Adjusted net profit	**33,673**	**1,20,821**	**69,647**	**1,01,968**	**1,15,989**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	1,31,077	1,62,627	2,38,292	2,40,954	2,45,773
Other current liabilities	2,77,197	3,50,926	2,58,916	2,82,981	2,81,952
Provisions	36,354	35,592	35,592	35,592	35,592
Debt funds	6,16,482	4,75,881	5,51,873	5,14,373	4,56,872
Other liabilities	61,639	49,345	49,345	49,345	49,345
Equity capital	19,669	20,929	20,929	20,929	20,929
Reserves & surplus	3,45,655	5,14,622	5,49,123	6,02,023	6,64,279
Shareholders' fund	3,65,323	5,35,551	5,70,052	6,22,952	6,85,208
Total liab. and equities	**15,08,636**	**16,09,920**	**17,04,069**	**17,46,196**	**17,54,742**
Cash and cash eq.	11,648	81,101	58,303	25,372	13,058
Accounts receivables	53,780	78,348	68,884	70,268	71,297
Inventories	2,22,426	2,67,060	2,14,463	2,16,858	2,21,196
Other current assets	1,07,462	38,614	40,840	40,845	40,848
Investments	2,70,285	2,67,677	2,32,792	2,37,792	2,42,792
Net fixed assets	6,01,746	6,40,983	8,53,185	9,23,326	9,67,682
CWIP	1,77,567	1,71,401	1,70,865	1,66,998	1,33,133
Intangible assets	0	0	0	0	0
Deferred tax assets, net	13,848	11,616	11,616	11,616	11,616
Other assets	49,873	53,120	53,120	53,120	53,120
Total assets	**15,08,636**	**16,09,920**	**17,04,069**	**17,46,196**	**17,54,742**

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	**62,914**	**2,20,657**	**1,03,452**	**1,50,559**	**1,44,753**
Capital expenditures	(1,87,171)	(76,413)	(1,17,389)	(1,22,953)	(73,012)
Change in investments	(21,216)	2,608	(1,213)	(5,000)	(5,000)
Other investing cash flows	19,293	22,530	29,273	31,032	32,178
Cash flow from investing	**(1,89,093)**	**(51,275)**	**(89,329)**	**(96,922)**	**(45,834)**
Equities issued/Others	0	1,260	0	0	0
Debt raised/repaid	1,87,337	(1,40,602)	3,500	(37,500)	(57,500)
Interest expenses	0	0	0	0	0
Dividends paid	(37,971)	(1,93,448)	(40,421)	(49,068)	(53,733)
Other financing cash flows	(85,001)	1,80,202	0	0	0
Cash flow from financing	**64,365**	**(1,52,587)**	**(36,921)**	**(86,568)**	**(1,11,233)**
Chg in cash & cash eq.	**(61,814)**	**16,795**	**(22,798)**	**(32,931)**	**(12,314)**
Closing cash & cash eq.	**(55,189)**	**28,444**	**58,303**	**25,372**	**13,058**

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	7.0	77.2	33.3	48.7	55.4
Adjusted EPS	16.1	57.7	33.3	48.7	55.4
Dividend per share	16.5	79.0	16.5	20.0	21.9
Book value per share	185.7	255.9	272.4	297.6	327.4

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	0.5	0.7	0.5	0.4	0.4
EV/EBITDA	15.6	7.1	11.7	8.2	7.5
Adjusted P/E	28.6	8.0	13.8	9.4	8.3
P/BV	2.5	1.8	1.7	1.5	1.4

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	149.6	53.1	79.6	78.0	77.6
Interest burden (PBT/EBIT)	46.4	134.2	113.0	109.4	111.0
EBIT margin (EBIT/Revenue)	1.7	7.4	2.4	3.6	4.0
Asset turnover (Rev./Avg TA)	197.8	147.6	195.5	191.5	191.5
Leverage (Avg TA/Avg Equity)	3.8	3.5	3.0	2.9	2.7
Adjusted ROAE	8.9	26.8	12.6	17.1	17.7

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	(4.6)	(19.1)	40.7	2.0	1.5
EBITDA	(40.9)	138.5	(39.9)	37.8	11.9
Adjusted EPS	(54.4)	258.8	(42.4)	46.4	13.7
Profitability & Return ratios (%)					
EBITDA margin	3.1	9.3	3.9	5.3	5.9
EBIT margin	1.7	7.4	2.4	3.6	4.0
Adjusted profit margin	1.2	5.2	2.2	3.1	3.5
Adjusted ROAE	8.9	26.8	12.6	17.1	17.7
ROCE	5.3	13.1	4.9	7.4	8.3
Working capital days (days)					
Receivables	8	10	8	8	8
Inventory	33	48	30	27	27
Payables	20	26	24	28	28
Ratios (x)					
Gross asset turnover	4.3	2.9	3.4	2.9	2.6
Current ratio	0.6	0.8	0.6	0.6	0.6
Net interest coverage ratio	1.8	9.8	4.0	6.0	7.8
Adjusted debt/equity	1.7	0.7	0.9	0.8	0.6

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Financials – HPCL

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	**26,79,238**	**23,21,642**	**30,28,323**	**31,93,502**	**33,26,654**
EBITDA	44,947	1,49,191	93,158	1,17,631	1,45,389
Depreciation	(33,699)	(36,255)	(39,136)	(43,723)	(48,310)
EBIT	11,248	1,12,936	54,022	73,908	97,079
Net interest inc./(exp.)	(11,389)	(9,633)	(11,784)	(12,270)	(12,756)
Other inc./(exp.)	28,494	37,280	35,717	40,880	46,004
Exceptional items	(10,029)	0	0	0	0
EBT	28,354	1,40,583	77,955	1,02,518	1,30,327
Income taxes	12,644	(35,341)	(19,542)	(25,627)	(32,705)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	(4,582)	1,387	(2,969)	(6,070)	(8,161)
Reported net profit	**35,551**	**1,03,856**	**61,382**	**82,961**	**1,05,783**
Adjustments	0	0	0	0	0
Adjusted net profit	**45,580**	**1,03,856**	**61,382**	**82,961**	**1,05,783**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	1,14,726	1,77,987	1,80,349	1,88,321	1,94,071
Other current liabilities	35,077	64,494	65,649	68,796	71,154
Provisions	26,852	28,839	28,839	28,839	28,839
Debt funds	3,93,858	4,26,741	4,21,741	4,61,741	4,56,741
Other liabilities	2,88,780	2,62,729	2,66,761	2,72,049	2,78,798
Equity capital	15,242	14,524	14,524	14,524	14,524
Reserves & surplus	2,94,564	3,66,285	4,00,477	4,47,752	5,07,653
Shareholders' fund	3,09,806	3,80,809	4,15,001	4,62,277	5,22,177
Total liab. and equities	**11,69,099**	**13,41,597**	**13,78,340**	**14,82,022**	**15,51,780**
Cash and cash eq.	2,231	5,749	7,545	4,918	6,343
Accounts receivables	39,342	68,700	58,085	61,253	63,807
Inventories	1,93,260	2,87,639	2,25,436	2,35,401	2,42,589
Other current assets	1,29,094	66,095	66,095	66,095	66,095
Investments	1,43,956	1,50,934	1,75,934	2,00,934	2,25,934
Net fixed assets	4,89,351	5,05,903	5,50,167	5,89,844	6,24,934
CWIP	1,71,698	2,53,360	2,91,860	3,20,360	3,18,860
Intangible assets	167	3,216	3,216	3,216	3,216
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	**11,69,099**	**13,41,597**	**13,78,340**	**14,82,022**	**15,51,780**

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	**48,911**	**1,13,478**	**1,45,168**	**89,078**	**1,13,203**
Capital expenditures	(1,79,253)	(1,34,469)	(1,21,900)	(1,11,900)	(81,900)
Change in investments	(1,051)	(5,131)	(25,000)	(25,000)	(25,000)
Other investing cash flows	28,564	35,432	35,717	40,880	46,004
Cash flow from investing	**(1,51,740)**	**(1,04,168)**	**(1,11,183)**	**(96,020)**	**(60,896)**
Equities issued/Others	0	(718)	0	0	0
Debt raised/repaid	1,33,493	32,883	(5,000)	40,000	(5,000)
Interest expenses	0	0	0	0	0
Dividends paid	(17,383)	(38,660)	(27,189)	(35,686)	(45,882)
Other financing cash flows	(5,467)	702	0	0	0
Cash flow from financing	**1,10,643**	**(5,793)**	**(32,189)**	**4,314**	**(50,882)**
Chg in cash & cash eq.	**7,814**	**3,518**	**1,796**	**(2,628)**	**1,425**
Closing cash & cash eq.	**9,999**	**5,749**	**7,545**	**4,918**	**6,343**

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	23.3	71.5	42.3	57.1	72.8
Adjusted EPS	29.9	71.5	42.3	57.1	72.8
Dividend per share	9.7	22.8	16.0	21.0	27.0
Book value per share	203.3	262.2	285.7	318.3	359.5

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	0.2	0.3	0.2	0.2	0.2
EV/EBITDA	11.8	4.1	7.4	5.8	4.7
Adjusted P/E	10.2	4.3	7.2	5.3	4.2
P/BV	1.5	1.2	1.1	1.0	0.8

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	248.7	73.9	78.7	80.9	81.2
Interest burden (PBT/EBIT)	162.9	124.5	144.3	138.7	134.2
EBIT margin (EBIT/Revenue)	0.4	4.9	1.8	2.3	2.9
Asset turnover (Rev./Avg TA)	238.9	184.9	222.7	223.3	219.3
Leverage (Avg TA/Avg Equity)	3.7	3.6	3.4	3.3	3.1
Adjusted ROAE	14.9	30.1	15.4	18.9	21.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	(2.3)	(13.3)	30.4	5.5	4.2
EBITDA	(56.3)	231.9	(37.6)	26.3	23.6
Adjusted EPS	(5.7)	139.1	(40.9)	35.2	27.5
Profitability & Return ratios (%)					
EBITDA margin	1.7	6.4	3.1	3.7	4.4
EBIT margin	0.4	4.9	1.8	2.3	2.9
Adjusted profit margin	1.7	4.5	2.0	2.6	3.2
Adjusted ROAE	14.9	30.1	15.4	18.9	21.5
ROCE	1.8	11.2	4.9	6.3	7.6
Working capital days (days)					
Receivables	7	8	8	7	7
Inventory	122	268	149	107	105
Payables	20	25	22	22	22
Ratios (x)					
Gross asset turnover	4.6	3.5	4.2	3.9	3.7
Current ratio	1.1	1.0	0.8	0.8	0.9
Net interest coverage ratio	1.0	11.7	4.6	6.0	7.6
Adjusted debt/equity	1.3	1.1	1.0	1.0	0.9

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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Financials – IOCL

Income Statement

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Total revenue	**48,37,630**	**36,39,497**	**51,96,102**	**52,91,033**	**54,64,317**
EBITDA	1,62,318	4,17,047	2,93,832	3,60,468	3,95,267
Depreciation	(1,02,734)	(1,09,415)	(1,11,136)	(1,24,400)	(1,40,904)
EBIT	59,584	3,07,633	1,82,696	2,36,068	2,54,363
Net interest inc./(exp.)	(65,787)	(35,891)	(54,406)	(59,756)	(61,946)
Other inc./(exp.)	33,818	23,799	32,021	35,197	34,516
Exceptional items	1,13,046	0	0	0	0
EBT	27,615	2,95,540	1,60,312	2,11,508	2,26,933
Income taxes	53,007	(89,885)	(40,221)	(53,185)	(57,037)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	23,493	10,727	11,231	11,258	11,037
Reported net profit	**(8,931)**	**2,16,382**	**1,31,322**	**1,69,581**	**1,80,934**
Adjustments	0	0	0	0	0
Adjusted net profit	**80,622**	**2,16,382**	**1,31,322**	**1,69,581**	**1,80,934**

Balance Sheet

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Accounts payables	2,75,763	3,72,480	3,38,705	3,39,536	3,47,457
Other current liabilities	5,64,560	7,06,279	5,60,750	5,64,054	5,80,355
Provisions	1,12,335	1,08,992	58,729	68,989	72,007
Debt funds	12,67,576	10,93,624	12,56,548	13,08,379	13,46,526
Other liabilities	1,14,393	1,39,645	1,40,140	1,40,508	1,40,992
Equity capital	91,810	91,810	91,810	91,810	91,810
Reserves & surplus	8,62,169	10,26,570	11,02,181	11,98,115	13,00,124
Shareholders' fund	9,53,979	11,18,381	11,93,992	12,89,925	13,91,934
Total liab. and equities	**32,97,368**	**35,49,159**	**35,59,359**	**37,22,596**	**38,91,406**
Cash and cash eq.	22,960	24,747	18,577	19,028	21,894
Accounts receivables	1,32,595	1,38,003	1,27,242	1,29,576	1,33,838
Inventories	6,70,108	8,34,275	6,82,988	6,84,734	7,01,647
Other current assets	3,17,328	1,71,213	1,77,977	1,81,083	1,86,755
Investments	3,55,709	4,47,168	4,47,168	4,47,168	4,47,168
Net fixed assets	14,70,211	15,70,838	16,59,358	18,26,818	20,02,776
CWIP	3,28,448	3,62,905	4,46,039	4,34,178	3,97,317
Intangible assets	10	10	10	10	10
Deferred tax assets, net	0	0	0	0	0
Other assets	0	0	0	0	0
Total assets	**32,97,368**	**35,49,159**	**35,59,359**	**37,22,596**	**38,91,406**

Cash Flows

Y/E 31 Mar (Rs mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Cash flow from operations	**21,997**	**5,38,883**	**1,36,649**	**2,66,362**	**2,88,197**
Capital expenditures	(1,90,925)	(2,44,498)	(2,82,790)	(2,80,000)	(2,80,000)
Change in investments	85,414	(91,460)	0	0	0
Other investing cash flows	33,818	23,799	32,021	35,197	34,516
Cash flow from investing	**(71,693)**	**(3,12,159)**	**(2,50,769)**	**(2,44,803)**	**(2,45,484)**
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	3,34,299	(1,73,952)	1,62,924	51,831	38,148
Interest expenses	0	0	0	0	0
Dividends paid	(56,394)	(1,50,734)	(55,710)	(73,648)	(78,925)
Other financing cash flows	(2,15,896)	99,750	736	709	930
Cash flow from financing	**62,009**	**(2,24,936)**	**1,07,950**	**(21,108)**	**(39,847)**
Chg in cash & cash eq.	**12,313**	**1,787**	**(6,170)**	**451**	**2,866**
Closing cash & cash eq.	**22,960**	**24,747**	**18,577**	**19,028**	**21,894**

Per Share

Y/E 31 Mar (Rs)	FY20A	FY21A	FY22E	FY23E	FY24E
Reported EPS	(1.0)	23.6	14.3	18.5	19.7
Adjusted EPS	8.8	23.6	14.3	18.5	19.7
Dividend per share	5.2	14.0	5.2	6.9	7.3
Book value per share	103.9	121.8	130.0	140.5	151.6

Valuations Ratios

Y/E 31 Mar (x)	FY20A	FY21A	FY22E	FY23E	FY24E
EV/Sales	0.4	0.6	0.4	0.4	0.4
EV/EBITDA	11.1	5.1	7.4	6.0	5.8
Adjusted P/E	12.4	4.6	7.6	5.9	5.5
P/BV	1.0	0.9	0.8	0.8	0.7

DuPont Analysis

Y/E 31 Mar (%)	FY20A	FY21A	FY22E	FY23E	FY24E
Tax burden (Net profit/PBT)	(94.4)	73.2	81.9	80.2	79.7
Interest burden (PBT/EBIT)	(143.4)	96.1	87.7	89.6	89.2
EBIT margin (EBIT/Revenue)	1.2	8.5	3.5	4.5	4.7
Asset turnover (Rev./Avg TA)	145.6	106.3	146.2	145.3	143.5
Leverage (Avg TA/Avg Equity)	3.2	3.3	3.1	2.9	2.8
Adjusted ROAE	7.8	20.9	11.4	13.7	13.5

Ratio Analysis

Y/E 31 Mar	FY20A	FY21A	FY22E	FY23E	FY24E
YoY growth (%)					
Revenue	(8.4)	(24.8)	42.8	1.8	3.3
EBITDA	(53.9)	156.9	(29.5)	22.7	9.7
Adjusted EPS	(53.6)	168.4	(39.3)	29.1	6.7
Profitability & Return ratios (%)					
EBITDA margin	3.4	11.5	5.7	6.8	7.2
EBIT margin	1.2	8.5	3.5	4.5	4.7
Adjusted profit margin	1.7	5.9	2.5	3.2	3.3
Adjusted ROAE	7.8	20.9	11.4	13.7	13.5
ROCE	2.8	9.6	5.8	7.0	7.1
Working capital days (days)					
Receivables	11	14	9	9	9
Inventory	63	100	61	55	55
Payables	27	37	26	25	25
Ratios (x)					
Gross asset turnover	2.8	1.9	2.4	2.2	2.0
Current ratio	0.7	0.7	0.7	0.7	0.7
Net interest coverage ratio	0.9	8.6	3.4	4.0	4.1
Adjusted debt/equity	1.3	1.0	1.0	1.0	1.0

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

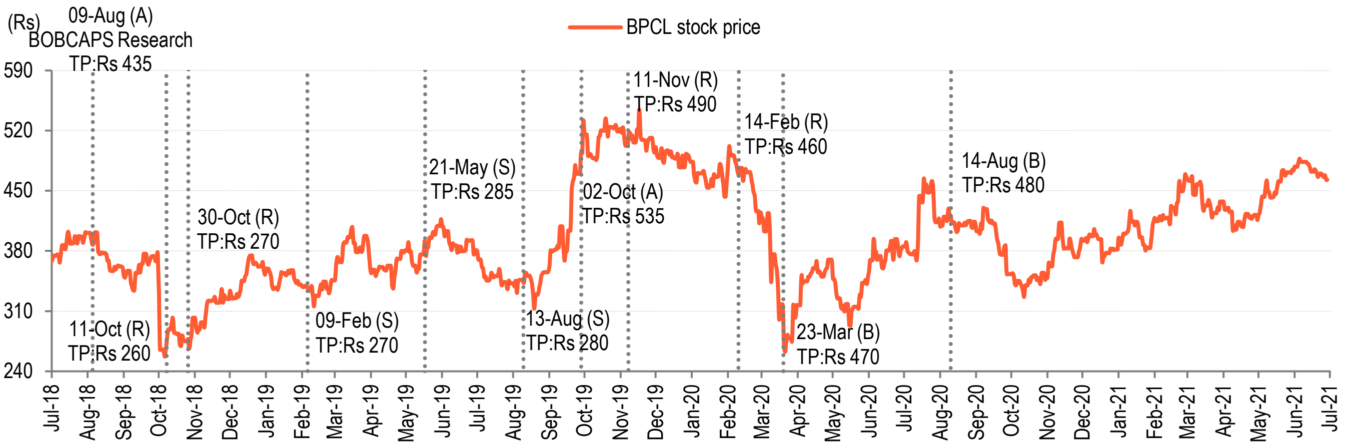
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

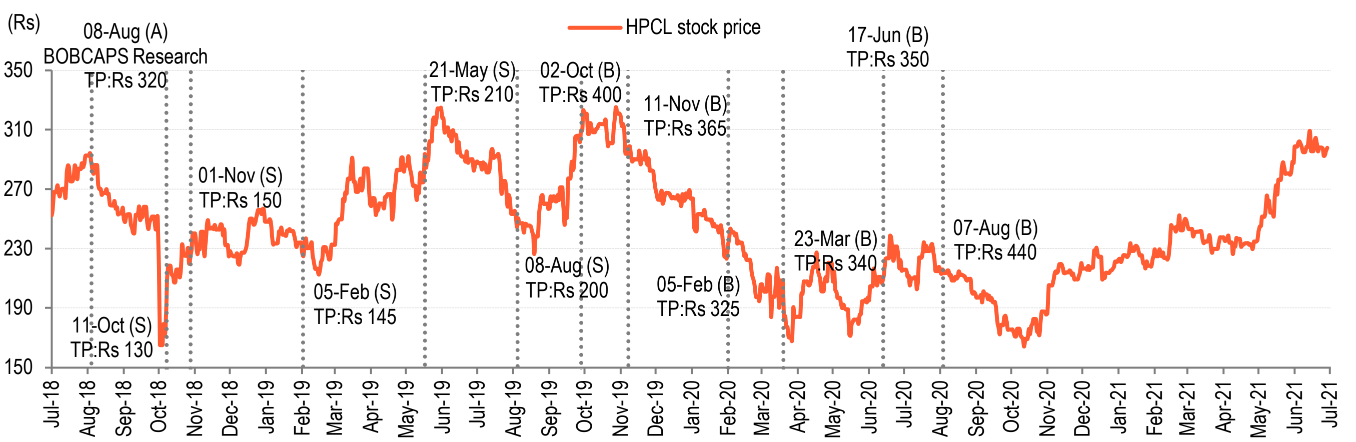
Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): BHARAT PETROLEUM CORP (BPCL IN)



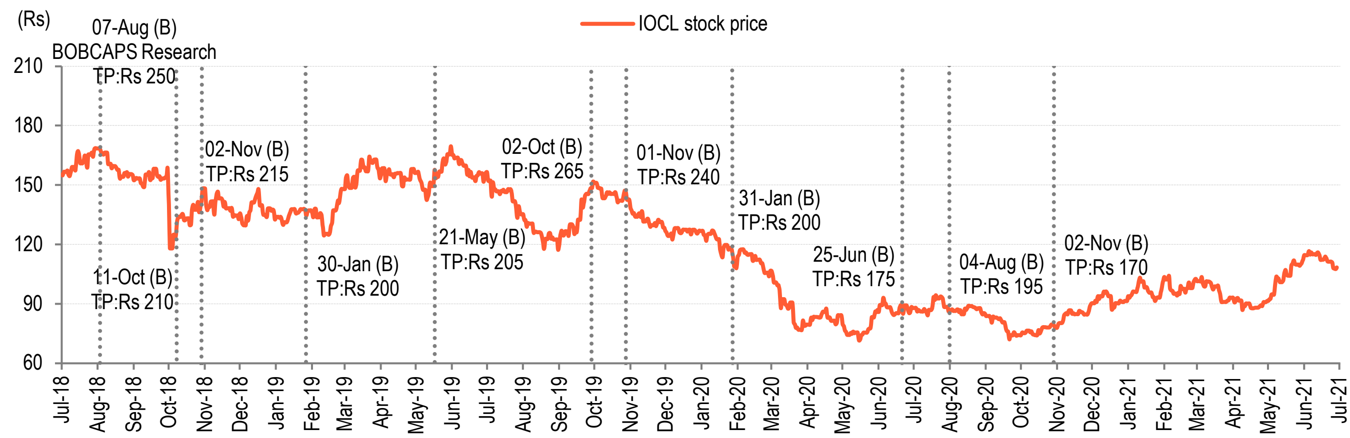
B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

Ratings and Target Price (3-year history): HINDUSTAN PETROLEUM CORP (HPCL IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

Ratings and Target Price (3-year history): INDIAN OIL CORP (IOCL IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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