

March 1, 2023

Oil & Gas

Sector Update

Earnings recovery continues

Quick Pointers:

- Current blended marketing margins at ~Rs4/ltr vs 9M loss of Rs8/ltr.
- Earnings recovery for OMCs continues to gather pace.

In Q3FY23 Oil Marketing Companies (OMCs) turned profitable at Rs27.4bn after H1FY23 losses of Rs227bn given 1) improvement in marketing margins (blended marketing loss Rs1.6/ltr) and 2) healthy refining margins at USD\$9.1-15.9/bbl. A year into the Ukraine-Russia war has led to high energy prices resulting in steep losses and severe OMCs underperformance (5-25%). However, Oil and product prices are now down by 12-18% vs last year. Going forward, we expect OMCs to report profits of ~Rs128bn in Q4FY23, based on current marketing margin trends and stock performance to reflect improving fundamentals. We maintain our estimates, recommendations and reiterate a positive stance on the sector. HPCL and BPCL are our preferred picks, given higher share of marketing revenues.

Bharat Petroleum Corporation (BPCL IN)

Rating: BUY | CMP: Rs316 | TP: Rs420

Key Financials - Standalone

Y/e Mar	FY22	FY23E	FY24E	FY25E
Sales (Rs. bn)	3,468	4,729	4,198	4,196
EBITDA (Rs. bn)	191	85	190	180
Margin (%)	5.5	1.8	4.5	4.3
PAT (Rs. bn)	105	28	85	78
EPS (Rs.)	49.5	13.0	40.1	36.7
Gr. (%)	(14.0)	(73.8)	208.9	(8.7)
DPS (Rs.)	15.7	-	10.5	11.3
Yield (%)	5.0	-	3.3	3.6
RoE (%)	20.0	5.3	15.8	13.4
RoCE (%)	12.6	1.9	10.2	8.5
EV/Sales (x)	0.4	0.3	0.3	0.3
EV/EBITDA (x)	6.5	14.4	6.0	6.0
PE (x)	6.4	24.4	7.9	8.6
P/BV (x)	1.3	1.3	1.2	1.1

Hindustan Petroleum Corporation (HPCL IN)

Rating: BUY | CMP: Rs215 | TP: Rs310

Key Financials - Standalone

Y/e Mar	FY22	FY23E	FY24E	FY25E
Sales (Rs. bn)	3,510	4,375	3,849	3,575
EBITDA (Rs. bn)	115	(81)	142	148
Margin (%)	3.3	(1.9)	3.7	4.1
PAT (Rs. bn)	77	(88)	67	83
EPS (Rs.)	54.0	(61.8)	47.0	58.7
Gr. (%)	(26.4)	(214.4)	(176.0)	24.8
DPS (Rs.)	15.0	-	15.7	19.6
Yield (%)	7.0	-	7.3	9.1
RoE (%)	20.5	(25.9)	21.1	22.3
RoCE (%)	9.4	(14.3)	8.4	8.3
EV/Sales (x)	0.2	0.2	0.2	0.2
EV/EBITDA (x)	6.0	(11.2)	6.0	5.2
PE (x)	4.0	(3.5)	4.6	3.7
P/BV (x)	0.8	1.0	0.9	0.8

Avishek Datta

avishek.datta@plindia.com | 91-22-66322254

A year of high volatility is behind: As the Ukraine-Russia war completes one year, global energy prices have seen huge volatility due to disruption fear and its impact on economic growth. Prices (crude oil, diesel etc) increased 25-48%, since start of the war. This in-turn pushed up global inflation and led to higher interest rates, which helped bring prices down 12-18% vs last year. Currently, energy prices are down YoY despite 1) OPEC cutting production by 2mbpd since Nov-22 to support prices 2) oil price cap of USD60/bbl on Russian oil prices along with 3) expectations of higher demand from China post reopening.

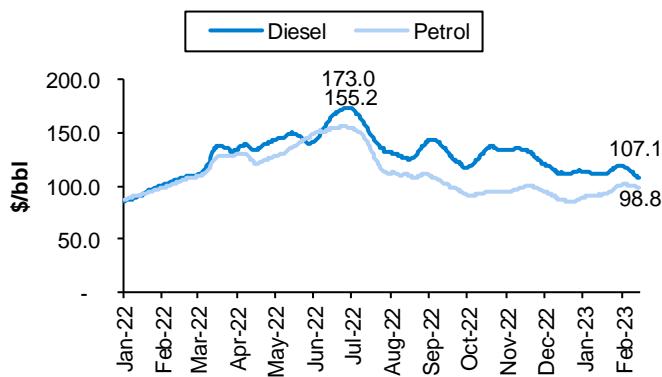
Slowing global growth to keep a lid on crude oil prices: After a year of high volatility, we expect energy prices to remain benign as global growth is projected to slow at 2.9% for CY23 from 3.4% in CY22 as per IMF. The agency expects rise in central bank rates to fight inflation (CY23: 6.6% in CY23 vs 8.85 in CY22 and pre pandemic 2017-19 level of 3.5%) and Russia's war in Ukraine will continue to weigh on economic activity.

Marketing margins to benefit from benign oil prices: Likely benign crude oil prices augur well for OMCs, as marketing margins turn positive for diesel. At current trends, we calculate diesel marketing margins at Rs4/ltr, while petrol margins have been positive since Q3FY23; we calculate positive blended marketing margins at ~Rs4/ltr from loss of Rs1.6/ltr in Q3 & loss of Rs14/ltr in Q1.

Low inventory & healthy demand to keep refining margins healthy: Refining margins in CY22 (Singapore GRMs \$10.7/bbl) were strongest ever on a sustained basis, particularly driven by middle distillate strength (CY22 diesel spread USD34/bbl vs USD7 YoY). While some refining cracks will weaken over CY23 due to slower demand growth and new refinery startups (~3mbpd capacity addition in CY23), diesel cracks are expected to stay much stronger than historical averages (CY15-21- USD11.3/bbl) in 2023. We believe that low diesel inventories and potential for larger reductions of Russian diesel exports will likely keep refining margins strong in 2023. We have factored in GRMs of USD6.0-7.5/bbl for FY24/25E.

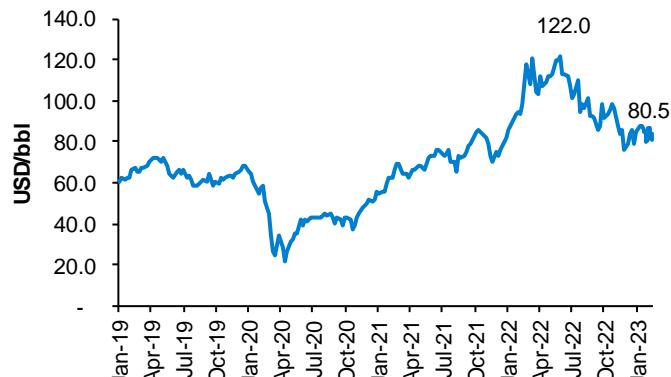
PAT of Rs128bn for Q4FY23: Based on current positive marketing margin trends of ~Rs3/ltr and stable refining margins, we expect OMCs to report PAT of Rs128bn for Q4FY23 against Q3 PAT of Rs27.4bn and 9MFY23 loss of Rs199.1bn.

Exhibit 1: Diesel/petrol prices down 38%/36% from peak



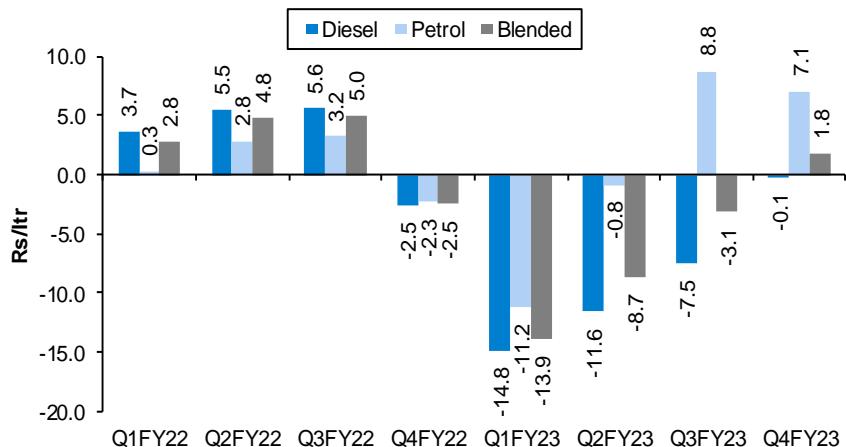
Source: Industry, PL

Exhibit 2: Brent down 34% from Jun 22 high



Source: Industry, PL

Exhibit 3: Q4FY23E blended marketing margins have turned positive



Source: Industry, PL

Exhibit 4: OMC's Q4FY23E PAT is likely at Rs128bn

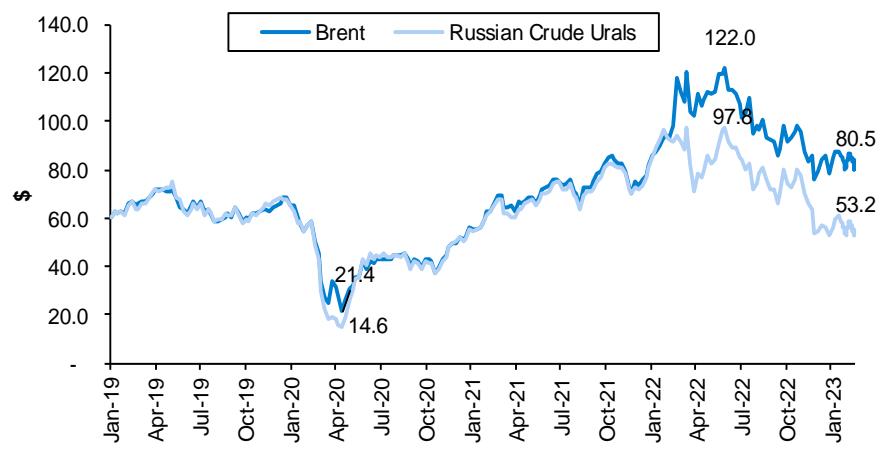
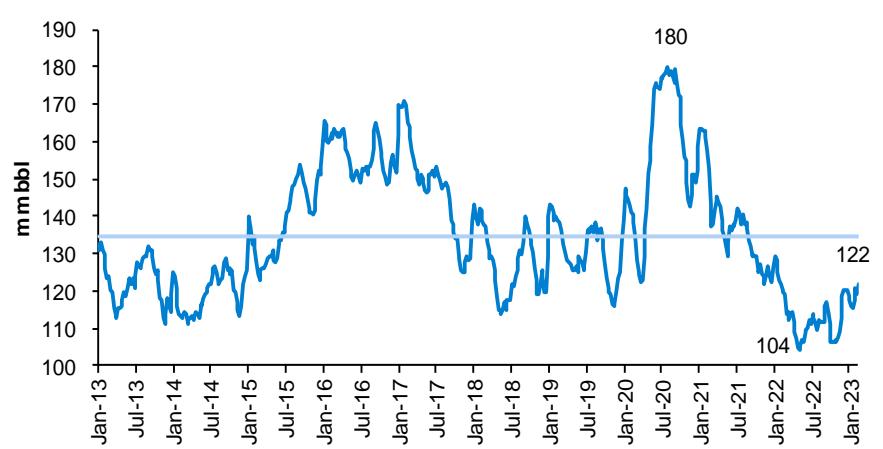
(Rs mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23E
OMCs Sales	4,191,311	4,353,003	5,117,713	4,708,643	4,776,264	4,485,373
EBIDTA	154,748	179,755	(170,006)	18,962	94,989	218,571
PAT	92,520	99,989	(198,413)	(28,203)	27,463	128,644

Source: Company, PL

Exhibit 5: Russian share in Indian crude oil basket at 23%

	Q1FY23	Q2FY23	Q3FY23
Total Crude Import (mbbl)	400	443	487
Russian share of Oil Imports	12%	21%	23%
Realised discount (\$/bbl)	7	12	6

Source: Industry, PL

Exhibit 6: Ural trades at 30% discount to Brent and OMCs have bought crude**Exhibit 7: US Distillate Fuel Oil stock remain below 5 yr average**

Analyst Coverage Universe

Sr. No.	Company Name	Rating	TP (Rs)	Share Price (Rs)
1	Bharat Petroleum Corporation	BUY	420	335
2	Bharti Airtel	BUY	1,008	775
3	GAIL (India)	BUY	123	95
4	Gujarat Gas	Hold	530	485
5	Hindustan Petroleum Corporation	BUY	310	232
6	Indian Oil Corporation	BUY	125	82
7	Indraprastha Gas	BUY	564	413
8	Mahanagar Gas	BUY	1,103	850
9	Oil & Natural Gas Corporation	BUY	190	147
10	Oil India	BUY	305	224
11	Petronet LNG	BUY	326	223
12	Reliance Industries	BUY	2,878	2,443

PL's Recommendation Nomenclature

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

ANALYST CERTIFICATION

(Indian Clients)

We/I Mr. Avishek Datta- MBA Research Analysts, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

(US Clients)

The research analysts, with respect to each issuer and its securities covered by them in this research report, certify that: All of the views expressed in this research report accurately reflect his or her or their personal views about all of the issuers and their securities; and No part of his or her or their compensation was, is or will be directly related to the specific recommendation or views expressed in this research report.

DISCLAIMER

Indian Clients

Prabhudas Lilladher Pvt. Ltd, Mumbai, India (hereinafter referred to as "PL") is engaged in the business of Stock Broking, Portfolio Manager, Depository Participant and distribution for third party financial products. PL is a subsidiary of Prabhudas Lilladher Advisory Services Pvt Ltd. which has its various subsidiaries engaged in business of commodity broking, investment banking, financial services (margin funding) and distribution of third party financial/other products, details in respect of which are available at www.plindia.com.

This document has been prepared by the Research Division of PL and is meant for use by the recipient only as information and is not for circulation. This document is not to be reported or copied or made available to others without prior permission of PL. It should not be considered or taken as an offer to sell or a solicitation to buy or sell any security.

The information contained in this report has been obtained from sources that are considered to be reliable. However, PL has not independently verified the accuracy or completeness of the same. Neither PL nor any of its affiliates, its directors or its employees accepts any responsibility of whatsoever nature for the information, statements and opinion given, made available or expressed herein or for any omission therein.

Recipients of this report should be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The suitability or otherwise of any investments will depend upon the recipient's particular circumstances and, in case of doubt, advice should be sought from an independent expert/advisor.

Either PL or its affiliates or its directors or its employees or its representatives or its clients or their relatives may have position(s), make market, act as principal or engage in transactions of securities of companies referred to in this report and they may have used the research material prior to publication.

PL may from time to time solicit or perform investment banking or other services for any company mentioned in this document.

PL is a registered with SEBI under the SEBI (Research Analysts) Regulation, 2014 and having registration number INH000000271.

PL submits that no material disciplinary action has been taken on us by any Regulatory Authority impacting Equity Research Analysis activities.

PL or its research analysts or its associates or his relatives do not have any financial interest in the subject company.

PL or its research analysts or its associates or his relatives do not have actual/beneficial ownership of one per cent or more securities of the subject company at the end of the month immediately preceding the date of publication of the research report.

PL or its research analysts or its associates or his relatives do not have any material conflict of interest at the time of publication of the research report.

PL or its associates might have received compensation from the subject company in the past twelve months.

PL or its associates might have managed or co-managed public offering of securities for the subject company in the past twelve months or mandated by the subject company for any other assignment in the past twelve months.

PL or its associates might have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months.

PL or its associates might have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past twelve months

PL or its associates might have received any compensation or other benefits from the subject company or third party in connection with the research report.

PL encourages independence in research report preparation and strives to minimize conflict in preparation of research report. PL or its analysts did not receive any compensation or other benefits from the subject Company or third party in connection with the preparation of the research report. PL or its Research Analysts do not have any material conflict of interest at the time of publication of this report.

It is confirmed that Mr. Avishek Datta- MBA Research Analysts of this report have not received any compensation from the companies mentioned in the report in the preceding twelve months

Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions.

The Research analysts for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report.

The research analysts for this report has not served as an officer, director or employee of the subject company PL or its research analysts have not engaged in market making activity for the subject company

Our sales people, traders, and other professionals or affiliates may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest.

PL and its associates, their directors and employees may (a) from time to time, have a long or short position in, and buy or sell the securities of the subject company or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the subject company or act as an advisor or lender/borrower to the subject company or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions.

US Clients

This research report is a product of Prabhudas Lilladher Pvt. Ltd., which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This report is intended for distribution by Prabhudas Lilladher Pvt. Ltd. only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a 6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, Prabhudas Lilladher Pvt. Ltd. has entered into an agreement with a U.S. registered broker-dealer, Marco Polo Securities Inc. ("Marco Polo").

Transactions in securities discussed in this research report should be effected through Marco Polo or another U.S. registered broker dealer.

Prabhudas Lilladher Pvt. Ltd.

3rd Floor, Sadhana House, 570, P. B. Marg, Worli, Mumbai-400 018, India | Tel: (91 22) 6632 2222 Fax: (91 22) 6632 2209

www.plindia.com