

## 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.**

**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.

March 1, 2023

#### 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

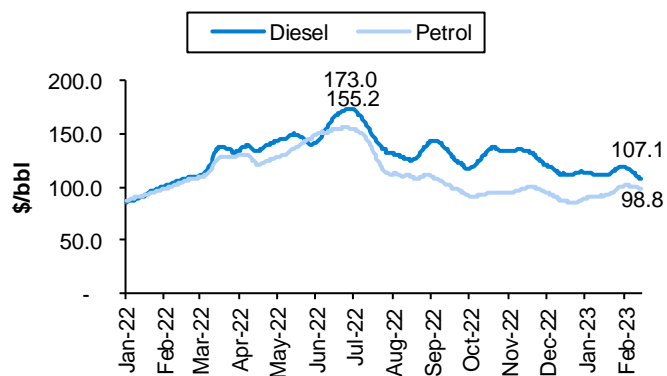
##### Key Financials - Standalone

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

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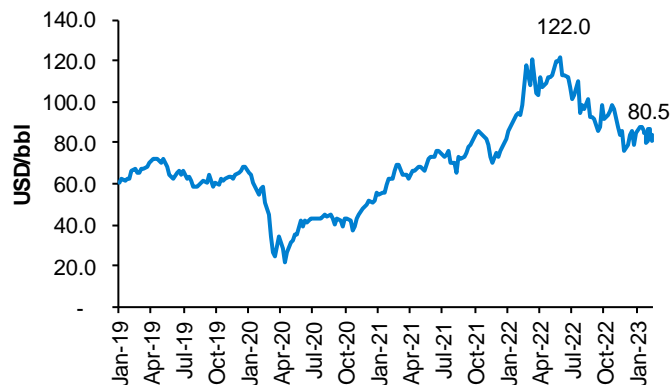
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**Exhibit 1: Diesel/petrol prices down 38%/36% from peak**



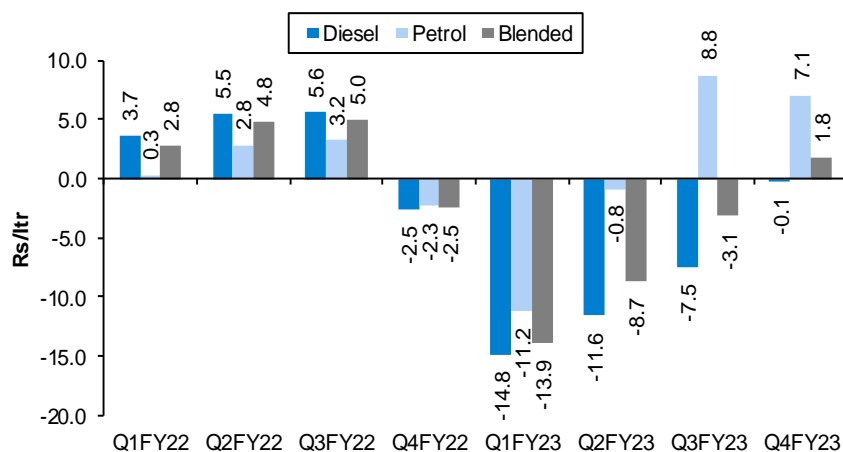
Source: Industry, PL

**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

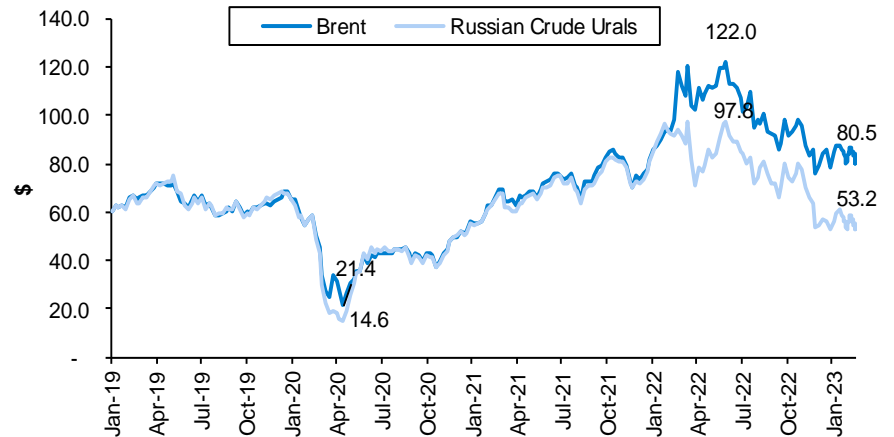
Source: Company, PL

**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

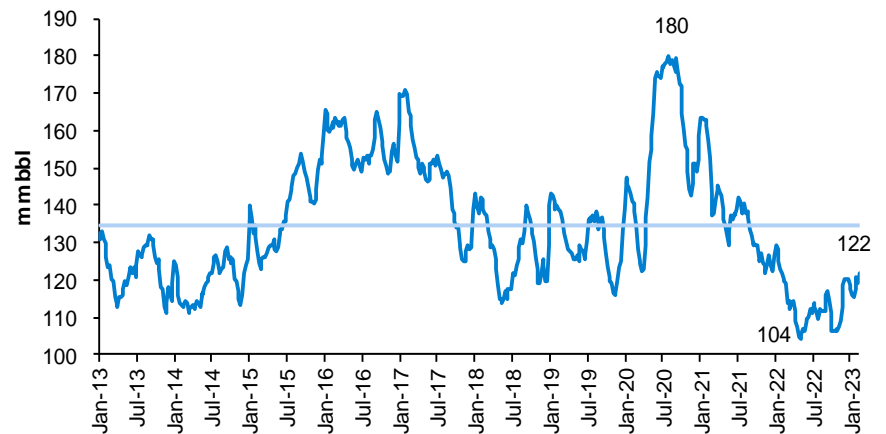
Source: Industry, PL

**Exhibit 6: Ural trades at 30% discount to Brent and OMCs have bought crude**



Source: Industry, PL

**Exhibit 7: US Distillate Fuel Oil stock remain below 5 yr average**



Source: Industry, PL

### 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

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

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