

## Oil & Gas Sector

10 April 2019

### Short-term Improvement In Marketing Margin To Help Profitability

We expect 300%, 544% and 225% QoQ increase in the March 2019 quarter earnings of Indian Oil Corporation (IOCL), Hindustan Petroleum Corporation (HPCL) and Bharat Petroleum Corporation (BPCL), respectively. Earnings of Indraprastha Gas (IGL) are expected to grow 6.5% QoQ. Earnings growth for oil marketing companies or OMCs will be primarily driven by: 1) Likely increase in marketing margin compensating for the price control earlier. However, this will be partially negated by: 1) Average Singapore GRM declining from US\$8.7/bbl in 3QFY19 to US\$4.57/bbl in 4QFY19. 2) Rising interest costs and depreciation. 3) Inventory losses on account of the decline in average crude oil price (Dubai-Fateh) from US\$66.8/bbl to US\$63.3/bbl. However, earnings growth of IGL will be supported by: 1) Expected rise in CNG and PNG consumption by 3% and 2% QoQ and 17% and 4% YoY, respectively. 2) Ability of IGL to increase CNG and PNG prices following the rise in input costs to support EBITDA margin.

**Adjusted GRM to disappoint:** Average Singapore GRM declined from US\$8.7/bbl in 3QFY19 to US\$4.6/bbl in 4QFY19. Average Singapore GRM stood at US\$7.0/bbl in 4QFY18. Average MS cracks witnessed a sharp decline from US\$9.9/bbl in 4QFY18 and US\$4.5/bbl in 3QFY19 to US\$0.04/bbl in 4QFY19. However, HSD cracks at US\$13.2/bbl in 4QFY19 registered a decrease from US\$18.0/bbl in 3QFY19 and US\$14.7/bbl in 4QFY18.

**Inventory loss to worsen EBITDA performance:** OMCs have been posting strong earnings growth for the past few quarters in the back-drop of rising crude oil prices, leading to inventory gains. However, in the recent past, we have seen crude oil prices correcting because of strong production volume in the US, Russia and Saudi Arabia. Average crude oil price (Dubai-Fateh) declined from US\$66.8/bbl in 3QFY19 to US\$63.3/bbl in 4QFY19. Decline in average crude oil price by US\$3.5/bbl leads to inventory losses, worsening the impact on GRM.

**CNG and PNG volume to rise:** CNG and PNG volume are expected to increase 3% and 2% QoQ and 17% and 4% YoY, respectively. We expect CNG and PNG sales volume to rise on account of: 1) Additional volume from expansion in Rewari and Gurugram. 2) Increased fuel supply conversion in private vehicles because of cost benefit and pollution concerns. 3) PNG volume on the rise as it is cheaper, convenient and a safer alternative to other cooking fuels. We believe that IGL will be able to maintain its EBITDA margin by increasing CNG and PNG prices to counter any increase in input costs.

**Rise in marketing margin in 4QFY19 to compensate for price control earlier:** Marketing margin of BPCL is expected to increase 61% QoQ. Marketing margin of IOCL is expected to increase by 26% QoQ and that of HPCL is expected to rise by 5% QoQ.

**Reiterate Sell rating on OMCs, Buy on IGL with a revised target price of Rs411:** Our Sell rating on OMCs is because of: 1) GRM expected to remain range-bound. 2) Increase in capex to result in higher depreciation and interest costs, thereby impacting the quality of earnings. 3) Lower earnings growth to result in a decline in RoE and RoCE. 4) Sharp decline in OMC stocks in the recent past on account of re-introduction of subsidy burden leading to opaqueness in earnings of OMCs. However, we maintain our bullish stance on IGL, a city gas distribution or CGD company, driven by: 1) Monopoly situation in NCR region. 2) Government's focus on natural gas as a preferred mode for meeting energy needs. 3) Strong balance sheet with a net cash position. 4) Strong operational cash flow with negative working capital, which is expected to provide for future capital expenditure. We have revised our target price (25x FY21E EPS) on the stock, rolling over our base year from September 2020 to FY21.

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(Rsmn) Company	CMP (Rs)	TP (Rs)	Rating	Upside/ (Downside)	Sales			EBITDA			EBITDA margin (%)			PAT		
					4QFY19E	YoY(%)	QoQ(%)	4QFY19E	YoY(%)	QoQ(%)	4QFY19E	4QFY18	3QFY19	4QFY19E	YoY(%)	QoQ(%)
IOCL	155	112	Sell	(26)	1,635,894	12.2	0.2	69,557	(46.3)	95.6	4.3	8.9	2.2	30,681	(52.9)	299.7
HPCL	256	208	Sell	(18)	753,983	13.1	(2.3)	28,909	(1.1)	200.1	3.8	4.4	1.2	15,945	(8.8)	544.1
BPCL	356	300	Sell	(16)	864,638	13.7	(2.0)	25,281	(32.1)	242.9	2.9	4.9	0.8	16,077	(39.9)	224.7
IGL	311	411	Buy	31	15,859	28.6	5.1	3,269	12.2	2.8	20.6	23.6	21.1	2,109	20.7	6.5
<b>Grand total</b>					<b>3,270,374</b>	<b>16.9</b>	<b>0.2</b>	<b>127,017</b>	<b>(16.8)</b>	<b>135.4</b>	<b>7.9</b>	<b>10.4</b>	<b>6.3</b>	<b>64,813</b>	<b>(20.2)</b>	<b>268.7</b>

Source: Nirmal Bang Institutional Equities Research

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### Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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