

India

Overweight (no change)

Highlighted Companies

Bharat Petroleum

REDUCE, TP Rs352, Rs439 close

We maintain our Reduce rating and adjust TP to Rs352 as the stock is now ex-dividend. This is based on Rs331 for core business (1.5x Mar 23F P/BV, 18% ROE in FY23F and Rs21 value for E&P).

Hindustan Petroleum

HOLD, TP Rs285, Rs283 close

We reiterate our Add rating with a TP of Rs285 which is based on 1x Mar 23F P/BV, 15% ROE in FY23F. Large off-balance sheet debt will likely keep valuations in check.

Indian Oil Corp

ADD, TP Rs150, Rs118 close

We reiterate our Add rating with a TP of Rs150, which is based on 1.1x Mar 23F P/BV, 14% ROE in FY23F. Near 7% dividend yield is the key rerating catalyst.

Summary Valuation Metrics

P/E (x)	Mar21-A	Mar22-F	Mar23-F
Bharat Petroleum	5.37	12.38	11.08
Hindustan Petroleum	4	7.17	6.37
Indian Oil Corp	5.02	6.91	6.01

P/BV (x)	Mar21-A	Mar22-F	Mar23-F
Bharat Petroleum	1.59	2.18	2.01
Hindustan Petroleum	1.06	1.01	0.92
Indian Oil Corp	0.95	0.89	0.83

Dividend Yield	Mar21-A	Mar22-F	Mar23-F
Bharat Petroleum	19.84%	4.49%	4.49%
Hindustan Petroleum	8.36%	5.07%	4.96%
Indian Oil Corp	10.14%	6.76%	8.45%

Oil & Gas Refinery

Focusing on marketing

- Oil demand recovery remains tepid with auto fuel volumes at 4.5% below pre-Covid levels in Aug 2021. We expect strong recovery from 2HFY22F.
- Auto fuel marketing margins remain very high and could provide upside to our forecasts if they do not decline in FY23F/24F, even as GRMs recover.
- We reiterate sector Overweight with Add on IOC (TP Rs150), Hold on HPCL (TP Rs285) and Reduce on BPCL (TP adjusted to Rs352 as now ex-dividend).

Full recovery on marketing volumes still awaited

Latest data for Aug 2021 indicates that compared to pre-Covid levels (Aug 2019), demand was 6.6% lower for the Indian oil market and 4.5% lower for auto fuels (diesel/ gasoline). We expect strong recovery from 2HFY22F with auto fuel volumes in FY22F reaching 103% of FY20 levels and growing at 4.2% CAGR in FY23F/24F (compared to CAGR of 5.5% over 5 years pre-Covid). Normalisation of oil demand will improve marketing volumes of the oil marketing companies (OMCs) as well as enable them to run their refineries at full utilization.

OMC focus on market share is lowering throughput per outlet

With the focus on market share, OMCs have sacrificed efficiency, increasing their retail station network well in excess of growth in the auto fuels market. Despite the auto fuel market nearly trebling over the last 18 years, throughput per outlet (kl/month) for the OMCs dropped from 206 in FY01 to 195 in FY10 and 131 in FY21 (though the right comparison would be 168 in FY19 to ignore the Covid impact). In the event BPCL is privatized, we would expect the new owner to focus on profitability rather than market share, and significantly reduce the network size (shutting down low throughput outlets). OMC volumes have also been impacted by the entry of private players whose market share has steadily been rising by 100bp every year (11.3% in diesel and 10% in gasoline in FY21).

Marketing margins are robust and could provide positive surprise

OMCs have managed to keep auto fuel marketing margins (MMs) elevated (relative to historical levels of FY16-18) despite absolute prices for auto fuels touching new highs, due to rise in global prices. The Reliance-BP JV reported a profit of Rs6.3bn in FY21 (9 months operation) on opening net worth of Rs16bn, indicating high profitability in pure marketing. We have assumed that the high MMs are partly to compensate for poor gross refining margins (GRMs) and MMs will moderate over FY23F/24F as GRMs improve. There could be upside to our forecasts if MMs remain at current levels despite improvement in GRMs.

Retain Add on IOC, Hold on HPCL and Reduce on BPCL

We retain our Overweight stance on the sector given expectations of volume and GRM recovery with IOC remaining our top pick. We prefer IOC to HPCL. While both are at similar valuations, HPCL has large off-balance debt in its joint ventures, Hindustan Mittal Energy (Rs361bn) and the Rajasthan refinery (Rs331bn projected debt), which makes it more expensive. We retain Reduce on BPCL as the stock is above fair value with investors focusing on upside from strategic sale, which is uncertain, in our view.

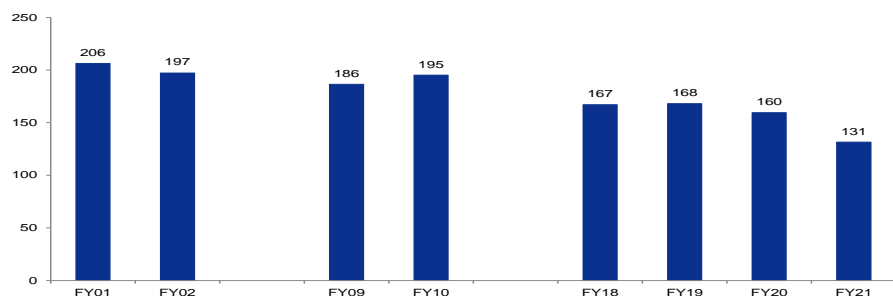
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Figure 1: Throughput per outlet of OMCs (kl/month)



SOURCES: INCRED RESEARCH, COMPANY REPORTS

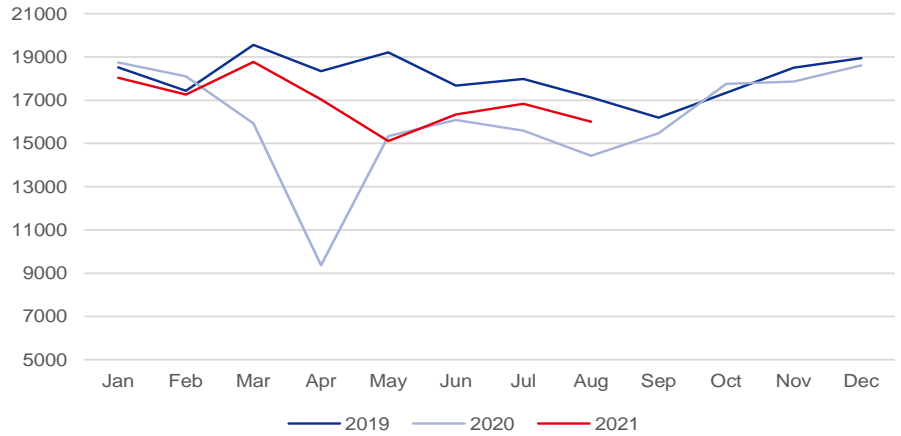
Focusing on marketing

Latest data relating to Aug 2021 shows that oil demand is yet to recover to pre-Covid levels which is CY19 (comparing yoy to CY20 is meaningless given the Covid impact last year). Aug 2021 volumes were 6.6% lower than Aug 2019. Lower oil demand impacts the sales volumes of the OMCs as well as limits their ability to run their refineries at full capacity. Our forecasts assume a relatively sharp recovery in demand post Sep 2021, similar to what was experienced last year.

Diesel normally takes up 39% of total Indian oil demand and slower pick up in diesel demand is curtailing overall demand. Aug 2021 volumes were 8.4% below Aug 2019 levels and we assume a sharp pick up in subsequent months so that FY22F ends up just 1.2% below FY19 levels.

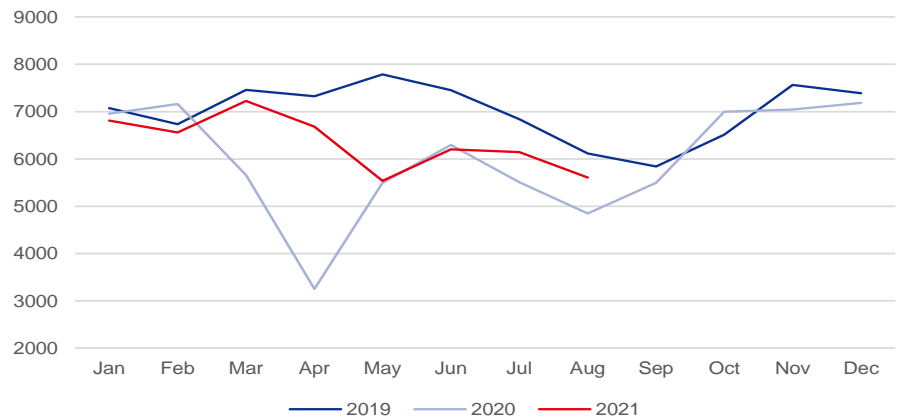
Given the Covid impact, consumers have relied largely on personal transportation which has resulted in relatively better growth for gasoline. Volume in Aug 2021 was 4.5% above Aug 2019 levels and we expect FY22F volumes to be 11.9% above FY19 levels.

Figure 2: India's monthly oil demand ('000t)



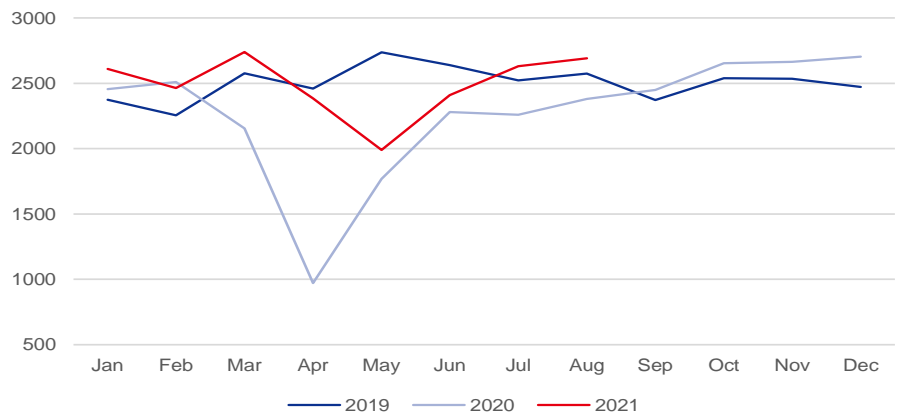
SOURCES: PETROLEUM PLANNING & ANALYSIS CELL, INCRED RESEARCH

Figure 3: India's monthly diesel demand ('000t)



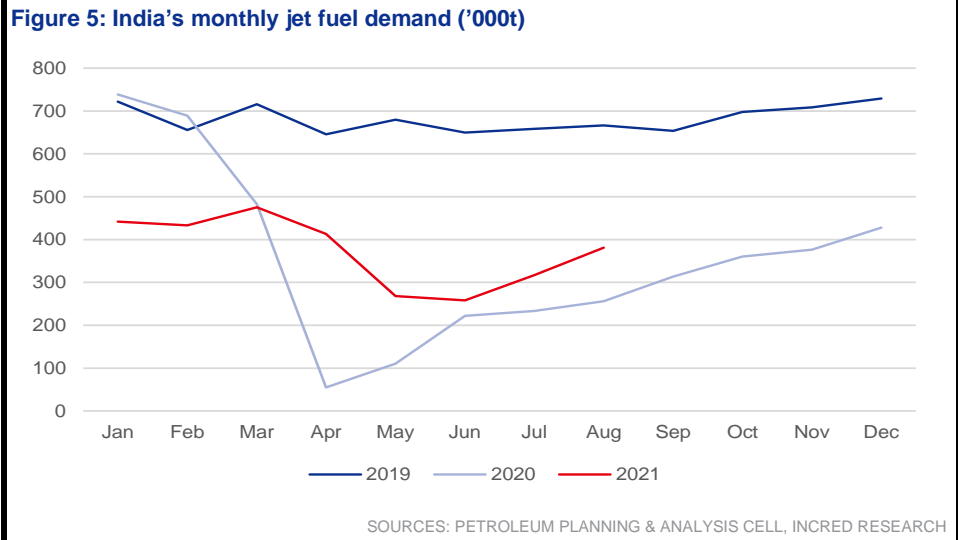
SOURCES: PETROLEUM PLANNING & ANALYSIS CELL, INCRED RESEARCH

Figure 4: India's monthly gasoline demand ('000t)

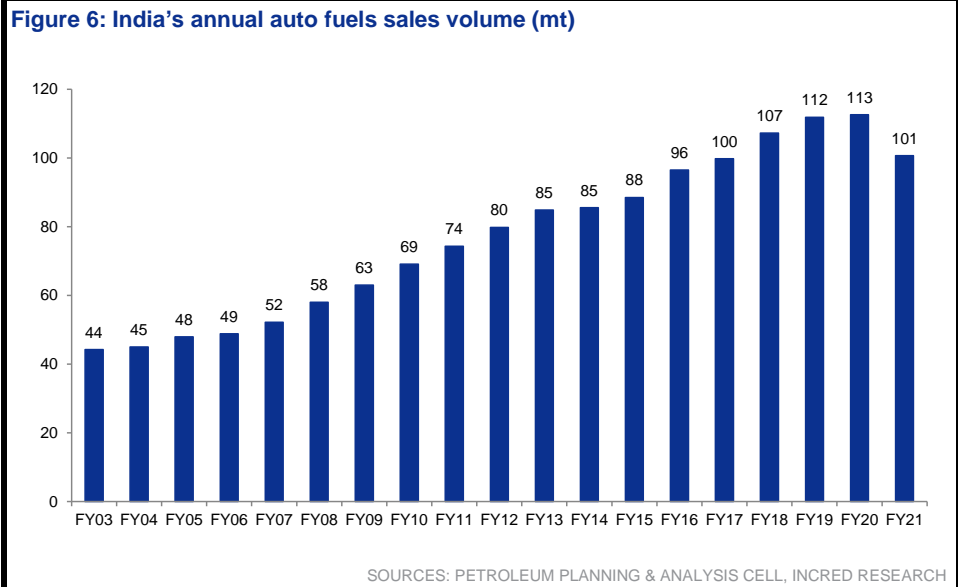


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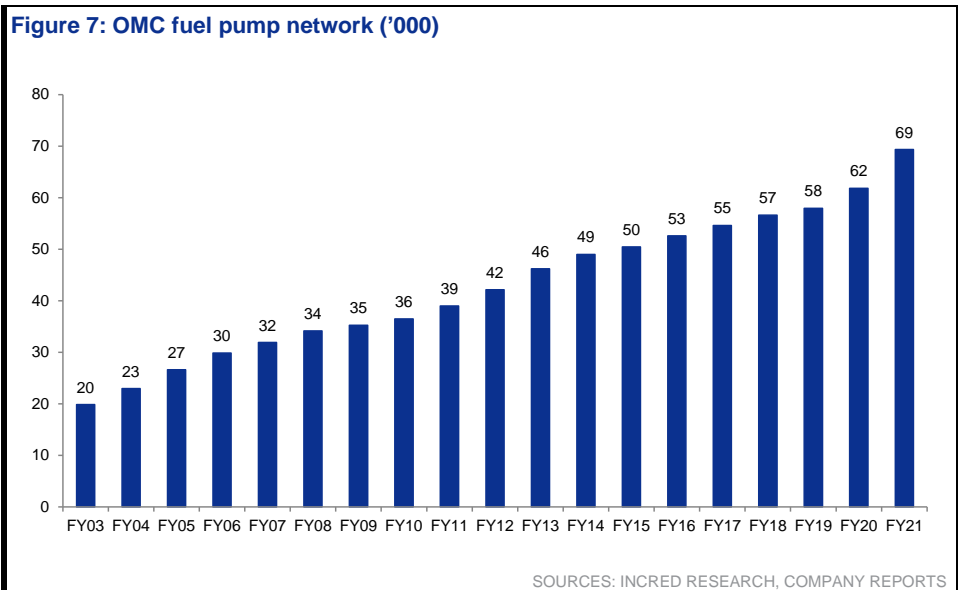
Jet fuel demand has been worst impacted with Aug 2021 volumes still 43% below Aug 2019 levels. With slow recovery expected for business travel, we estimate FY22F volumes to be 40% below FY19.



Indian auto fuels (diesel/gasoline) demand CAGR was 4.7% over FY03-21. Excluding FY20/21 (impacted by Covid), demand CAGR over FY03-19 was robust at 6%. CAGR over prior five years (FY14-19) was 5.5%. Post FY22F (when we are assuming normalization of economic activity), we forecast CAGR of 4.2%, lower than historical levels, assuming some negative impact due to higher CNG and EV vehicles.

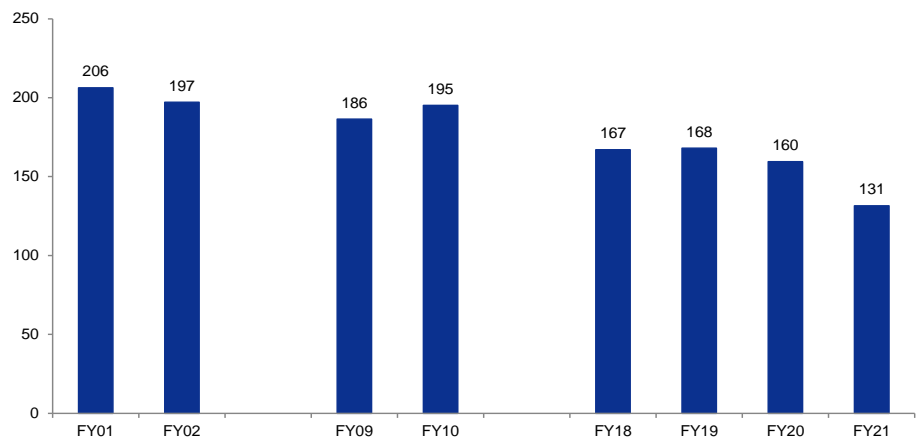


The OMCs have been growing their retail network far faster than growth in the market. The CAGR in retail stations network was 7.2% over FY03-21, well above CAGR of 4.7% in fuel sales. This big gap is partly due to the anomaly in the last two years when fuel sales dropped while retail additions were at record levels. Between FY14-19, network addition CAGR was only 3.4% compared to CAGR of 5.5% in fuel sales. Given the gestation period in commissioning new outlets, the large network addition in FY20/21 unfortunately coincided with fall in demand.



Notwithstanding the data for the last two years, OMCs have generally focused on growing the retail network faster than auto fuel sales volume with the result that throughput per outlet over the last 20 years declined despite growth in the market. Hence from an efficiency perspective, the OMCs have done worse, with all players adding to network fearing loss of market share. If BPCL is privatized, we would expect the new owner to significantly reduce the network size (shutting down low throughput stations) and focusing on retail profitability rather than volume market share.

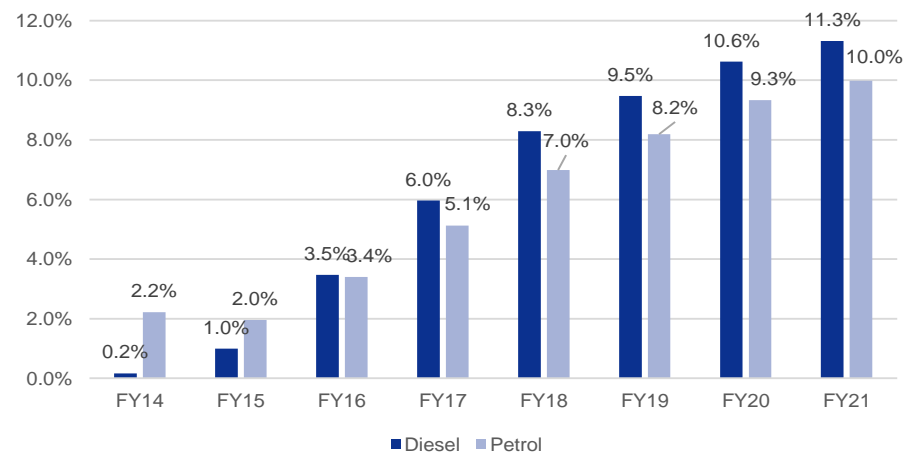
Figure 8: Throughput per outlet of OMCs (kl/month)



SOURCES: INCRED RESEARCH, COMPANY REPORTS

Market share of private sector players (Reliance, Nayara, Shell) in the auto fuels market continues to inch up every year (by around 100bp) which results in the OMCs' auto fuel sales volume growth remaining below market growth and impacting their throughput per outlet. High MM in auto fuels (see below) will also provide higher profitability to the private sector players enabling them to finance their market share growth over the next few years.

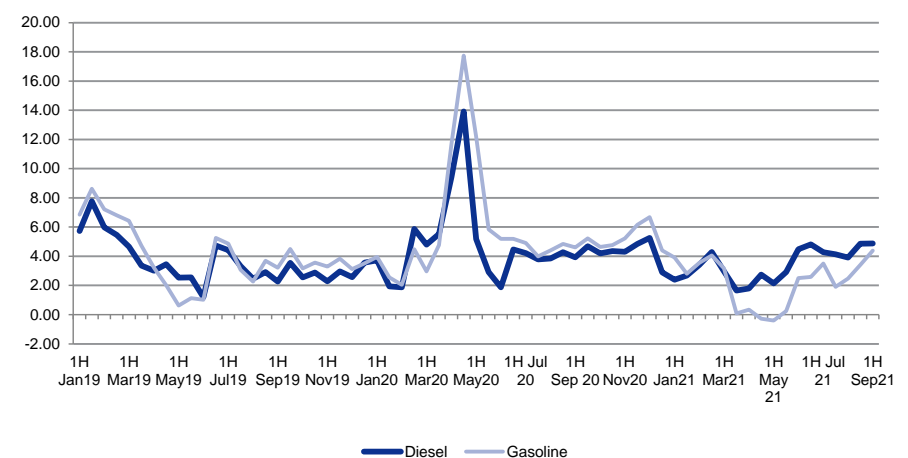
Figure 9: Private sector market share in auto fuels



SOURCES: PETROLEUM PLANNING & ANALYSIS CELL, INCRED RESEARCH

Except for minor hiccups like state elections in May 2021, OMCs have managed to keep auto fuel MMs quite high (relative to historical levels of FY16-18) despite absolute prices touching new highs due to rise in global prices. We have assumed that the high MMs are partly to compensate for poor GRMs and MMs will moderate over FY23F/24F as GRMs improve. There could be upside to our forecasts if MMs remain at current levels despite improvement in GRMs.

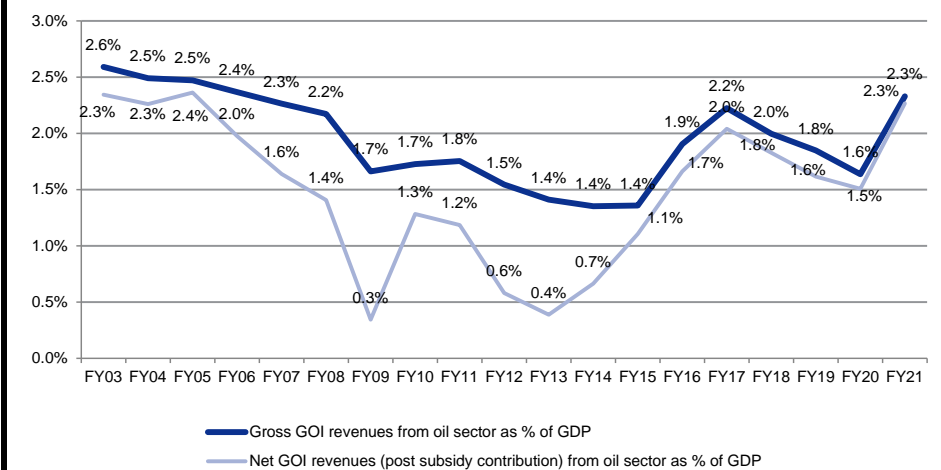
Figure 10: Auto fuels marketing margin (Rs/l)



SOURCES: INCRED RESEARCH, COMPANY REPORTS, BLOOMBERG

Retail diesel and petrol prices have been at all-time record levels mainly due to increase in taxation and MMs have remained high despite the absolute high price levels. We expect no reduction in tax levels. GOI revenues from the oil sector as percentage to GDP touched 2.3% in FY21, nearly back to earlier record levels in FY03 (when oil sector deregulation commenced). FY21 was also the first time in 20 years that the gross and net contribution was nearly the same (i.e. virtually negligible payments on subsidy).

Figure 11: GOI revenues from oil sector as a % to GDP



SOURCES: PETROLEUM PLANNING & ANALYSIS CELL, INCRED RESEARCH

Our SOP valuation for BPCL included the one-time special dividend of Rs58. With the stock going ex-dividend, we have accordingly adjusted our TP from Rs410 to Rs352.

Figure 12: BPCL's SOP valuation

	Book value	P/BV (x)	Value per share (Rs)	
			OLD	NEW
Core refining and marketing business at Mar23F P/BV	219	1.5	331	331
Special dividend payable in FY22			58	
E&P value for Mozambique gas assets			21	21
Target price			410	352

SOURCES: INCRED RESEARCH ESTIMATES, COMPANY REPORTS

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Score Range:	90 - 100	80 – 89	70 - 79	Below 70	No Survey Result
Description:	Excellent	Very Good	Good	N/A	N/A

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Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2020, Anti-Corruption 2020

ADVANC – Excellent, Certified, **AMATA** – Excellent, Certified, **ANAN** – Excellent, n/a, **AOT** – Excellent, n/a, **AP** – Excellent, Certified, **ASP** – Excellent, n/a, **AU** – Good, n/a, **BAM** – Very Good, Certified, **BAY** – Excellent, Certified, **BBL** – Very Good, Certified, **BCH** – Good, Certified, **BCP** - Excellent, Certified, **BCPG** – Excellent, Certified, **BDMS** – Excellent, n/a, **BEAUTY** – Good, n/a, **BH** - Good, n/a, **BJC** – Very Good, n/a, **BLA** – Excellent, Certified, **BTS** - Excellent, Certified, **CBG** – Very Good, n/a, **CCET** – n/a, n/a, **CENTEL** – Excellent, Certified, **CHAYO** – Very Good, n/a, **CHG** – Very Good, n/a, **CK** – Excellent, n/a, **COM7** – Very Good, Certified, **CPALL** – Excellent, Certified, **CPF** – Excellent, Certified, **CPN** - Excellent, Certified, **CPNREIT** – n/a, n/a, **CRC** – Very Good, n/a, **DELTA** - Excellent, Certified, **DDD** – Very Good, n/a, **DIF** – n/a, n/a, **DOHOME** – Very Good, n/a, **DREIT** – n/a, n/a, **DTAC** – Excellent, Certified, **ECL** – Excellent, Certified, **EGCO** - Excellent, Certified, **EPG** – Excellent, Certified, **ERW** – Very Good, Certified, **GFPT** - Excellent, Certified, **GGC** – Excellent, Certified, **GLOBAL** – Very Good, n/a, **HANA** - Excellent, Certified, **HMPRO** - Excellent, Certified, **HUMAN** – Good, n/a, **ICHI** – Excellent, Certified, **III** – Excellent, n/a, **INTUCH** - Excellent, Certified, **IRPC** – Excellent, Certified, **ITD** – Very Good, n/a, **IVL** - Excellent, Certified, **JASIF** – n/a, n/a, **JKN** – Excellent, Declared, **JMT** – Very Good, Declared, **KBANK** - Excellent, Certified, **KCE** - Excellent, Certified, **KEX** – n/a, n/a, **KKP** – Excellent, Certified, **KSL** – Excellent, Certified, **KTB** - Excellent, Certified, **KTC** – Excellent, Certified, **LH** - Excellent, n/a, **LPN** – Excellent, Certified, **M** – Very Good, Certified, **MAKRO** – Excellent, Certified, **MC** – Excellent, Certified, **MEGA** – Very Good, n/a, **MINT** - Excellent, Certified, **MTC** – Excellent, Certified, **NETBAY** – Very Good, n/a, **NRF** – n/a, n/a, **OR** – n/a, n/a, **ORI** – Excellent, Certified, **OSP** – Very Good, n/a, **PLANB** – Excellent, Certified, **PRINC** – Very Good, Certified, **PR9** – Excellent, n/a, **PSH** – Excellent, Certified, **PTT** - Excellent, Certified, **PTTEP** - Excellent, Certified, **PTTGC** - Excellent, Certified, **QH** – Excellent, Certified, **RBF** – Good, n/a, **RS** – Excellent, n/a, **RSP** – Good, n/a, **S** – Excellent, n/a, **SAK** – n/a, n/a, **SAPPE** – Very Good, Certified, **SAWAD** – Very Good, n/a, **SCB** - Excellent, Certified, **SCC** – Excellent, Certified, **SCGP** – n/a, n/a, **SHR** – Very Good, n/a, **SIRI** – Excellent, Certified, **SPA** – Very Good, n/a, **SPALI** - Excellent, Declared, **SPRC** – Excellent, Certified, **SSP** - Good, Declared, **STEC** – n/a, n/a, **SVI** – Excellent, Certified, **SYNEX** – Very Good, n/a, **TCAP** – Excellent, Certified, **THANI** – Excellent, Certified, **TIDLOR** – n/a, n/a, **TISCO** - Excellent, Certified, **TKN** – Very Good, n/a, **TMB** - Excellent, Certified, **TOP** - Excellent, Certified, **TRUE** – Excellent, Certified, **TU** – Excellent, Certified, **TVO** – Excellent, Certified, **VGI** – Excellent, Certified, **WHA** – Excellent, Certified, **WHART** – n/a, n/a, **WICE** – Excellent, Certified, **WORK** – Good, n/a.

- CG Score 2020 from Thai Institute of Directors Association (IOD)

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Stock Ratings

Definition:

Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.