

RESEARCH
OIL & GAS

OMCs: Closing the gap

Daily macro indicators

Indicator	19-Dec	20-Dec	Chg (%)
US 10Y yield (%)	3.93	3.85	(8bps)
India 10Y yield (%)	7.17	7.17	(1bps)
USD/INR	83.19	83.18	0.0
Brent Crude (US\$/bbl)	79.2	79.7	0.6
Dow	37,558	37,082	(1.3)
Hang Seng	16,505	16,614	0.7
Sensex	71,437	70,506	(1.3)
India FII (US\$ mn)	18-Dec	19-Dec	Chg (\$ mn)
FII-D	259.7	150.5	(109.2)
FII-E	215.2	223.6	8.4

Source: Bank of Baroda Economics Research

SUMMARY
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- Despite recent rally in OMCs, we believe stock prices are yet not fully reflecting long-term sustainable marketing margins
- However, near term, a combination of potential inventory loss and proximity to general election will likely limit upside in margins
- Reiterate BUY on BPCL and HPCL with higher TPs of Rs 525 and Rs 450 but downgrade IOCL to HOLD with higher TP of Rs 125

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21 December 2023

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Sustainable margins largely factored in valuation: We believe the current rally of ~40% since 27 October has largely captured a significant portion of a sustainable margin expansion for the Oil Marketing Companies (OMCs). We further acknowledge that there is a case for stock prices to reflect a mid-cycle marketing margin given that Indian consumers have largely accepted retail prices of petrol and diesel that allow OMCs to cover crude price level of US\$80-85/bbl. We also acknowledge that a higher discount on Russian crude is not likely and that proximity to general elections will limit any near-term upside to marketing margins despite moderation in crude oil prices.

Margin normalisation likely: Although marketing margins in H1FY24 were significantly higher than historical levels, they were supported by a combination of higher retail prices despite lower crude oil prices and discounted Russian crude. With OMCs largely recouping their historical losses, as evident from net debt reverting back to FY22 levels, we see little rationale for continuation of higher marketing margin.

Building in normalisation of margins from FY25: We are forecasting ~230% growth in OMCs' FY24e EBITDA despite potentially weaker H2 on lower crude price. We are however penciling a 27% YoY decline in FY25e EBITDA assuming benchmark refining margin of US\$ 5.5/bbl, and mid-cycle marketing margins.

Closing gap with fair value zone: We roll forward our valuation to FY26e and discount back to Dec'24. We raise TPs for BPCL to Rs 525 (from Rs 450), HPCL to Rs 450 (Rs 410) and for IOCL to Rs 125 (from Rs 100). We believe the recent rally has helped OMCs close gap with their fair values. This is reflected in 17% and 20% upside for BPCL and HPCL, which are close to our hurdle-rate upside of 15% for a BUY rating. We downgrade IOCL to HOLD with 1% upside to our TP. A visible path towards reducing net debt and delivering on their volume expansion projects will likely act as upside triggers in our view.

Recommendation snapshot

Ticker	Price	Target	Rating
BPCL IN	450	525	BUY
HPCL IN	376	450	BUY
IOCL IN	124	125	HOLD

Price & Target in Rupees | Price as of 21 Dec 2023



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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.

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