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FIRST LIGHT

06 July 2021

RESEARCH

Oil & Gas

OMCs – Prefer HPCL over BPCL and IOCL

BOB Economics Research | Weekly Wrap

Indian yields inch up, global yields fall

SUMMARY

Oil & Gas

- Positive view on oil marketing companies with earnings supported by post-Covid recovery, potential BPCL divestment
- Prefer HPCL over IOCL with the former geared to deliver earnings growth over FY23-FY24 driven by Vizag expansion and upgrade
- Downgrade BPCL to HOLD from BUY on fair valuation

Click here **for the full report.**

India Economics: Weekly Wrap

Global yields fell, led by US 10Y which declined by 10bps even as consumer confidence, payrolls and home sales were strong. However, unemployment rate did edge up to 5.9% (est. 5.6%). India was an exception with yields rising on the back of concerns over higher borrowing by government and rising inflation. INR depreciated to a 2-month low amidst elevated oil prices. With gradual easing of restrictions, our weekly economic activity tracker picked up to 92 from 89 last week. Markets await US FOMC minutes to gauge future moves by US Fed.

Click here **for the full report.**

Daily macro indicators

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.42	(3bps)	(18bps)	75bps
India 10Y yield (%)	6.07	3 bps	4bps	22bps
USD/INR	74.75	(0.3)	(2.5)	(0.1)
Brent Crude (US$/bbl)	76.17	0.4	8.4	78.0
Dow	34,786	0.4	0.6	34.7
Shanghai	3,519	(2.0)	(2.9)	11.6
Sensex	52,485	0.3	1.1	45.7
India FII (US$ mn)	**1-Jul**	**MTD**	**CYTD**	**FYTD**
FII-D	(23.2)	(23.2)	(3,190.0)	(1,162.7)
FII-E	(150.7)	(15.4)	8,068.8	742.5

Source: Bank of Baroda Economics Research

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OIL & GAS

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Positive view on OMCs: Given our expectation of gradual improvement in refining margin and marketing margin holding up, we have a positive view on oil marketing companies (OMC). Potential BPCL divestment could establish a value for the marketing business. While OMCs are exposed to climate related risks, their valuations provide comfort.

Recovery in refining margin likely to be gradual: To achieve sustainable utilisation above 80%, IEA estimates that 6mbpd of closures are needed to offset the planned addition of 8.5mbpd till 2026. So far, only 3.6mbpd of closures have been announced. In the interim, we see only a gradual improvement of US$ 3.5/bbl in benchmark refining margin over the next three years to US$ 3.8/bbl by FY24.

Marketing margin to hold up; expect crude to retract to US$ 65 by year-end: Crude price has surged to US$ 75/bbl with recovery in demand running ahead of release of supply. However, any sustainable upside will be capped by higher OPEC spare capacity at 5mbpd even after end of CY21 (vs. the average of 2.3mbpd over the last decade) and potential ramp-up of US production. We consider US$ 65/bbl a more sustainable level, which meets the financial needs of OPEC and also keeps investments in US liquids production in check.

Downgrade BPCL to HOLD: At our estimates, we believe the current market price reflects a fair value for BPCL's business and a portion of control premium. Our new Mar'22 TP of Rs 518 (Rs 480 earlier) is based on 6x FY23E EV/EBITDA for the refining/marketing business, control premium at 20% of core equity value and stakes in listed entities at market price with no holding discount. We do not see a strong case for a higher control premium given growing global concerns with scope 3 emission.

Prefer HPCL over IOCL: We maintain BUY on HPCL (TP: Rs 368 vs. Rs 440 earlier) and IOCL (TP: Rs 135 vs. Rs 170) with potential upsides of 21% and 24% respectively. We prefer HPCL as earnings growth driven by completion of Vizag expansion and the residue upgrade project over FY22/FY23 would be a key catalyst. While IOCL is on a larger expansion drive, its key projects are due for completion only in FY24 and beyond.

Recommendation snapshot

Ticker	Price	Target	Rating
BPCL IN	460	518	HOLD
HPCL IN	304	368	BUY
IOCL IN	109	135	BUY

Price & Target in Rupees | Price as of 5 Jul 2021

WEEKLY WRAP

05 July 2021

Indian yields inch up, global yields fall

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Global yields fell, led by US 10Y which declined by 10bps even as consumer confidence, payrolls and home sales were strong. However, unemployment rate did edge up to 5.9% (est. 5.6%). India was an exception with yields rising on the back of concerns over higher borrowing by government and rising inflation. INR depreciated to a 2-month low amidst elevated oil prices. With gradual easing of restrictions, our weekly economic activity tracker picked up to 92 from 89 last week. Markets await US FOMC minutes to gauge future moves by US Fed.

Markets

- **Bonds:** Despite higher than estimated addition to payrolls, US 10Y yield fell by 10bps (1.42%) as unemployment rate picked up to 5.9% from 5.8%. Yields were lower even in Europe and UK. Crude prices closed flat at US$ 76/bbl as OPEC+ talks on supply policy got delayed. India's 10Y yield rose by 4bps (6.07%) with concerns over higher borrowing by government. RBI changed the price discovery method as more securities devolved on PDs. System liquidity surplus rose to Rs 5.7tn as on 2 Jul 2021 from Rs 4.6tn last week.

- **Currency:** Global currencies closed lower this week. DXY rose by 0.4% this week on the back of strong macro data (consumer confidence, jobless claims, payrolls and factory orders). AUD fell the most by 0.8% amidst rising Covid-19 cases. INR depreciated by 0.7% as oil prices remained elevated at above US$ 75/bbl. FII outflows were muted at US$ 21mn.

- **Equity:** Barring Dow and Dax (higher), other global indices ended lower in the week. Better than expected non-farm payroll in the US helped Dow gain by 1%. On the other hand Shanghai Comp (2.5%) and Nikkei (1%) fell the most. Sensex (0.8%) too fell, led by power, oil and gas, and metal stocks.

- **Covid-19 tracker:** Global Covid-19 cases rose by 2.7mn this week versus 2.6mn last week led by UK (0.2mn versus 89k). In India, cases rose by 0.3mn versus 0.4mn, last week. Our weekly economic activity tracker index rose to 92 (100=Feb'20) from 89. Israel has fully vaccinated 60% of its population, UK at 49% and US at 47%. India is at 4.5%.

- **Upcoming key events:** Major events this week include RBA policy and FOMC minutes. Additionally, global services PMIs, Europe industrial production and China's CPI and PPI are also due. In India, trajectory of Covid-19 cases following a gradual reopening will be monitored. Monsoon has seen a lull and is now 1% above LPA versus 15% last year. Kharif sowing is also lower.

Disclaimer

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

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