

## OIL & GAS

25 September 2019

### Gains from tax cuts – PSUs, gas utilities top bets

The tax rate cut announced by the government will be earnings accretive by 6-15% for energy companies in our coverage universe. Most of these, being PSUs (or owned by PSUs), would pass the gains on as dividend payouts. RIL may retain the benefit due to its limited earnings delta. However, fair value changes will not be commensurate with the earnings uptick considering differing valuation methodologies – gas utilities stand to gain the most (DCF-based valuations), followed by upstream players; OMCs and RIL gain the least.

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**PSUs to pass on the gains:** Earnings for all the energy PSUs are expected to surge by ~15% from FY20, as they were at the full 33% tax rate until FY19. However, from a valuation perspective, upstream companies (ONGC/Oil India) gain the most, as we have based their fair value calculations on cash earnings multiples. OMC valuations change the least as these are derived from EBITDA multiples (for cyclical businesses). A common thread across PSUs would be an increase in dividend payouts, as none of these companies are likely to retain the earnings gains. Our preferred picks are ONGC, OINL and IOCL, all of which are attractively valued at 6-7x FY21E EPS.

**Gas utilities to gain the most:** Earnings for gas utilities are expected to surge by an average of ~12%, with GAIL and Indraprastha Gas (IGL) gaining the most (~15%). Our valuations being DCF-based for most companies (SOTP for GAIL includes DCF for pipelines), the fair values across utilities improve closely in line with earnings (implying GAIL and IGL are the most attractive bets on tax cuts). Considering most of these companies have aggressive capex plans due to their improving volume prospects, a bulk of the incremental earnings would be ploughed back into the business (GAIL could be an exception, being a PSU).

**Limited gains for RIL:** RIL's FY19 tax rate at 28% (consolidated financials) was one of the lowest in our coverage universe, and management guidance over FY20-FY22 has been at ~25%. Hence, earnings change from the tax rate proposal is marginal. Considering the recent uptick in global GRMs, we now raise RIL's GRM estimates to US\$ 12/bbl for FY20/FY21 (from US\$ 11), leading to a ~5% increase in FY20/21 earnings. Consumer-facing businesses (RJio and Retail) gain the most from tax cuts and could amplify valuation expectations if RIL were to plan an IPO for these businesses (especially Retail). Cyclical business valuations remain unchanged as they are based on EBITDA multiples.

### TOP PICKS

Ticker	Price	Target	Rating
RIL IN	1,280	1,500	BUY
GAIL IN	137	200	BUY
PLNG IN	259	380	BUY
ONGC IN	132	200	BUY
IGL IN	349	455	BUY
GUJGA IN	176	270	BUY

Price &amp; Target in Rupees



Earnings for energy PSUs are expected to surge ~15% and for gas utilities ~12% (from FY20); limited change for RIL

FIG 1 – REVISED ESTIMATES

Company	New EPS (Rs)			EPS chg (%)			EPS CAGR (%) (FY19E-FY21E)	Effective tax rate (%)	
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E		FY19	FY20E onwards
RIL	81.5	108.3	135.2	5.8	5.6	(0.6)	28.8	27.9	25.3
IOCL	21.3	23.3	25.7	15.1	15.1	15.2	9.9	35.3	25.2
BPCL	49.2	52.0	55.3	8.5	8.1	7.6	6.1	36.6	25.1
HPCL	43.6	45.3	55.3	12.4	11.6	13.6	12.5	36.5	25.9
ONGC	24.9	30.0	34.4	29.8	28.2	28.0	17.5	33.1	26.4
OINL	34.4	38.0	40.5	15.1	15.1	15.1	8.5	31.0	25.2
GAIL	15.5	17.1	18.3	14.3	14.6	15.8	8.7	32.5	25.2
PLNG	19.4	22.2	25.2	10.1	10.3	2.9	14.0	33.3	25.2
IGL	16.3	19.0	23.2	14.9	16.3	24.7	19.3	35.6	25.4
MAHGL	74.8	80.0	83.1	6.5	14.3	14.6	5.4	34.7	30.1
GUJS	17.9	18.3	21.3	13.4	7.2	7.3	9.2	33.9	25.2
GUJGA	13.1	16.4	17.9	10.0	10.0	10.0	16.9	29.8	25.2

Source: BOBCAPS Research

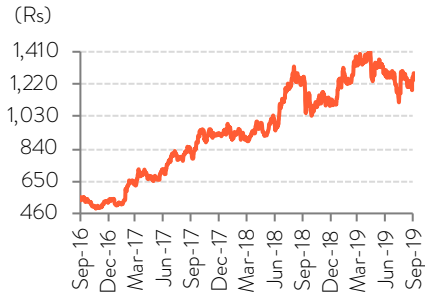
FIG 2 – VALUATION SUMMARY

Company	CMP (Rs)	Rating	New TP (Rs)	Chg in TP (%)	PE (x)			ROE (%)			Comments
					FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	
RIL	1,280	BUY	1,500	6.4	15.7	11.8	9.5	11.6	13.7	14.9	Change in fair value on change in GRM estimates and minor earnings upgrade
IOCL	141	BUY	205	0.0	6.6	6.0	5.5	17.2	18.1	18.7	GRM estimates maintained. Fair value remains unchanged as based on EBITDA multiple
BPCL	465	SELL	280	0.0	9.5	8.9	8.4	21.8	20.5	19.5	
HPCL	285	SELL	200	0.0	6.5	6.3	5.2	20.6	19.3	21.1	
ONGC	132	BUY	200	14.3	5.3	4.4	3.8	13.6	15.1	15.9	Fair value improves on cash earnings increase. OVL earnings unaffected
OINL	146	BUY	260	8.3	4.2	3.8	3.6	12.2	12.7	12.7	Fair value improves on cash earnings increase. Downstream/midstream valuations unaffected
GAIL	137	BUY	200	14.3	8.9	8.0	7.5	15.5	15.9	13.8	Change in fair value due to DCF-based valuations (for GAIL, DCF of pipelines segment)
PLNG	259	BUY	380	8.6	13.3	11.7	10.3	26.9	27.4	27.4	
IGL	349	BUY	455	7.1	21.4	18.3	15.0	23.3	22.2	22.1	
MAHGL	903	ADD	1,020	17.2	12.1	11.3	10.9	28.8	27.5	25.6	
GUJS	217	BUY	280	12.0	12.1	11.9	10.2	17.0	15.4	15.9	
GUJGA	176	BUY	270	31.7	13.4	10.7	9.8	36.9	41.2	42.3	

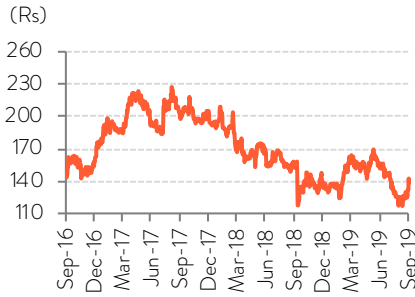
Source: BOBCAPS Research

Stock performance

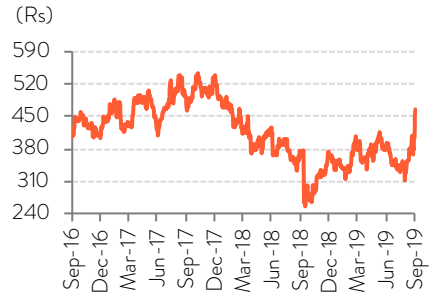
**FIG 3 – RELIANCE INDUSTRIES**



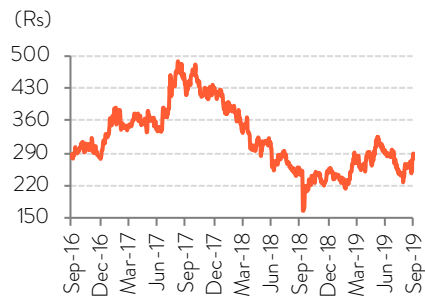
**FIG 4 – INDIAN OIL CORP**



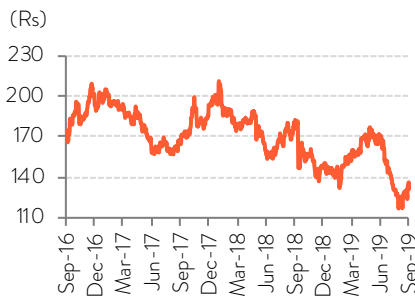
**FIG 5 – BHARAT PETROLEUM CORP**



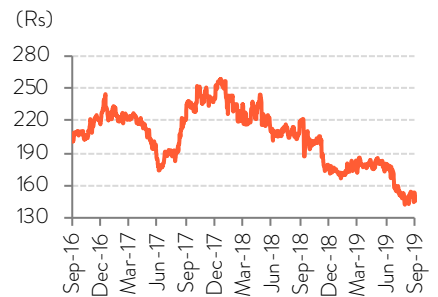
**FIG 6 – HINDUSTAN PETROLEUM CORP**



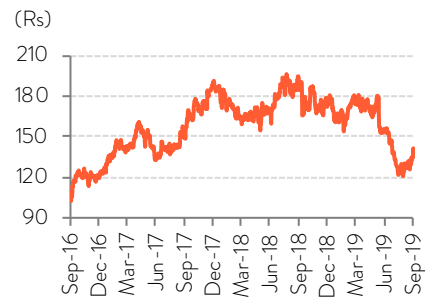
**FIG 7 – ONGC**



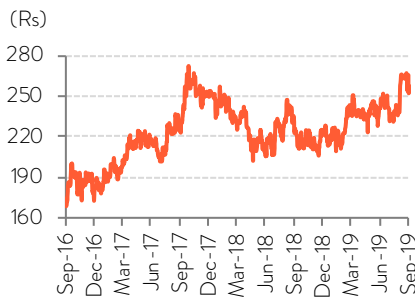
**FIG 8 – OIL INDIA**



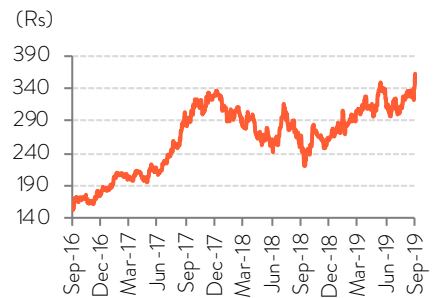
**FIG 9 – GAIL**



**FIG 10 – PETRONET LNG**



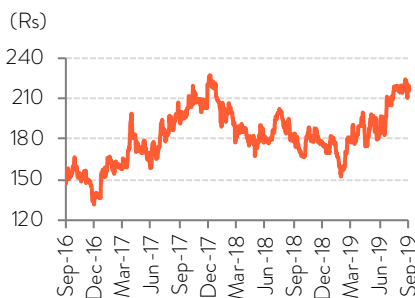
**FIG 11 – INDRAPRASTHA GAS**



**FIG 12 – MAHANAGAR GAS**



**FIG 13 – GUJARAT STATE PETRONET**



**FIG 14 – GUJARAT GAS**



Source: NSE

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### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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