December 7, 2022

Sector Update

ICICI Securities – Retail Equity Research

Crude prices fall; near term positive for marketing segment of OMCs…

Oil prices have fallen sharply from US$95/bbl seen in the first week of November to ~US$79/bbl. The decline in crude prices was on account of a number of reasons, from weak demand in China (its PMI fell to a seven-month low of 48), the EU price cap on Russian oil, to uncertainty on the direction of Federal Reserve's rate hike. A rise in Covid-19 cases in China led to stringent restrictions in the country although they have started relaxing these restrictions to a certain limit. The EU and G7 nations have agreed on a price cap of US$60/bbl for seaborne Russian oil. The recent release of strong services data in the US raised concerns that the Federal Reserve would increase interest rates more aggressively. The correction in prices would have a dual impact on OMCs (although overall positive impact). Firstly, OMCs would incur one-time inventory loss (on GRMs front) due to the impact of falling oil prices on existing inventory. Secondly, and more significantly, we expect the performance of the marketing segment to improve owing to lower losses on the diesel front.

OMCs to benefit from price correction

- On the refining front, average Singapore GRMs in Q2FY23 were at $7.1/bbl and currently trading at ~US$5.39/bbl in Q3FY23-TD. At present, average cracks on petrol are at ~US$4.4/bbl, down US$4.6/bbl. For diesel, average cracks are at ~US$41/bbl, up US$5.8/bbl QoQ. Owing to the fall in GRMs, we expect inventory losses for the refining segment.
- As per our understanding, OMCs witnessed a marketing loss of ₹ 1.2/litre on petrol and ₹ 13.4/litre on diesel in Q2FY23. We estimate an average profit of ₹ 8/litre on petrol and an average loss of ₹ 10.5/litre on diesel in Q3FY23-TD. With the decline in crude prices we expect the profit on petrol to increase further (profit of ₹ 10/litre as on December 6) and losses on diesel to narrow (loss of ₹ 4.4/litre as on December 6). On account of the above developments, we expect marketing margins to improve (lower losses) in the current quarter
- For upstream companies such as ONGC we expect minimal impact on account of the windfall tax levied by the government

Valuation and Outlook

We maintain our **HOLD** rating on IOCL with a target price of ₹ 85/share. For BPCL, we retain our **HOLD** rating with a target price of ₹ 350/share. For HPCL also, we retain our **HOLD** rating with a target price of ₹ 250/share.

Recent highlights & Key Risks

Key Risk: (i) Lower inventory losses (ii) Higher than expected diesel losses

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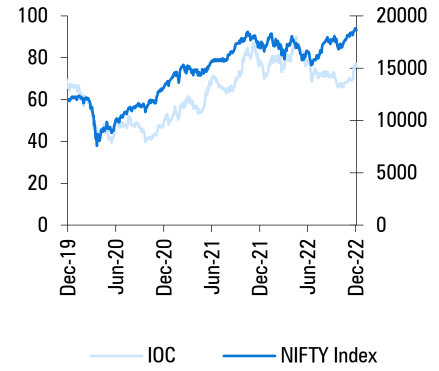
Exhibit 1: Rating matrix

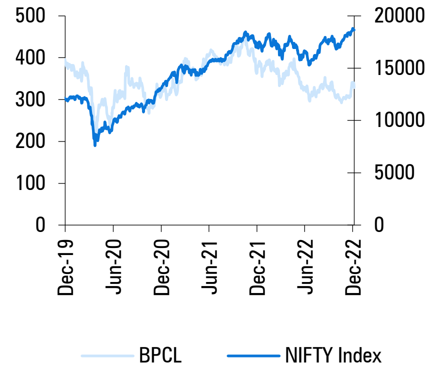
Company	Rationale	Old Target	CMP	New Target	Rating
IOC	IOC's marketing segment (80.5 MMT) is slightly larger than its refining segment (67.7 MMT). Although the fall in crude prices is expected to benefit IOC, it would not be as much as the other two OMCs	75	77	85	HOLD
BPCL	BPCL's marketing segment (42.5 MMT) is around one and a half times its refining segment (30.1 MMT). Hence, the fall in crude prices is expected to improve its profitabilty more than IOC	330	335	350	HOLD
HPCL	HPCL is likely to benefit the most from the OMC pack, from the decline in prices as its marketing segment (37.4 MMT)is more than double its refining segment(14 MMT). Hence, the fall in crude prices is expected to overall improve its profitability	220	232	250	HOLD

Source: Company, ICICI Direct Research, FY22 Numbers

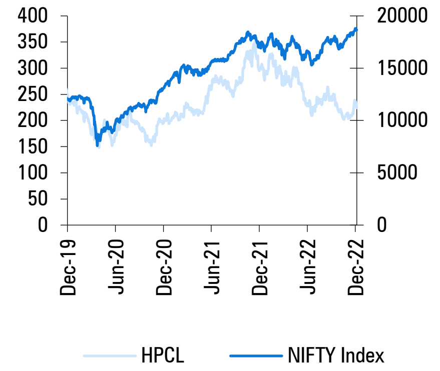
Price Chart (IOC)



Price Chart (BPCL)



Price Chart (HPCL)



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Reduce: -15% to -5%;

Sell: <-15%

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