

May 6, 2020

Excise duty hike to impact sentiment...

The central government has hiked the excise duty on petrol and diesel by ₹ 10/litre and ₹ 13/litre, respectively, from May 6 taking into consideration low crude oil prices at ~US\$25/bbl. However, retail prices at fuel outlets will not be increased. This implies that auto marketing margins for oil marketing companies (OMCs), which are at super-normal levels of ~₹ 16-17/litre will get reduced to normal levels at current crude oil prices. Also, OMCs will have to increase retail selling price to maintain normal margins in case of increase in crude oil prices.

Marketing margins of OMCs to return to normal levels

Brent oil (more relevant for Indian downstream companies) prices witnessed a sharp decline from the start of CY20 at US\$66/bbl to ~US\$30/bbl currently due to spread of Covid-19 across the globe, which substantially lowered its demand. OMCs did not pass on the cost benefit from a fall in oil prices to consumers, which led to very high marketing margins of ~₹ 16-17/litre from ₹ 2-3/litre in normal scenario. However, the latest excise duty hike will mean that OMCs' marketing margins return to normal levels. With demand for petrol & diesel declining by 61% YoY and 56.5% YoY in April and continuing subdued volumes, higher marketing margins had provided a cushion to its Q1FY21E profitability. Although we had not build in higher margins for the year, the current decline in marketing margins coupled with lower sales will impact OMCs' high profit visibility and impact overall sentiment.

Sustained normal marketing margins a necessity

The excise duty has been increased taking into account lower oil prices at US\$25/bbl. Brent oil prices have been on upward trend in May. They are currently at US\$31/bbl. If oil prices increase from current levels, OMCs will have to take a hike in retail prices to sustain normal marketing margins. Sustainable marketing margins will be a key to marketing segment and overall profits if oil prices increase from lower levels.

Valuation & Outlook

The excise duty hike will dent marketing margins to normal levels of ₹ 2-3 per litre at current oil prices from very high levels seen in April. Also, with lower marketing sales volume in near term, weak refining outlook and recent run-up in stock prices from lower levels, we downgrade our rating for both BPCL and HPCL from BUY to **HOLD** with a target price of ₹ 340/share (based on average of P/BV multiple: ₹ 356/share and P/E multiple: ₹ 324/share) and ₹ 200/share (based on average of P/BV multiple: ₹ 215/share and P/E multiple: ₹ 184/share), respectively. We maintain **HOLD** rating on IOC with a target price of ₹ 85/share (based on average of P/BV multiple: ₹ 95/share and P/E multiple: ₹ 76/share).

Rating Matrix

Company	Old Rating	New rating	CMP (₹)	Target Price (₹)	Upside
BPCL	BUY	HOLD	340	340	0
HPCL	BUY	HOLD	204	200	-2%
IOC	HOLD	HOLD	77	85	10%

Source: Company, ICICI Direct Research

Key Highlights

- Central government has hiked excise duty on petrol and diesel by ₹ 10/litre and ₹ 13/litre, respectively, from May 6. However, retail prices at fuel outlets will not be increased
- OMCs will have to absorb excise duty hike against marketing margins. This will reduce their marketing margins for the rest of Q1FY21E to normal levels at current oil prices, which were earlier very high
- On account of recent run-up in stock prices from lower levels and change in expected margin outlook, we downgrade our rating for both BPCL, HPCL from BUY to HOLD while we maintain HOLD rating for IOC

Research Analyst

Mayur Matani
Mayyur.matani@icicisecurities.com

Amogh Deshpande
Amogh.deshpande@icicisecurities.com

Bharat Petroleum Corp (BPCL)

Exhibit 1: Key Financial Summary

(Year-end March)	FY18	FY19	FY20E	FY21E	FY22E	CAGR (FY19-22E)
Revenues (₹ crore)	2,77,155.8	3,37,495.3	3,07,140.3	2,04,520.8	2,84,562.5	(8.2)
EBITDA (₹ crore)	11,662.4	11,837.0	7,092.4	10,300.7	10,982.7	(3.7)
Net Profit (₹ crore)	7,919.3	7,132.0	3,488.0	5,694.7	5,992.6	(8.3)
EPS (₹)	40.3	36.3	17.7	29.0	30.5	
P/E (x)	8.4	9.4	19.2	11.7	11.2	
Price / Book (x)	2.0	1.8	1.8	1.7	1.6	
EV/EBITDA (x)	7.7	8.1	13.8	10.0	8.9	
RoCE (%)	15.7	13.1	4.8	8.3	8.8	
RoE (%)	23.2	19.4	9.5	14.6	14.7	

Source: Company, ICICI Direct Research

Hindustan Petroleum Corp (HPCL)

Exhibit 2: Key Financial Summary

(Year-end March)	FY18	FY19	FY20E	FY21E	FY22E	CAGR (FY19-22E)
Revenues (₹ crore)	2,44,027.9	2,96,928.4	2,72,222.7	1,84,787.7	2,87,935.1	(1.5)
EBITDA (₹ crore)	10,614.7	11,442.0	5,678.0	7,917.1	9,159.8	(10.5)
Net Profit (₹ crore)	6,357.1	6,028.7	1,982.0	3,615.7	4,002.3	(18.5)
EPS (₹)	41.7	39.5	13.0	23.7	26.2	
P/E (x)	4.9	5.2	15.7	8.6	7.8	
Price / Book (x)	1.3	1.1	1.1	1.1	1.0	
EV/EBITDA (x)	4.8	5.1	11.2	8.4	6.9	
RoCE (%)	17.5	15.2	3.9	6.6	7.6	
RoE (%)	26.5	21.4	7.1	12.3	13.2	

Source: Company, ICICI Direct Research.

Indian Oil Corp (IOC)

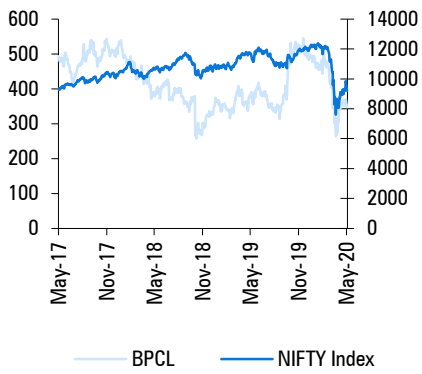
Exhibit 3: Key financial summary

(Year-end March)	FY18	FY19	FY20E	FY21E	FY22E	CAGR (FY19-22E)
Revenues (₹ crore)	5,06,425.3	6,05,923.8	5,42,685.4	3,89,681.5	5,02,615.3	(8.9)
EBITDA (₹ crore)	39,662.8	33,826.2	18,058.0	25,312.9	26,692.0	(11.2)
Net Profit (₹ crore)	21,346.1	16,894.1	4,122.3	9,895.2	10,680.7	(20.5)
EPS (₹)	22.5	18.4	4.5	10.8	11.6	
P/E (x)	3.4	4.2	17.1	7.1	6.6	
Price / Book (x)	0.7	0.7	0.7	0.6	0.6	
EV/EBITDA (x)	1.8	2.1	3.9	2.8	2.6	
RoCE (%)	19.4	13.5	4.9	8.2	8.6	
RoE (%)	19.4	15.5	3.9	9.0	9.7	

Source: Company, ICICI Direct Research

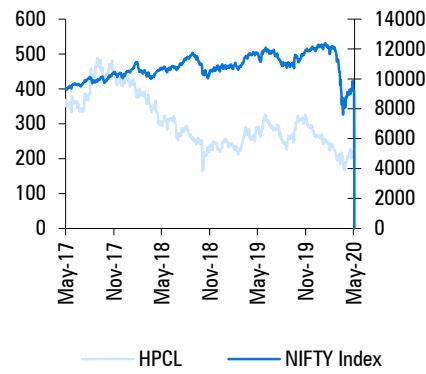
Exhibit 4: Price Charts

BPCL



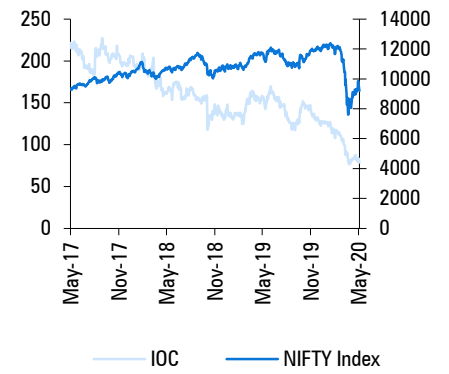
Source: Bloomberg, ICICI Direct Research

HPCL



Source: Bloomberg, ICICI Direct Research

IOC



Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com**

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