Equity Research
May 19, 2021
BSE Sensex: 50193

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Sector update

Oil & Gas and Petrochemicals

BPCL (BUY)
Target price: Rs544

IOCL (ADD)
Target price: Rs105

RIL (HOLD)
Target price: Rs2,033

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INDIA

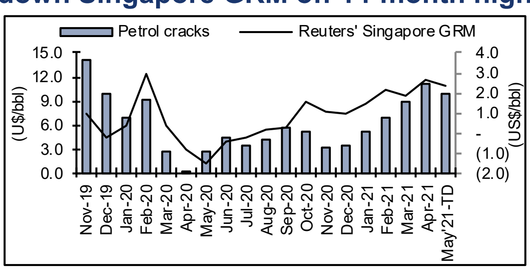
Refining & marketing

GRM & marketing margins weak but hopeful of recovery

Reuters' Singapore GRM in May'21-TD is down 10% MoM from 14-month high of US$2.7/bbl in Apr'21, hit by MoM fall in petrol, LPG and fuel oil cracks. GRM on 18-May'21 is sharply lower at just US$1.16/bbl. We estimate Q1FY22-TD GRMs of BPCL, IOC and RIL to be weak at US$0.4-3.5/bbl. Recovery in diesel cracks, which were pre-covid at US$11.0-14.3/bbl in Q4-Q3FY20, is key to GRM rising to our FY22E estimate of US$3.4-7.0/bbl. Auto fuel net marketing margins are also weak at Rs0.42/l in Q1FY22-TD and Rs0.66/l on 18-May'21. For OMCs, marketing margin recovery to Rs2.0-2.5/l is also key to stock performance; price hikes of Rs2.2-3.2/l are required, which we are optimistic about. Lockdowns have meant auto fuel sales volumes are up YoY on a low base but down 3-9% on Apr'19 and 27-29% on 1-15 May'19 base.

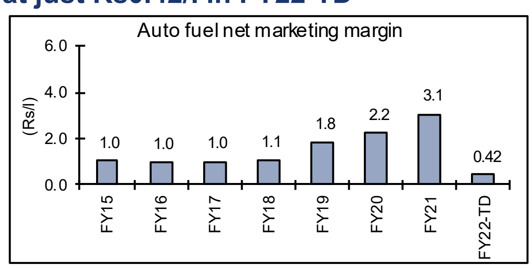
- **Singapore GRM down from 14-month high in Apr**: Reuters' Singapore GRM, which was at 14-month high of US$2.7/bbl in Apr'21, is down 10% MoM to US$2.4/bbl in May'21-TD hit by MoM fall in petrol, LPG and fuel oil cracks; GRM is sharply lower at just US$1.16/bbl on 18-May'21. Petrol cracks at 17-month high of US$11.1/bbl in Apr'21 were main driver of GRM recovery but are down to US$10/bbl MoM in May'21-TD and at US$8.7/bbl on 18-May'21. Petrol cracks' strength was driven by US snowstorms in mid-Feb'21 that cut US refinery utilisation rates and led to steep fall in US inventories to 6.8m bbls below five-year average level. Recent correction appears to be due to rise in US inventories in the last six consecutive weeks by 5.6m bbls and steep fall in petrol consumption in India in 1-15 May'21 due to second covid wave.
- **Diesel cracks recovery key to GRM recovery:** Diesel cracks at US$5.7/bbl in May'21-TD are up MoM and higher at US$6.1/bbl on 18-May'21 but still well below pre-covid level of US$11.0-14.3/bbl in Q4-Q3FY20. Diesel cracks have been hit by surge in covid in parts of Europe, e.g. Germany, and rise in refinery yields as jet fuel output is capped. Recent diesel cracks recovery appears to be due to decline in US distillate inventory in the last five consecutive weeks by 11.1m bbls to 5.8% below five-year average levels. We estimate Q1FY22-TD GRMs of BPCL, IOC and RIL at US$0.4-3.5/bbl, lower than our FY22E estimate of US$3.4-7.0/bbl. Recovery in diesel cracks would be key to FY22E GRM rising to our estimates. Recovery in global diesel demand as vaccines are rolled out and refinery closures are likely to drive recovery in diesel cracks. IEA estimates global diesel demand to be at pre-covid level in CY22E and global refinery utilisation at 77.8-79.2% in CY21-CY22E vs 72.5% in CY20.

Petrol cracks off 17-month high pulled down Singapore GRM off 14-month high



Source: Reuters, I-Sec research

Auto fuel net marketing margins weak at just Rs0.42/l in FY22-TD



Source: PPAC, Reuters, I-Sec research

- **Auto fuel net marketing margin weak, but optimistic of recovery**: Auto fuel net marketing margin is at Rs0.42/l in FY22-TD and at Rs0.66/l on 18-Apr'21 despite hike in domestic petrol and diesel prices by Rs2.5-.2.8/l in the last two weeks. We estimate net margin at Rs0.19/l on 1-Jun'21 and at minus Rs0.15/l on 16-Jun'21. We are optimistic of further price hikes required (Rs2.2-3.2/l) or excise duty cut that are not passed on to boost net margin to Rs2.0-2.5/l given the government's track record.
- **Prefer BPCL as a play on privatisation; core OMC story based on hope of recovery**: Among OMCs, we prefer BPCL, which is a play on privatisation. The core OMC story is based on hope of recovery in net auto fuel marketing margin to Rs2.5/l and GRM to US$3.4-3.5/bbl in FY22E; downside to estimates is not ruled out. IOC will gain from petrochemical margin strength and is cheap at 0.89x FY22E P/BV.

GRM & marketing margins weak; hope of recovery

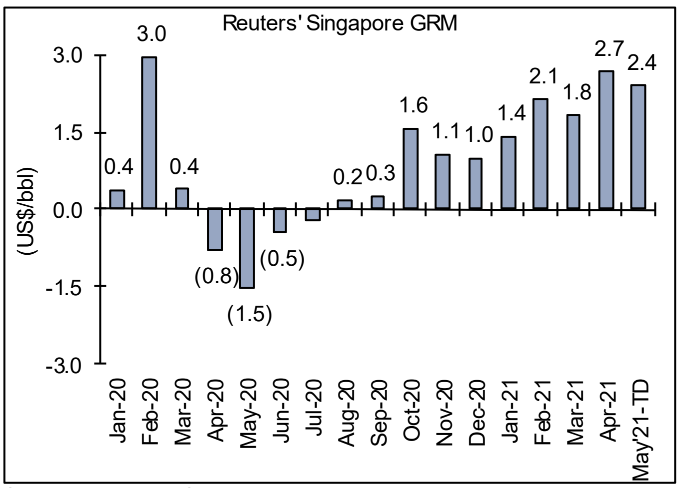
Singapore GRM off 14-month high in May-TD as cracks correct

Singapore GRM & petrol cracks off 14-17-month highs in May'21-TD

Reuters' Singapore GRM touched a low of minus US$0.93/bbl in Q1FY21 hit by lockdowns due to covid leading to collapse in global oil demand. However, Singapore GRM recovered to 14-month high of US$2.7/bbl in Apr'21 driven mainly by petrol cracks at 17-month high. However:

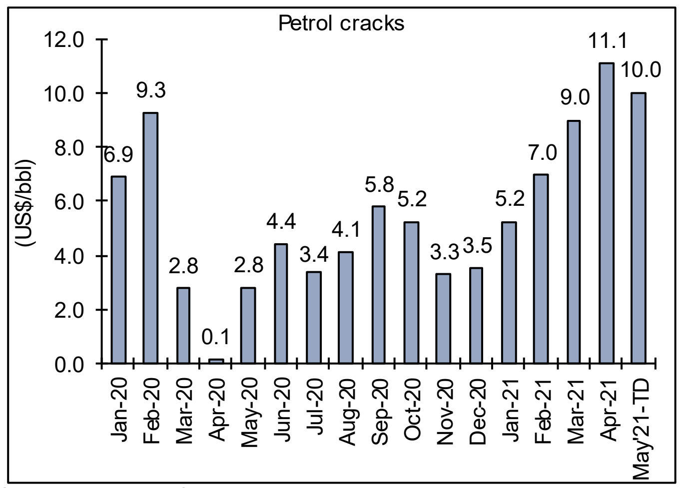
- Singapore GRM is down 10% MoM to US$2.4/bbl in May'21-TD and sharply lower at just US$1.16/bbl on 18-May'21.
- Petrol cracks are down to US$10.0/bbl MoM in May'21-TD and at US$8.7/bbl on 18-May'21.

Chart 1: Singapore GRM down in May'21-TD to US$2.4/bbl from 14-month high of US$2.7/bbl in Apr



Source: Reuters, I-Sec research

Chart 2: Petrol cracks off 17-month high of US$11.1/bbl in Apr'21 to US$10/bbl in May'21-TD



Source: Reuters, I-Sec research

Singapore GRM down MoM hit by fall in petrol, FO & LPG cracks

Singapore GRM is down:

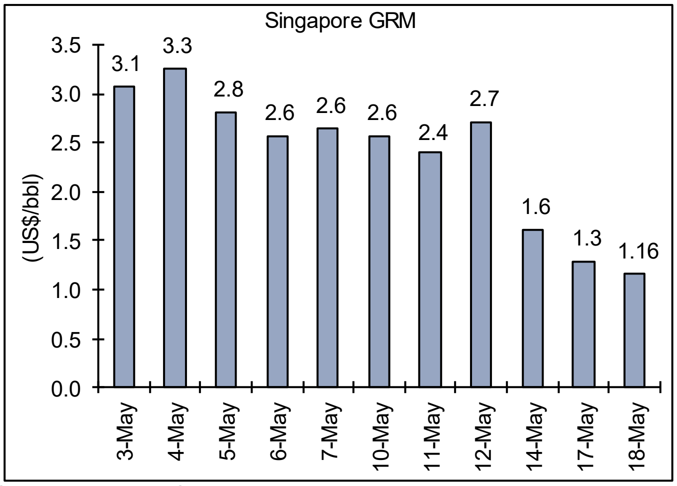
- MoM in May'21-TD hit by MoM fall in petrol, LPG and fuel oil (FO) cracks. Diesel, jet fuel and naphtha cracks are up MoM in May'21-TD.
- On 18-May'21 vs levels in Apr'21 hit by fall in all product cracks except diesel and jet fuel.

Petrol cracks boosted by US snowstorm; hit now by US inventory rise

Petrol cracks' strength was driven by US snowstorm in mid-Feb'21 that cut US refinery utilisation rates and led to steep fall in US inventories to 6.8m bbls below five-year average level. Recent correction appears to be due to:

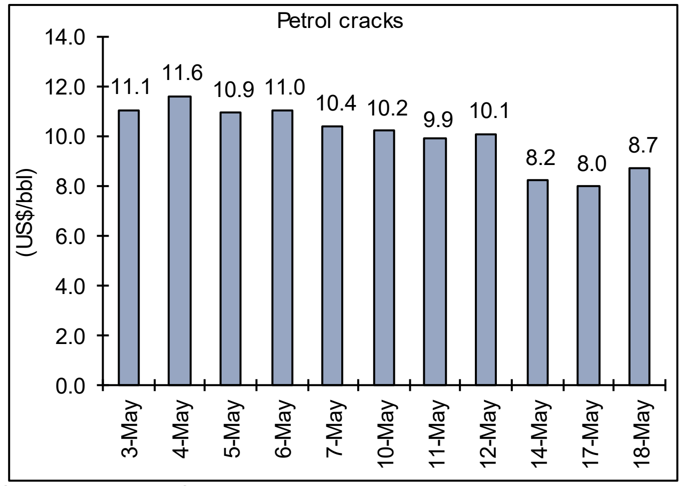
- **Fall in petrol consumption in India due to second covid wave.** Petrol consumption in 1-15 May'21 though up 39% YoY on a very low base (national lockdown in 1-15 May'20) was down 27% over 1-15 May'19 level.

Chart 3: Singapore GRM plunged from US$3.3/bbl on 4-May'21 to US$1.16/bbl on 18-May'21



Source: Reuters, I-Sec research

Chart 4: Petrol cracks down to US$8.7/bbl on 18-May'21 from US$11.6/bbl on 4-May'21



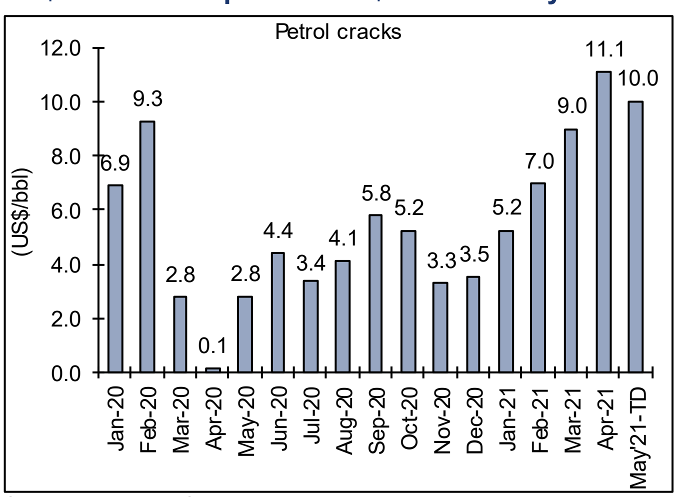
Source: Reuters, I-Sec research

- **Rise in US inventories in the last six consecutive weeks by 5.6m bbls**

Indian petrol demand fell steeper in May'21-TD vs Mar-Apr on 2nd wave

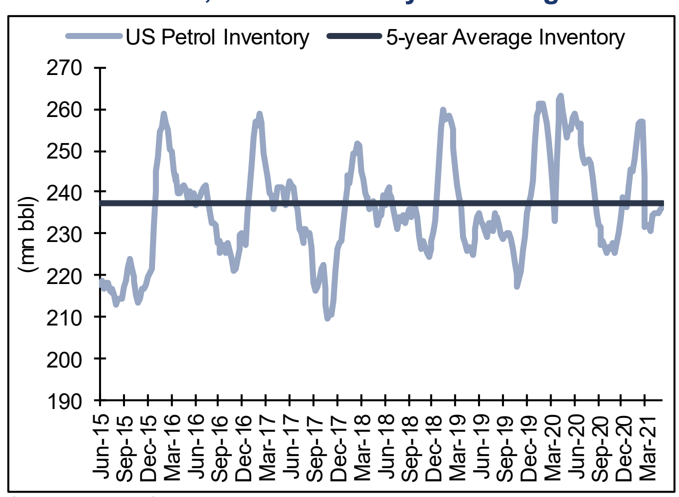
India accounted for 3% of global petrol consumption in CY19. Petrol demand declined sharply in Mar-May'20 due to national lockdown in India from 25-Mar'20 fall. India petrol demand in Mar'21, Apr'21 and in 1-15 May'21 is up YoY on the low base of these periods in CY20. We have therefore compared demand in Mar-May'21 with that in Mar-May'19.

Chart 5: Petrol cracks off 17-month high of US$11.1/bbl in Apr'21 to US$10/bbl in May'21-TD



Source: Reuters, I-Sec research

Chart 6: US gasoline inventory down by 5.6m bbls in last 6 weeks; 0.4% below 5-year average level



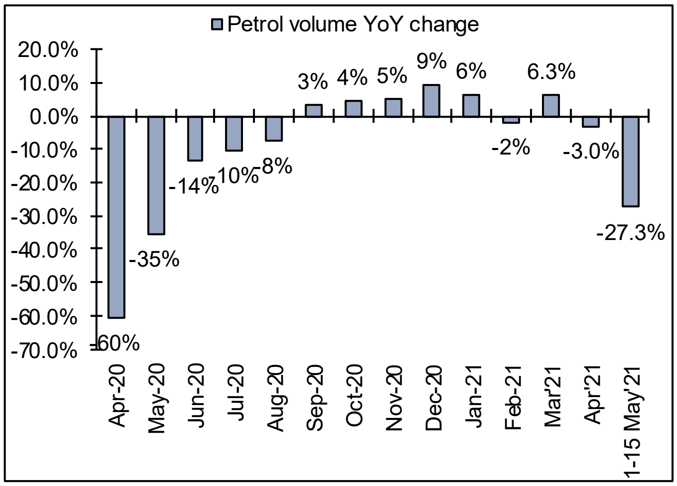
Source: EIA, I-Sec research

Petrol consumption in India was:

- Up 6.3% in Mar'21 over Mar'19 (pre-covid) level. Petrol consumption was up 27.1% YoY in Mar'21 on a low base of Mar'20, when it was down 16.4% YoY.

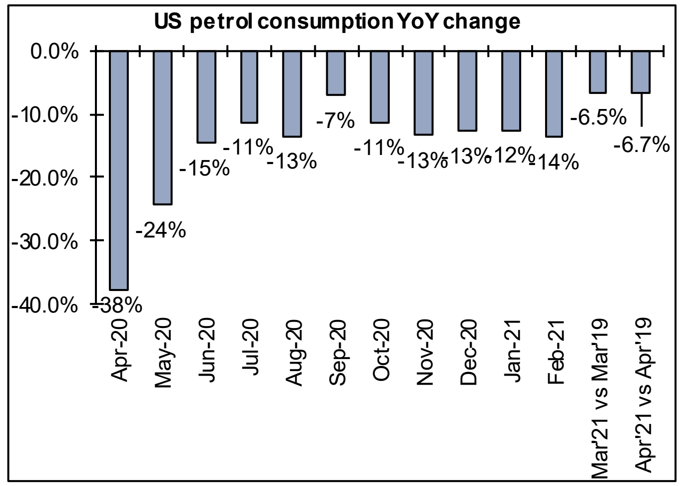
- Down 3.0% in Apr'21 over Apr'19 (pre-covid) level. Petrol consumption was up 145% YoY in Apr'21 on a low base of Apr'20, when it was down 60.5% YoY.
- Down 27.3% in 1-15 May'21 *vs* 1-15 May'19 as per preliminary data

Chart 7: Petrol demand in India down 27.3% in 1-15 May'21 *vs* 1-15 May'19; up 6.3% in Mar'21



Source: PPAC, I-Sec research
*Mar-May'21 fall is compared to Mar-May'19

Chart 8: Petrol consumption in US down 6.5-6.7% in Mar-Apr'21 *vs* Mar-Apr'19; 14% YoY fall in Feb'21



Source: EIA, I-Sec research

Petrol demand modestly below pre-covid levels in US in Mar'21-May-TD

US accounted for 35% of global petrol consumption in CY19. Petrol demand in US is modestly below pre-covid levels. Petrol consumption in US was:

- Down 14% YoY in Feb'21
- Down 6.5% in Mar'21 over Mar'19 (pre-covid) level. US petrol consumption was up 10% YoY in Mar'21 on a low base of Mar'20, when it was down 15.3% YoY.
- Down 6.7% in Apr'21 over Apr'19 (pre-covid) level. US petrol consumption was up 50% YoY in Apr'21 on a low base of Apr'20, when it was down 37.8% YoY.
- Down 3.8% in the first week of May'21 vs first week of May'19

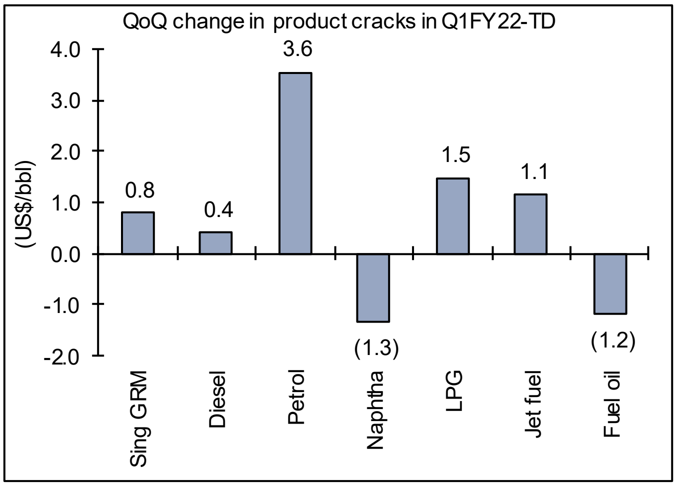
Singapore GRM up QoQ & YoY in line with petrol cracks

Singapore GRM is up US$0.8/bbl QoQ and US$3.5/bbl YoY in Q1FY22-TD. The QoQ and YoY rise in Singapore GRM in Q1FY22-TD has been driven by:

- Rise in petrol cracks by US$3.6/bbl QoQ and US$8.3/bbl YoY to US$10.7/bbl
- Rise in jet fuel cracks by US$1.1/bbl QoQ and US$4.4/bbl YoY.
- Rise in diesel cracks by US$0.4/bbl QoQ. However, they are down US$0.6/bbl YoY.
- Rise in LPG cracks by US$1.5/bbl QoQ. However, they are down US$12.4/bbl YoY.
- Rise in naphtha cracks by US$2.3/bbl YoY. They are down US$1.3/bbl QoQ

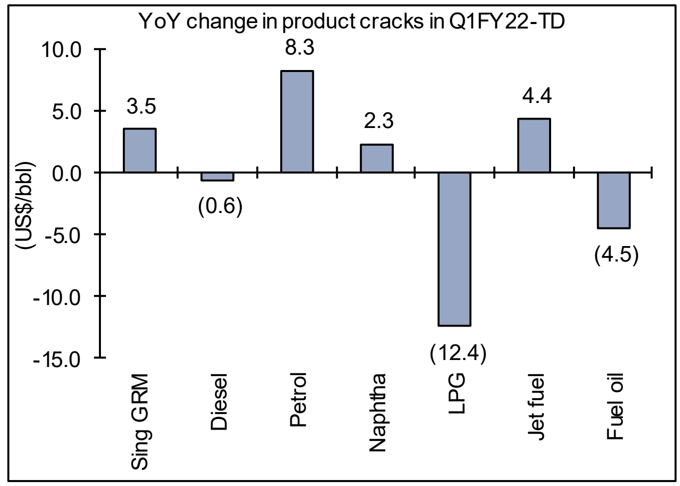
Fuel oil cracks are down US$1.2-4.5/bbl QoQ and YoY.

Chart 9: Rise in all product cracks except naphtha and FO drove rise in Singapore GRM in Q1FY22-TD



Source: Reuters, I-Sec research

Chart 10: Naphtha, jet fuel & petrol cracks rise by US$2.3-8.3/bbl YoY drove Singapore GRM in Q1-TD



Source: Reuters, I-Sec research

Diesel cracks recovery key to GRM recovery

Diesel cracks up MoM driven by US inventory fall

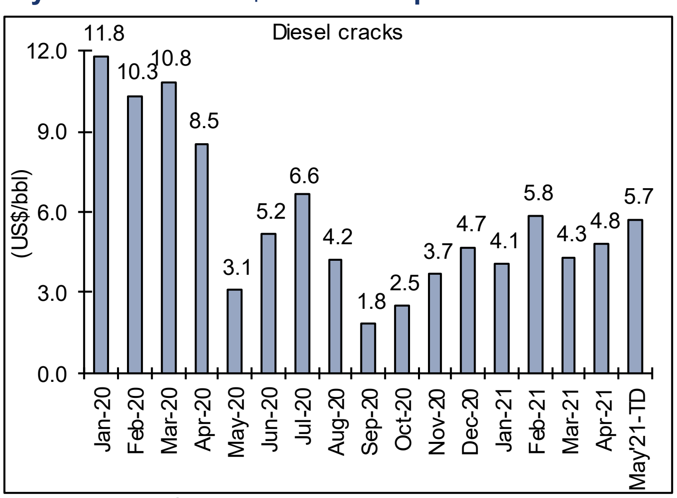
US snowstorm also led to a plunge in US distillate inventories to below five-year average levels. Diesel cracks, which were at 7-month high of US$5.8/bbl in Feb'21, were down to US$4.8/bbl in Apr'21. Diesel cracks at US$5.7/bbl in May'21-TD are up MoM and higher at US$6.1/bbl on 18-May'21 due to decline in US distillate inventory in last five consecutive weeks by 11.1m bbls to 5.8% below five year average levels.

Diesel cracks still weak and well below pre-covid levels

Diesel cracks are still:

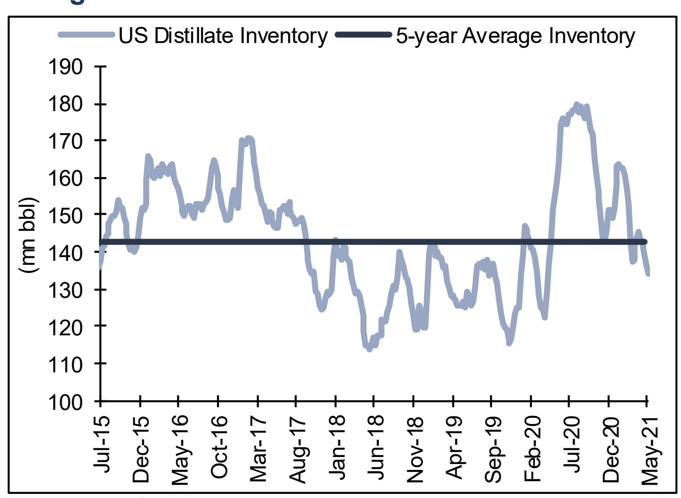
- Well below pre-covid levels of US$11-14.3/bbl in Q4-Q3FY20.
- Even below US$8.5/bbl in Apr'20 in the initial period of the pandemic.

Chart 11: Diesel cracks up MoM at US$5.7/bbl in May'21-TD from US$4.8/bbl in Apr'21



Source: Reuters, I-Sec research

Chart 12: US distillate inventory 5.8% below 5-year average after 11.1m bbls fall in five weeks



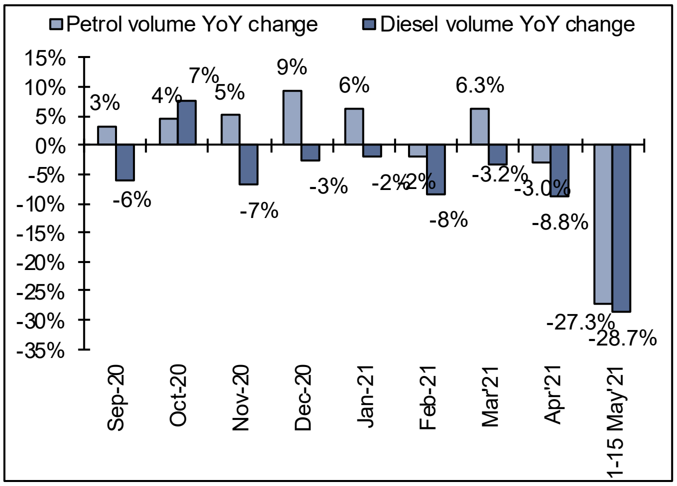
Source: EIA, I-Sec research

Diesel cracks hit by covid rise in India/Europe & rise in refinery yields

Some factors that may be hurting diesel cracks are:

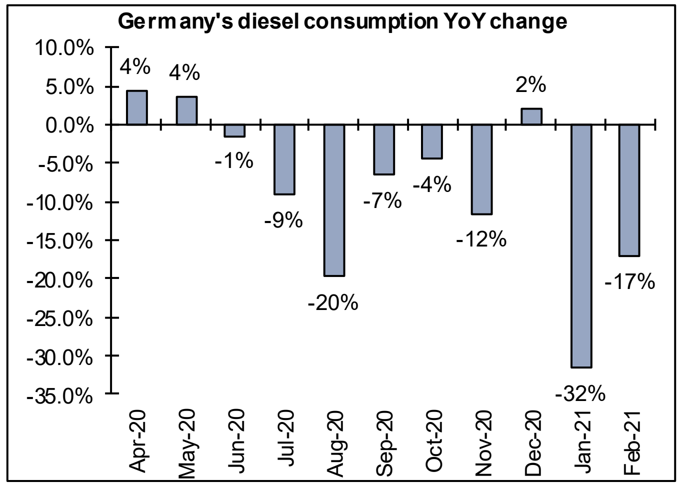
- **Second wave of covid in India.** Second wave of covid meant diesel consumption in Apr'21 was down 8.8% over Apr'19 level (up 105% YoY on a low base) and in 1-15 May'21 is down 29% YoY (up 14% YoY on a low base). Even before the second wave, Indian diesel consumption recovery lagged that in petrol.

Chart 13: Diesel demand recovery slower than petrol in India



Source: PPAC, I-Sec research
* Mar-May'21 change is compared to Mar-May'19

Chart 14: Germany diesel demand fall at 17% YoY in Feb'21; was steepest ever at 32% YoY in Jan'21

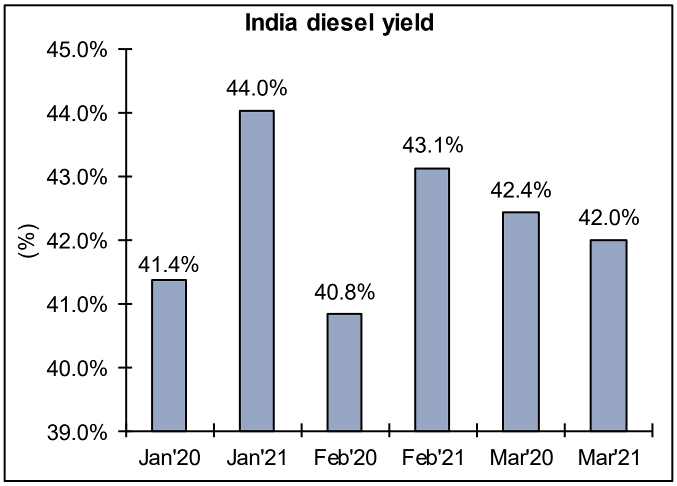


Source: JODI, I-Sec research

- **Diesel demand weakness in Germany – Europe's largest economy.** Diesel demand decline in Germany at 32% YoY in Jan'21 was the steepest ever since the pandemic began. Demand decline at 17% YoY in Feb'21 is also one of the steepest in Europe in the same period. The fact that new lockdowns were imposed in Mar'21, vaccine rollout is slow and average daily infections are high and rising, indicates that diesel demand in Germany continues to be weak in Mar-Apr'21. **Europe accounted for 23% of global diesel demand *vs* just 7% in case of petrol in CY19. Weakness in European diesel demand is therefore likely to have a bigger impact on diesel cracks than in case of petrol cracks.**

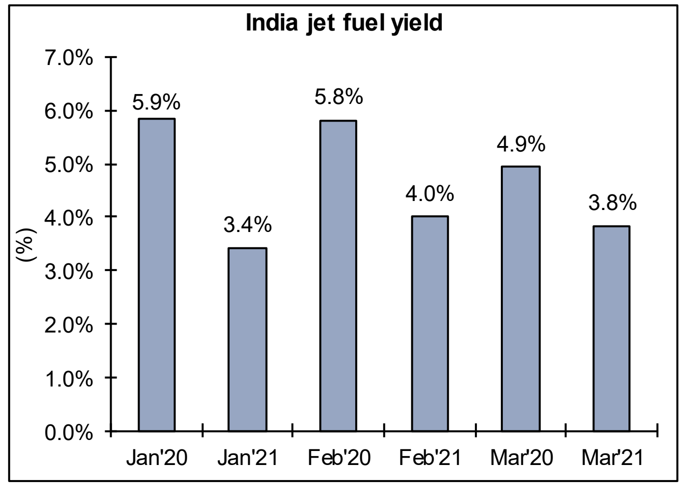
- **Continued weakness in jet fuel demand has meant rise in diesel yield of Indian refiners.** In India, jet fuel demand is down 37-41% YoY vs 2.1-8.4% YoY fall for diesel in in Dec'20-Feb'21. In Mar-Apr'21 too jet fuel demand was down 33.7-36.7% compared to Mar-Apr'19 vs 3.2-8.8% fall for diesel. This has meant diesel yield of Indian refiners was up 2.3-2.7pct points YoY to 43.1-44.0% in Feb'21 and Jan'21. Diesel yield was down 0.4pct points YoY to 42% in Mar'21. Jet fuel yield in India is down 2.4-1.1pct points YoY to 3.4-4.0%% in Jan'21-Mar'21. Global jet fuel demand decline is far steeper than auto fuels at 22.3-24.9% YoY in Jan-Feb'21 and 37.8-30.6% in Mar-Apr'21 vs Mar-Apr'19. Thus, diesel yield of refiners in other countries, especially those operating at high utilisation rates, may also have risen and hit diesel cracks.

Chart 15: Indian refiners' diesel yield up YoY in Jan'21 and Feb'21; marginally down in Mar'21



Source: PPAC, I-Sec research

Chart 16: Indian refiners' jet fuel yield down YoY in Jan-Mar'21



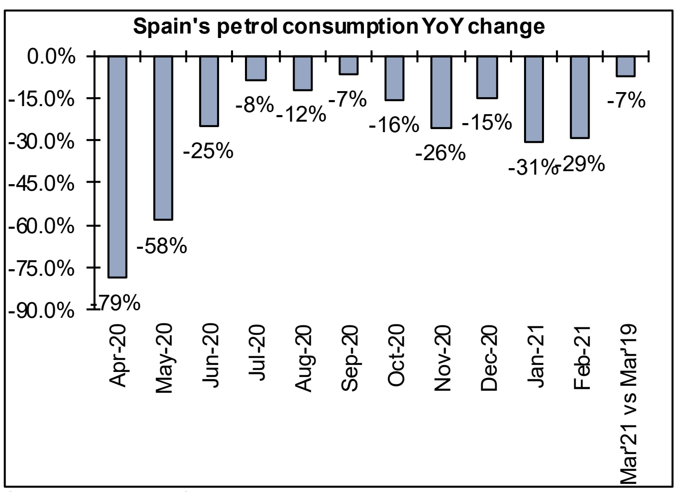
Source: PPAC, I-Sec research

Auto fuel demand in Europe showing signs of recovery

Smart auto fuel demand recovery in Spain in Mar'21 vs in Mar'19

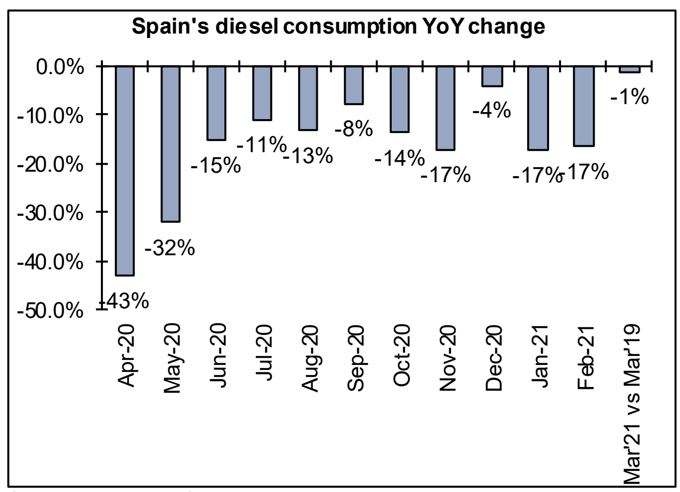
Petrol and diesel demand in Spain has shown a marked improvement in Mar'21. Diesel demand is up 16% YoY and petrol is up 44% YoY on a low base; diesel demand was down 14.7% YoY and petrol was down 35.6% YoY in Mar'20.

Chart 17: Spain's petrol consumption down 7% in Mar'21 *vs* Mar'19; down 29% YoY in Feb'21



Source: Exolum, I-Sec research
*Mar'21 fall is compared to Mar'19

Chart 18: Spain's diesel consumption down 1% in Mar'21 *vs* Mar'19; down 17% YoY in Feb'21



Source: Exolum, I-Sec research
*Mar'21 fall is compared to Mar'19

We have therefore compared diesel and petrol consumption data in Spain in Feb-Mar'21 over levels in Feb-Mar'19, which also confirms the significant improvement in consumption in Mar'21 as follows:

- Diesel and petrol consumption is up 12-23% MoM in Mar'21 adjusted for lower number of days in Feb than in Mar.
- Diesel consumption was down 1% in Mar'21 vs Mar'19 while that in Feb'21 was down 16.7% vs Feb'19.

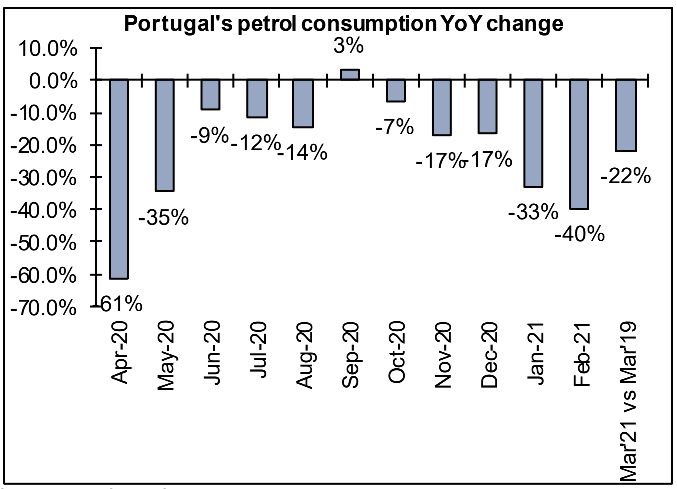
- Petrol consumption was down 7% in Mar'21 vs Mar'19 while that in Feb'21 was down 23.4% vs Feb'19.

Auto fuel demand fall in Portugal in Mar'21 vs Mar'19 modest vs in Feb

Petrol and diesel demand in Portugal has shown a marked improvement in Mar'21 from levels in Feb'21. Diesel demand in Portugal is up 3% YoY and petrol is down just 1% YoY in Mar'21 on a low base; diesel demand was down 12% YoY and petrol was down 21% YoY in Mar'20. We have therefore compared diesel and petrol consumption data in Portugal in Feb-Mar'21 over levels in Feb-Mar'19, which also confirms the marked improvement in consumption in Mar'21 as follows:

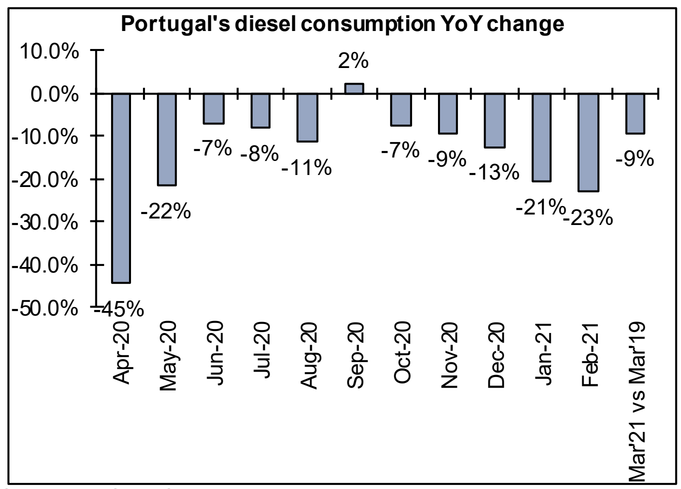
- Diesel and petrol consumption is up 12-23% MoM in Mar'21 adjusted for lower number of days in Feb than in Mar.
- Diesel consumption was down 9.4% in Mar'21 *vs* Mar'19 while that in Feb'21 was down 22.9% *vs* Feb'19.
- Petrol consumption was down 21.8% in Mar'21 *vs* Mar'19 while that in Feb'21 was down 36.9% vs Feb'19.

Chart 19: Portugal's petrol consumption down 22% in Mar'21 *vs* Mar'19; down 40% YoY in Feb'21



Source: ENSE, I-Sec research
*Mar'21 fall is compared to Mar'19

Chart 20: Portugal's diesel consumption down 9% in Mar'21 *vs* Mar'19; down 23% YoY in Feb'21



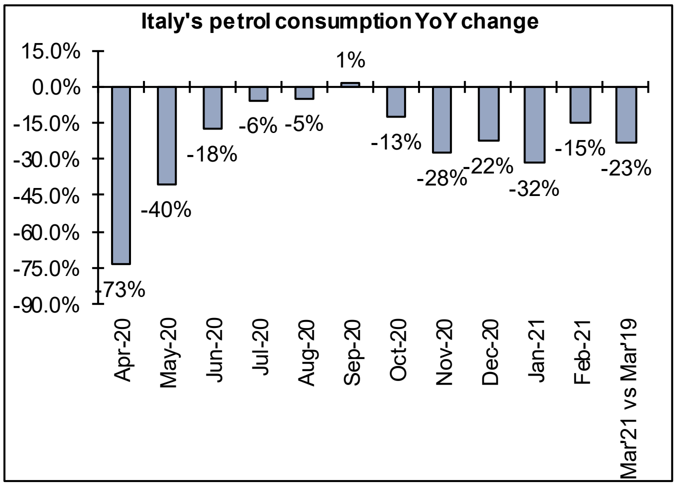
Source: ENSE, I-Sec research
*Mar'21 fall is compared to Mar'19

Petrol and diesel demand deteriorated in Italy in Mar'21 vs in Feb'21

Petrol and diesel demand in Italy deteriorated in Mar'21 from levels in Feb'21. Diesel demand in Italy is up 34% YoY and petrol is up 63% YoY in Mar'21 on a low base; diesel demand was down 34.7% YoY and petrol was down 51.9% YoY in Mar'20. We have therefore compared diesel and petrol consumption data in Italy in Feb-Mar'21 over levels in Feb-Mar'19 which also suggests that demand in Italy has deteriorated in Mar'21 as follows:

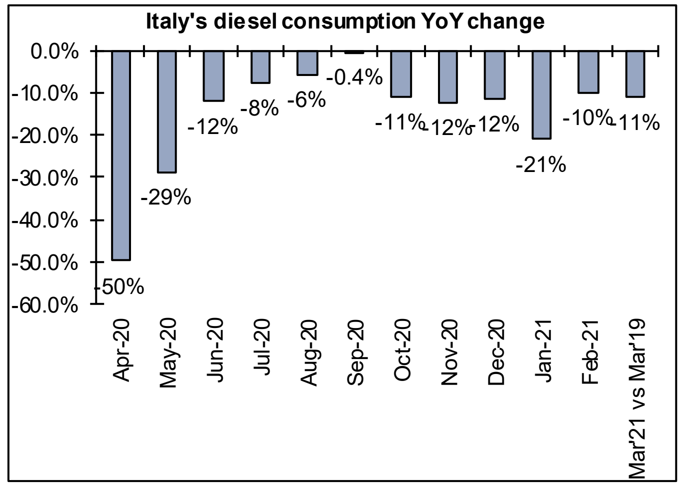
- Diesel and petrol consumption is down 1-10% MoM in Mar'21 adjusted for lower number of days in Feb than in Mar.
- Diesel consumption was down 11.1% in Mar'21 *vs* Mar'19 while that in Feb'21 was down 10.2% *vs* Feb'19.
- Petrol consumption was down 23.3% in Mar'21 *vs* Mar'19 while that in Feb'21 was down 12.7% *vs* Feb'19.

Chart 21: Italy's petrol consumption down 23% in Mar'21 *vs* Mar'19; down 15% YoY in Feb'21



Source: MoED Italy, I-Sec research
*Mar'21 fall is compared to Mar'19

Chart 22: Italy's diesel consumption down 11% in Mar'21 *vs* Mar'19; down 10% YoY in Feb'21



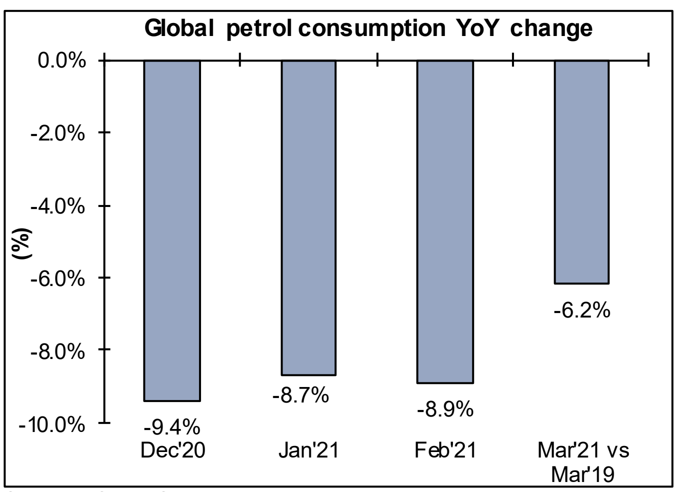
Source: MoED Italy, I-Sec research
*Mar'21 fall is compared to Mar'19

Global petrol demand fall more modest but diesel steeper in Mar'21

Global data suggests that petrol demand fall in Mar'21 is more modest than in Feb'21 while that of diesel is steeper *vs* that in Feb'21 as follows:

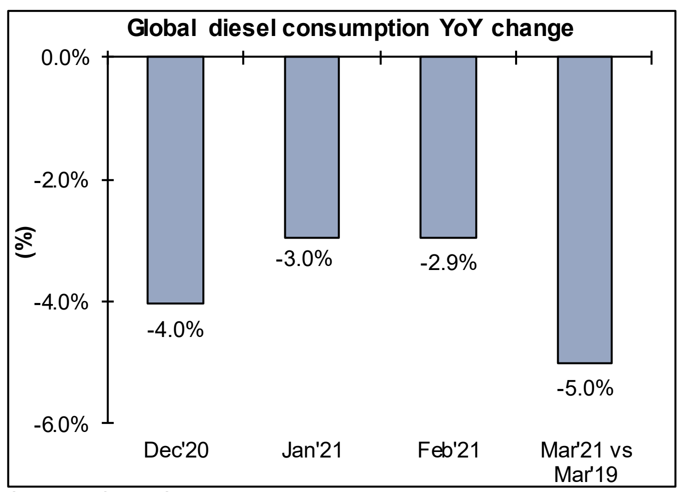
- Diesel demand in Mar'21 in six countries which account for 27% of global demand was down 5.0% in Mar'21 *vs* Mar'19 levels. This compares with 4.0% YoY fall in Dec'20, 3.0% YoY fall in Jan'21 and 2.9% YoY fall in Feb'21 based on 13 countries – 53% of global demand.

Chart 23: Global petrol consumption down 6.2% in Mar'21 *vs* Mar'19; down 8.9% YoY in Feb'21



Source: JODI, I-Sec research
*Mar'21 fall is compared to Mar'19

Chart 24: Global diesel consumption down 5.0% in Mar'21 *vs* Mar'19; down 2.9% YoY in Feb'21



Source: JODI, I-Sec research
*Mar'21 fall is compared to Mar'19

- Petrol demand in Mar'21 in six countries which account for 40% of global demand was down 6.2% in Mar'21 *vs* Mar'19 levels. This compares with 9.4% YoY fall in Dec'20, 8.7% YoY fall in Jan'21 and 8.9% YoY fall in Feb'21 based on 13 countries – 63% of global demand.

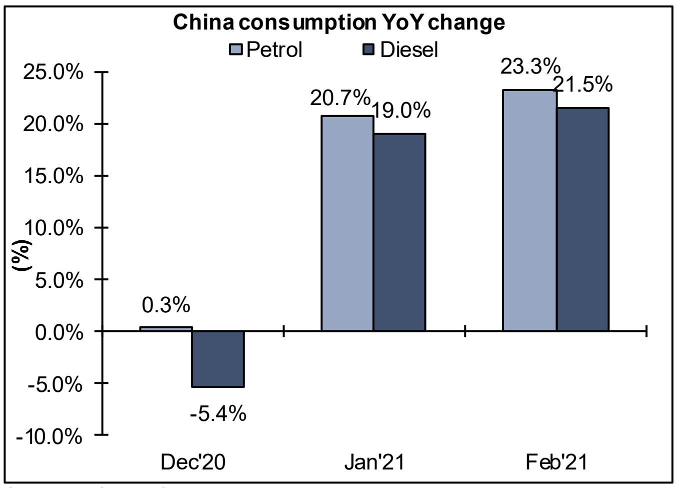
Excluding Chinese data, demand recovery MoM both in petrol & diesel

Chinese diesel and petrol demand was up YoY on low base at 19-22% and 21-23% in Jan-Feb'21 respectively as Covid first struck in China. We do not have Chinese auto fuel consumption data for Mar'21. Global auto fuel consumption in Jan-Mar'21 excluding Chinese data would mean:

- Global petrol consumption is down 14% YoY in Jan'21, down 14.7% YoY in Feb'21 but is down 6.2% in Mar'21 over Mar'19 level.

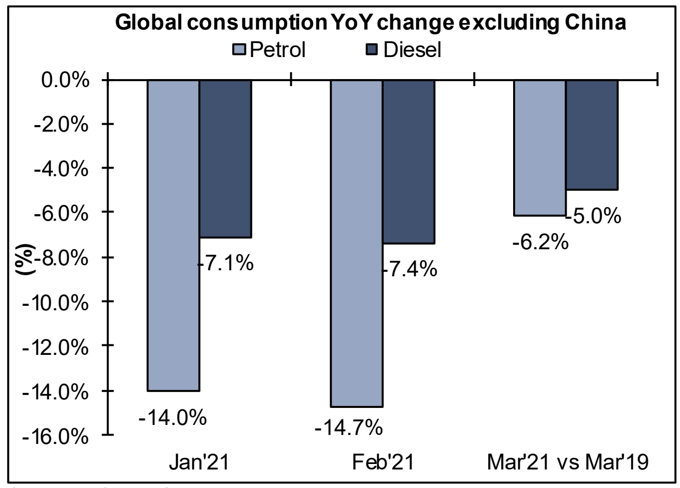
- Global petrol consumption is down 7.1% YoY in Jan'21, down 7.4% YoY in Feb'21 but is down 5% in Mar'21 over Mar'19 level.

Chart 25: Chinese auto fuel demand flat/down YoY in Dec'20; YoY surge in Jan-Feb'21 on low base



Source: JODI, I-Sec research

Chart 26: Excluding Chinese data, global petrol demand recovery steeper than diesel in Mar'21



Source: JODI, I-Sec research

Diesel cracks recovery key to Indian refiners' GRM recovery

Indian refiners' Q1FY22-TD GRM remain weak

Core GRMs of BPCL, IOC and RIL remain weak in Q1FY22-TD, as follows:

- BPCL's Q1FY22-TD GRM is estimated at US$0.44/bbl.

- IOC's Q1FY22-TD GRM is estimated at US$0.79/bbl.

- RIL's Q1FY22-TD GRM is estimated to be one of the strongest since pandemic began at US$3.53/bbl *vs* US$2.3-2.4/bbl in Q2-Q3FY21.

Indian refiners' Q1FY22-TD GRM lower than our FY22E estimate

Core GRMs of BPCL, IOC and RIL in Q1FY22-TD are lower than our FY22E estimates as follows:

- BPCL's Q1FY22-TD GRM is estimated at US$0.44/bbl *vs* our FY22E estimate of US$3.5/bbl

- IOC's Q1FY22-TD GRM is estimated at US$0.79/bbl *vs* our FY22E estimate of US$3.4/bbl

- RIL's Q1FY22-TD GRM is estimated at US$3.53/bbl *vs* our FY22E estimate of US$7.0/bbl

Diesel cracks recovery key to GRM recovery to levels estimated by us

As discussed, diesel cracks are languishing well below pre-covid levels though petrol cracks have recovered to above pre-covid levels. Diesel cracks recovery is key to GRM of Indian refiners recovering to levels estimated by us for FY22E as diesel accounts for 40-50% of their product slate while petrol accounts for only 17-29%.

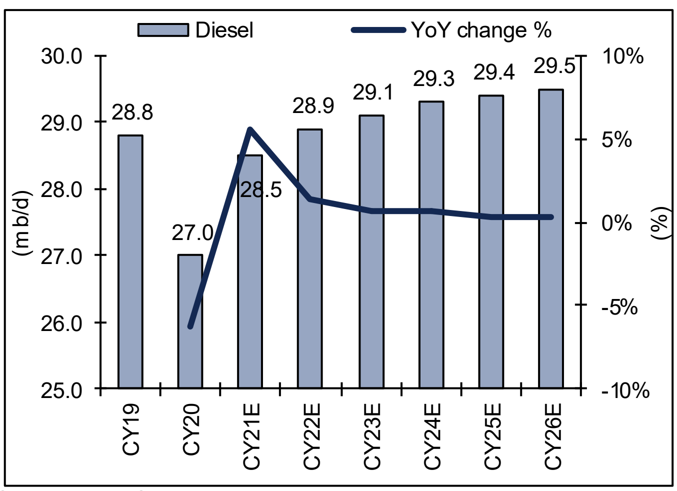
Diesel demand up 1.5m b/d in CY21E; above pre-covid level in CY22E

IEA estimates global diesel demand, which declined by 1.8m b/d (6.3%) YoY to 27m b/d in CY20, would:

- Be up 1.5m b/d (5.6%) YoY to 28.5m b/d in CY21E
- Go above pre-covid levels to 28.9m b/d (*vs* 28.8m b/d in CY19) in CY22E
- Rise by 2.5m b/d to 29.5m b/d in CY20-CY26E

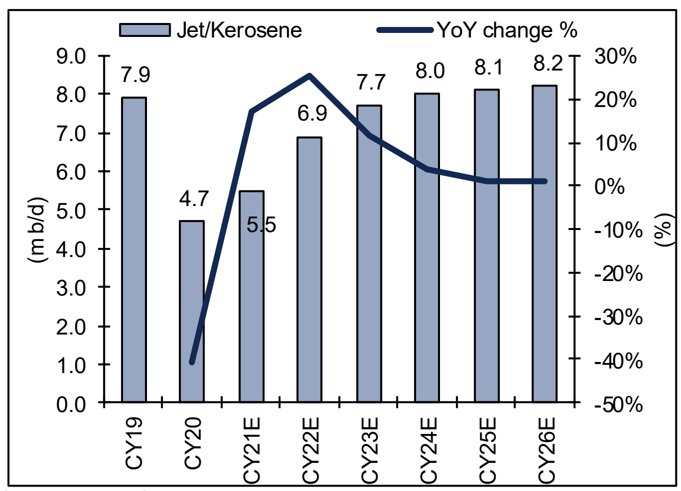
IEA estimates global jet fuel demand to rise by 0.8-1.4m b/d (17-25%) YoY in CY21E-CY22E and to rise above pre-covid levels in CY24E. Recovery in jet fuel demand is likely to help reduce diesel yield of refiners and help boost diesel cracks.

Chart 27: Global diesel demand to go above pre-covid levels in CY22E



Source: IEA, I-Sec research

Chart 28: Global jet fuel demand to go above pre-covid levels in CY24E



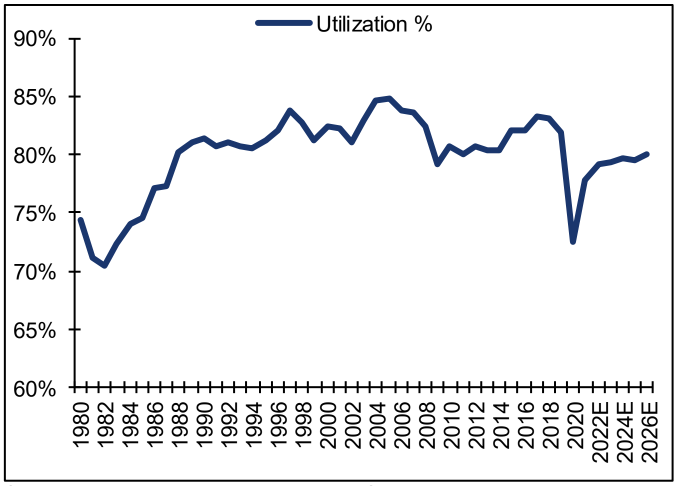
Source: IEA, I-Sec research

GRMs to be up YoY as vaccines boost demand and capacity is shut

Recovery in global oil demand, decline in bloated product inventories and closure of refineries to reduce refining overcapacity are key to GRM recovery. We expect GRM to be up YoY in CY21E/FY22E driven by:

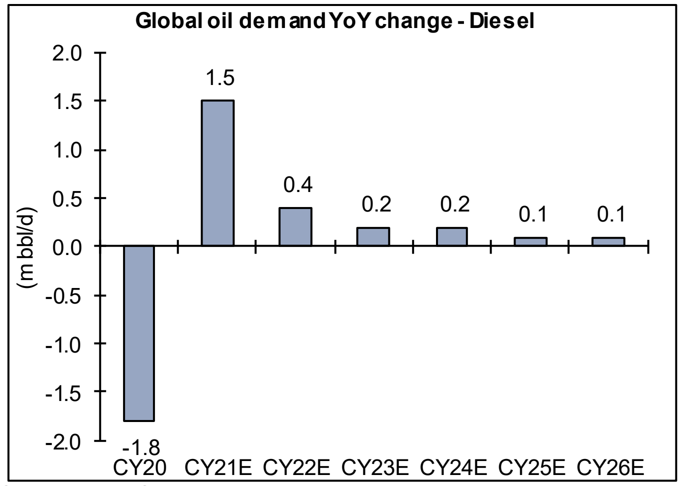
- Gradual vaccine rollout globally, which is expected to boost global refinery products demand. IEA estimates global refinery products demand, which is down 8.7m b/d YoY in CY20E, to be up 5.5m b/d YoY in CY21E.

Chart 29: Global refinery utilisation to rise to 77.8-79.2% in CY21E from 37-year low of 72.5% in CY20



Source: EIA, IEA, Wood Mackenzie, I-Sec research

Chart 30: Global diesel demand to rise by 1.5-0.4m b/d YoY in CY21-CY22E & more modestly thereafter



Source: IEA, I-Sec research

- Permanent closure of refining capacity helps boost global refinery utilisation to 77.8-79.2% in CY21E-CY22E from 37-year low of 72.5% in CY20E. We estimate permanent closure of 1.5m b/d refining capacity globally in CY20-CY21E. Permanent closure of another 1.4m b/d of capacity is under consideration.

Table 1: 1.5m b/d refining capacity may be shut in CY20-CY21; closure of another 1.4m b/d possible

Refinery	Country	Capacity (k b/d)
Refinery shutdowns		
Royal Dutch Shell	Philippines	110
Royal Dutch Shell	Louisiana, USA	240
Marathon Petroleum	USA	161
Marathon Petroleum	USA	26
Neste	Finland	58
JXTG	Japan	115
BP	Kwinana, Australia	146
Irving Oil	Newfoundland	135
PBF	Paulsboro, NJ	85
Sub-total		**1,076**
Shutdown and conversion to biodiesel		
Holly Frontier	USA	48
Neste	Finland	240
Total	France	101
Sub-total		**389**
Total refinery closures		**1,465**
Potential Closures		
Gunvor Group	Belgium	110
BP	Netherlands	377
Petroineos	UK	200
Viva	Australia	120
New Zealand refining NZ	New Zealand	135
Petron	Philippines	180
Phillips 66	Santa Maria, CA, USA	44.5
Calcasieu Refining	Lake Charles, LA	136
Phillips 66	Rodeo, CA, USA	120
Phillips 66	USA	19
Sub-total		**1,441**
Total closures and potential closures		**2,906**

Source: Industry data, I-Sec research

Permanent closure of 1.5m b/d capacity likely in CY20-CY21E

GRMs in CY20E have been hit by decline in global refinery utilisation to 72.4%, which is the lowest in 38 years due to steep decline in global demand. Low GRMs and fall in demand is making it unviable for refineries to operate, as a result of which 1.5m b/d refining capacity in US, Japan, Philippines, Finland and France may be shut in CY20-CY21, out of which 0.4m b/d capacity would have been converted for biodiesel. Moreover, potential closure of another 1.4m b/d refining capacity in Europe, Australia, New Zealand and Philippines is under consideration.

Marketing margins weak in Q1FY22-TD but price hikes begin

Net marketing margin at Rs3.05/l in FY21; Rs0.42/l in Q1FY22-TD

Auto fuel net marketing margin was at a record high of Rs3.05/l in FY21. However, net margin is at 14-quarter low in Q1FY22-TD. Net marketing margin is at:

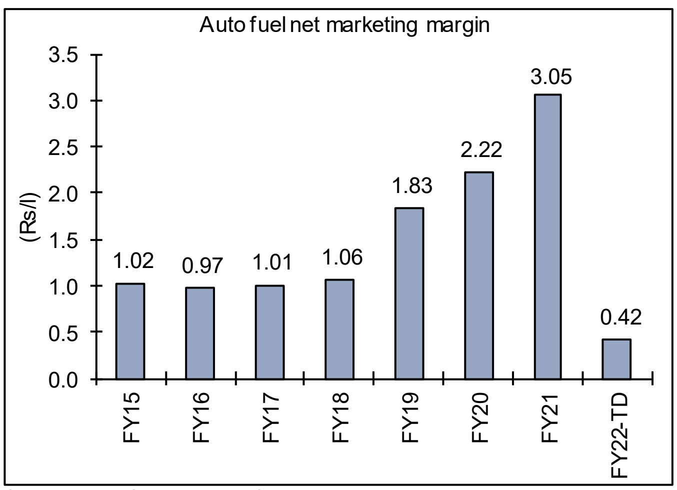
- Rs0.66/l on 18-May'21
- Rs0.42/l in Q1FY22-TD

Margin at Rs0.19/l on 1-Jun & minus Rs0.15/l on 16-Jun at latest prices

We estimate net auto fuel marketing margin at:

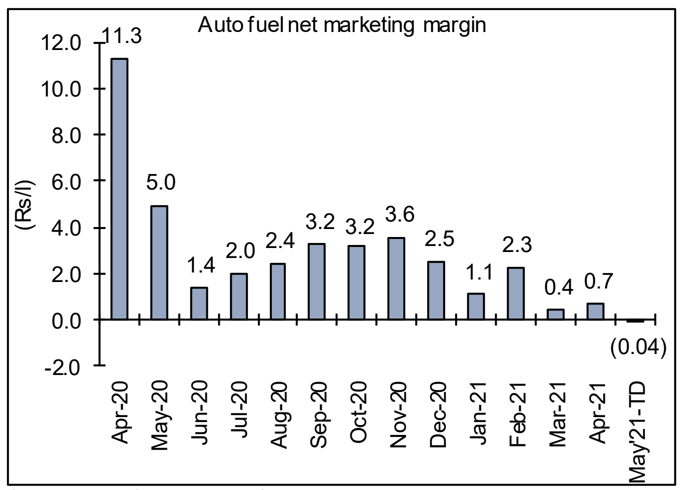
- Rs0.19/l on 1-Jun'21 based on international prices in 17-18 May'21
- Minus Rs0.15/l on 16-Jun'21 at latest international prices assuming domestic and international prices sustain at today's level in 1-15 Jun'21.

Chart 31: OMCs' auto fuel net marketing margin is Rs0.42/l in FY22-TD *vs* Rs3.05/l in FY21



Source: PPAC, Reuters, I-Sec research

Chart 32: OMCs' net margin at minus Rs0.04/l in May'21-TD *vs* Rs0.7/l in Apr'21



Source: PPAC, Reuters, I-Sec research

Net margin weak despite price hikes; further Rs2.2-3.2/l hikes required

Net marketing margin is weak at Rs0.66/l on 18-May'21 despite petrol and diesel price hikes of Rs2.5-2.8/l in the last two weeks. Further price hike or excise duty cut (which is not passed on to consumers) of:

- Rs2.2-2.8/l is needed for net marketing margin to be Rs2.0-2.5/l on 1-Jun'21 assuming international prices remain at 17-18 May'21 levels.
- Rs2.6-3.2/l is needed for net marketing margin to be Rs2.0-2.5/l on 16-Jun'21 assuming international prices remain at latest (18-May'21) levels.

Expect net margin at Rs2.5/l in FY22E given GoI track record

We are optimistic that net marketing margin will rise to Rs2.5/l in FY22E given the government's track record:

- During the first four years of the current government (FY15-FY18), net marketing margin was Rs0.96-1.07/l.
- In the next two years (FY19-FY20), it was higher at Rs1.83-2.22/l.
- Net margin is YoY higher in FY21 to make up for very weak GRMs.
- Price hikes were made to keep net margins at reasonable levels even when Brent surged to US$86/bbl and INR/USD weakened to 75 in Oct'18, seven months before the 2019 elections.
- Net margin being Rs2.0-2.5/l in the initial period of FY22E may be crucial for GoI to realise a high price in BPCL privatisation.

Net margin rise will require either price hikes and/or excise duty cuts that are not passed on. We estimate that GoI is well placed to meet its excise duty collection target of FY22E even if excise duty is cut by Rs8.5/l assuming FY22 consumption is same as FY20. Even if FY22 demand is lower than FY20, some cut in excise duty certainly looks possible.

Prefer BPCL as privatisation play; margin rise hope in OMCs

Prefer BPCL among OMCs as a play on privatisation

Among OMCs we prefer BPCL, which is a play on privatisation. Privatisation of BPCL is guided to be completed in Q2FY22. 56% of holding of investors in BPCL is likely to be sold in open offer by successful bidder, which we estimate at Rs609/share (based on 8x FY22 EV/EBITDA), and balance at Rs462/share (based on 6x FY22E EV/EBITDA). Bidders in BPCL are unlikely to focus too much on near term GRM and auto fuel net margins and likely to focus more on medium term outlook, which is better than near term outlook.

Hope of recovery in weak GRM & marketing margin in case of OMCs

The core OMC story is based on hope of recovery in net auto fuel net marketing margin to Rs2.5/l and GRM to US$3.4-3.5/bbl in FY22E. Downside to our FY22E EPS estimates of OMCs is not ruled out as:

- Marketing margins may recover to Rs2.5/l later in FY22E but FY22E average being below our estimate of Rs2.5/l cannot be ruled out given the weakness in Apr-May'21. Net margin was Rs0.97-2.22/l in FY15-FY20 (Rs3.05/l in FY21).
- FY22E GRM being lower than our estimate is not ruled out as diesel cracks may take longer to recover to pre-covid levels than hoped and petrol cracks strength may not sustain at current levels.

Petrochemical margin strength positive for IOC's FY22E EPS outlook

IOC would gain from petrochemical margin strength. Its petrochemical EBITDA was up 1.6-2.6x YoY at Rs12.1-19.5bn in Q2-Q3FY21 and we estimate it to be up 4.5x YoY at Rs21.5bn in Q4FY21; this implies FY21E petrochemical EBITDA of Rs60.4bn implying upside of 59% to our estimate of Rs37.9bn. IOC's Q1FY22E petrochemical EBITDA is estimated to be up QoQ at Rs23.2bn, which if annualised at Rs92.8bn would imply 99% upside to our FY22E petrochemical EBITDA estimate of Rs46.6bn and 21% upside to FY22E EPS.

IOC is also cheap at 0.89x FY22E P/BV and FY22E dividend yield is 7%.

RIL: awaiting trigger for stock performance to improve

RIL has underperformed all its peers across sectors since mid-Sep'20 probably hit by no tariff hikes by RJio in FY21, GRM weakness and Retail EBITDA and revenue below pre-covid levels until Q3FY21. RIL's stock performance would improve if any/some/all of the following share price drivers play out:

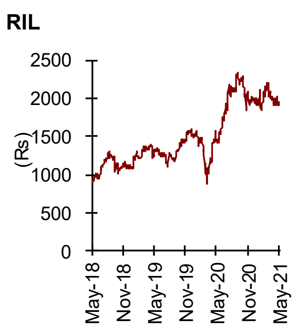
- Significant tariff hikes are made.
- Retail revenue and EBITDA growth returns to pre-covid levels. There is risk of its revenue and EBITDA, which was above pre-covid level in Q4FY21, going below pre-covid level or at least growth moderating QoQ in Q1FY22 because of restrictions imposed due to second wave.
- There is strong recovery in GRM at least to levels of our FY22 estimate of US$7/bbl.
- RIL is able to sell stake in O2C business at a good valuation.

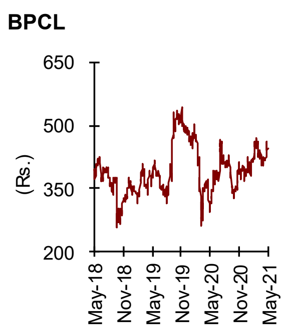
Risks to recommendation

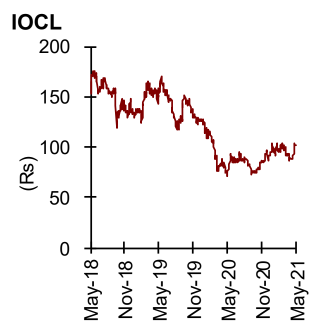
Risks to our recommendation are:

- **RIL:** 1) GRM being lower than assumed; 2) Higher/lower ARPU than estimate; 3) Petrochemical EBITDA higher/lower than estimated; 4) Net debt is significantly higher or lower than our estimate.
- **IOC:** Lower than estimated auto fuel marketing margin and GRM.
- **BPCL:** 1) Privatisation doesn't go through or bid price is sharply lower than estimated; 2) Lower than estimated auto fuel marketing margin and GRM.

Price charts







Source: Bloomberg

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