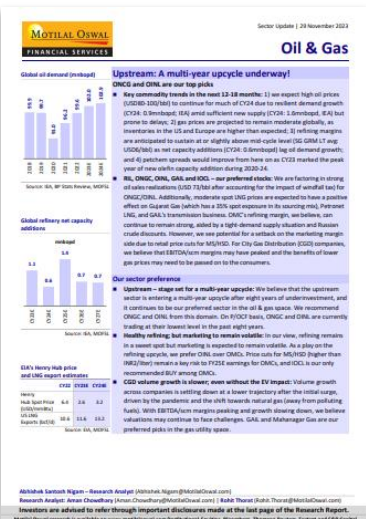
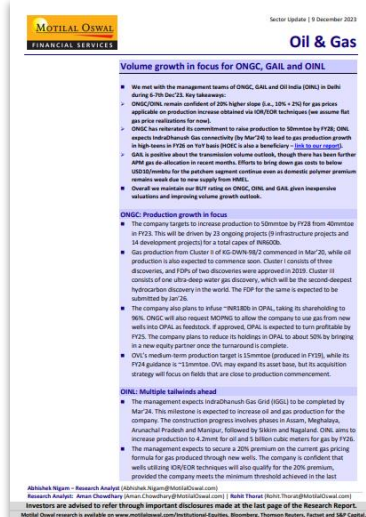
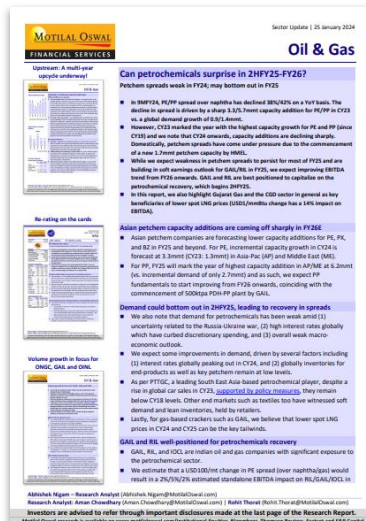


Oil & Gas

Our latest O&G updates



Refining bottoming out; marketing margins remain robust

- Refining has had a slow start in 1QFY25, but we anticipate a recovery as the summer driving season begins in the US (from Jul'24) and oil demand growth improves in 2HFY25. The marketing margins have remained robust, with oil declining to USD83/bbl in May'24YTD. The current MS and HSD marketing margins are ~INR5/lit each vs. our assumptions of INR3.3/lit each for both MS and HSD.
- With oil prices declining to near USD83/bbl recently, the focus remains on OPEC's upcoming meeting in early Jun'24. With OPEC's spare capacity at a multi-year high and strong non-OPEC supply growth, we believe the likelihood of OPEC not extending production cuts is increasing. As such, we believe oil prices will remain within a specific range in the coming months.
- HPCL, GAIL, and Oil India remain our top picks in the oil and gas sector. We favor HPCL due to: 1) a favorable marketing margin environment and an expected improvement in GRM with the commencement of the bottom upgrade project in 3QFY25, 2) significant volume growth from the Rajasthan refinery (+27% increase for HPCL on a proportionate basis), and 3) potential value unlocking from the demerger of the lubricant business.

Oil demand stable; non-OPEC supply strong

- The IEA recently released its monthly oil report, in which it revised down its estimates for global oil demand growth for CY24 by 140kb/d to 1.1mb/d, even as demand growth projection for CY25 was raised to 1.2mb/d (from 1.1mb/d in Apr'24).
- In 2024, the global oil supply is anticipated to increase by 580kb/d (vs. +770kb/d est. in Apr'24). This increase is attributed to a 1.4mb/d growth in non-OPEC+ output (vs. 1.6mb/d est. in Apr'24). Conversely, OPEC+ production is expected to decline by 840kb/d (vs. 820kb/d est. in Apr'24), assuming that voluntary cuts are maintained.
- In Mar'24, global oil inventories increased by 34.6mb (+43.3mb in Feb'24), with oil stored at sea reaching its highest level since the pandemic. Conversely, on land stocks decreased 5.1mb, reaching their lowest point since late 2016.
- Total OECD stocks decreased 8.8mb, reaching a 20-year low, while non-OECD inventories rose for the first time since Nov'23. Preliminary data suggests that global oil stocks continued to rise in Apr'24.

Refining GRMs weak for now but bottoming out

- Refining has had a slow start in 1QFY25YTD with SG GRM averaging USD3.86/bbl vs. 4QFY24 average of USD7.32/bbl. In 1QFY25YTD, diesel GRM has averaged USD17.2/bbl vs. 4QFY24 average of USD24.3/bbl. In contrast, gasoline GRM has remained strong at USD16.1/bbl vs. 4QFY24 average of USD14.64/bbl.
- The recent weakness in GRMs might be attributable to weaker-than-expected global oil demand growth. Further, the middle distillate markets experienced a spring sell-off, causing the global refining margins to fall to nearly two-year lows.

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- The IEA expects refinery activity to pick up pace, with annual growth projected to increase from slightly above zero in 1QCY24 to 500kb/d in 2QCY24 and further to 1.8mb/d in 2HCY24. As such, we foresee a stronger refining GRM environment in 2HCY25.
- Meanwhile, the current gross marketing margins are INR5/lit for HSD and MS, even as we are building in gross marketing margin of INR3.3/lit for both MS and HSD.
- As such, we believe, OMCs/MRPL/RIL are on course to post weaker refining performance sequentially even as marketing business profitability for OMCs, currently, is largely in line with their reported 4QFY24 results.

Petrochemicals stable but could rebound in 2HFY25

- HDPE and PP spreads over naphtha have averaged USD290/t and USD302/t in 1QFY25YTD, down 5% QoQ and up 1% QoQ, respectively.
- Average HDPE price in 1QFY25YTD is USD988/t vs. 4QFY24 price of USD990/t, even as spot LNG price has risen by 7.4% QoQ to USD10.1/mmbtu in 1QFY25YTD.
- While key petchem spreads have largely remained flat QoQ, we do believe petchem segment is bottoming out as capacities globally are coming off sharply and the excess supply situation continues to correct. Refer to our report titled “Can petrochemicals surprise in 2HFY26”.

Our top picks in the Oil and Gas sector are HPCL, GAIL, and Oil India.

- **HPCL** remains our preferred pick among the three OMCs. We model a marketing margin of INR3.3/lit in FY25-26E, while MS and HSD marketing margins are INR5.3/lit and INR4.7/lit, respectively, at present. We see the following as key catalysts for the stock: 1) demerger and potential listing of lubricant business, 2) the commissioning of its bottom upgrade unit, and 3) the start of Rajasthan refinery in 4QFY25.
- HPCL currently trades at 1.2x FY26E PB, which we think offers a reasonable margin of safety as we estimate FY26 ROE at 17.6%. We value the stock at 1.4x FY26E P/BV to arrive at our TP of INR600. **Reiterate BUY.**
- **For GAIL**, during FY24-26E, we are modeling PAT to report a 9.8% CAGR driven by: 1) rising natural gas transmission volumes to 142mmcmd in FY26 from 120mmcmd in FY24; and 2) substantial improvement in petchem segment's profitability over 2HFY25-FY26 as new petchem capacity will be operational and low inventories globally will drive re-stocking demand.
- We remain positive on GAIL ([our top pick in CY24](#)), valuing the core business at 13x FY26E adj. EPS of INR15. Adding the value of listed and unlisted investments of INR40, we arrive at our revised TP of INR235. Our TP implies FY26E P/B of 2x. The stock is currently trading at an FY26E P/B of 1.7x. **Reiterate BUY.**
- **Oil India** remains a strong conviction BUY with a 1.3x FY26E P/B (standalone) valuation. It is a unique play to benefit from the strong multi-year upcycle in both upstream and refining. The stock currently trades at a P/E multiple of 8x FY26E EPS and 5.8x FY26E EV/EBITDA. We value the stock at 7.9x FY26E standalone adj. EPS and add investments to arrive at our TP of INR694. **Reiterate BUY.**

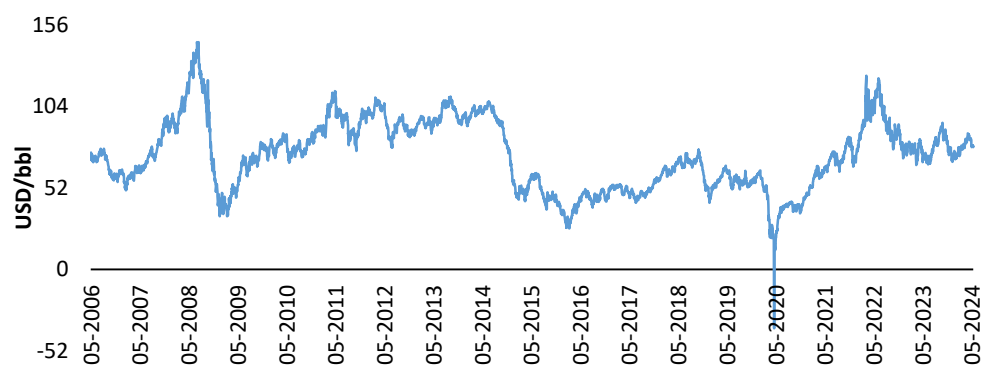
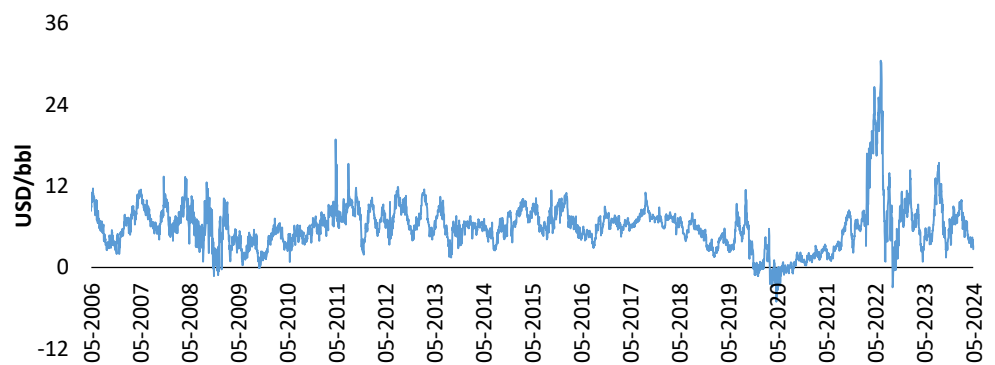
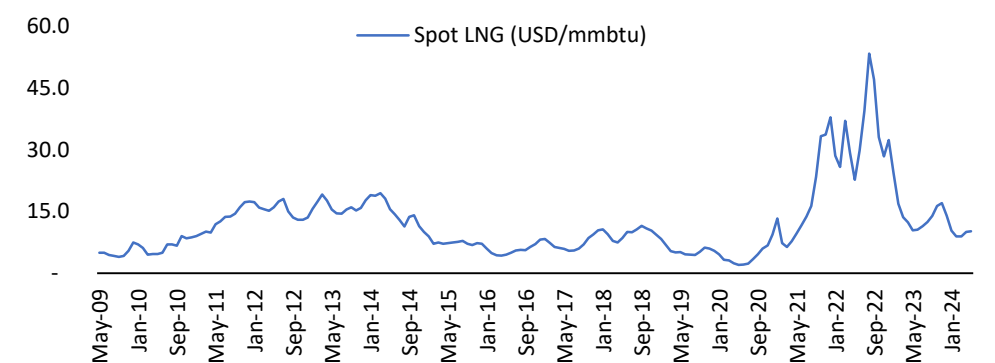
Exhibit 1: Brent crude historical trend (USD/bbl)**Exhibit 2: WTI historical price trend (USD/bbl)****Exhibit 3: SG GRM historical trend (USD/bbl)****Exhibit 4: Spot LNG historical price (USD/mmbtu)**

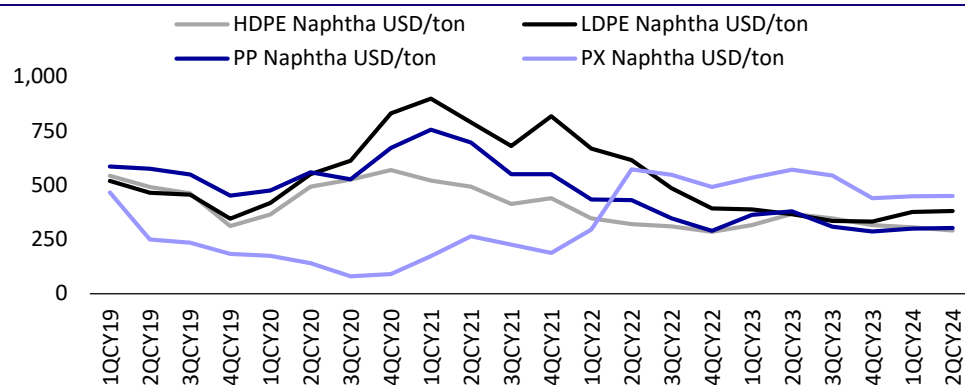
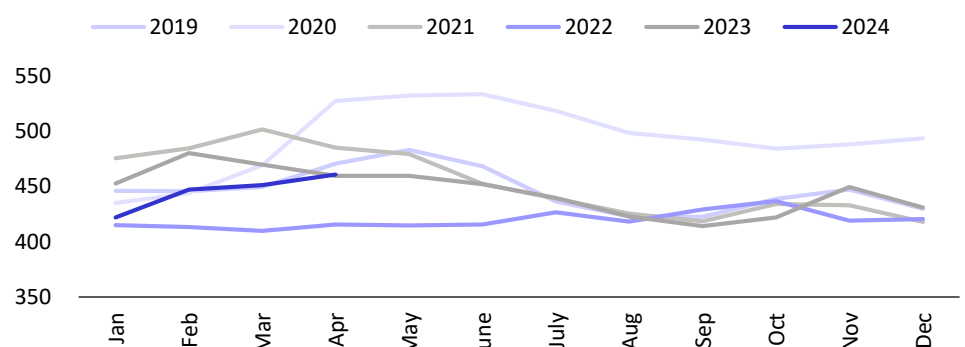
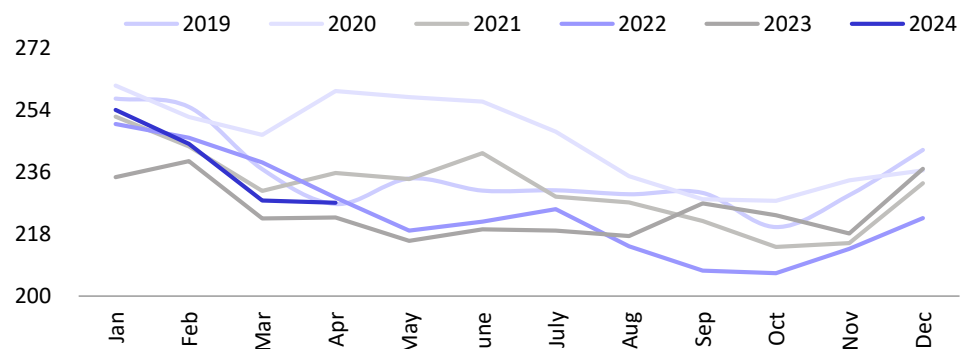
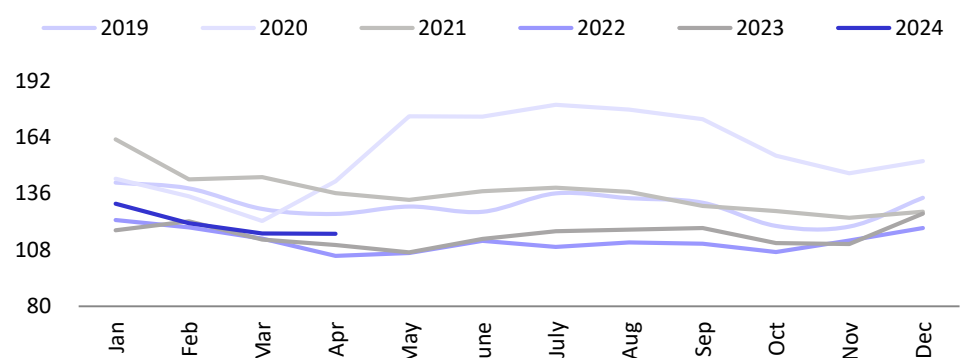
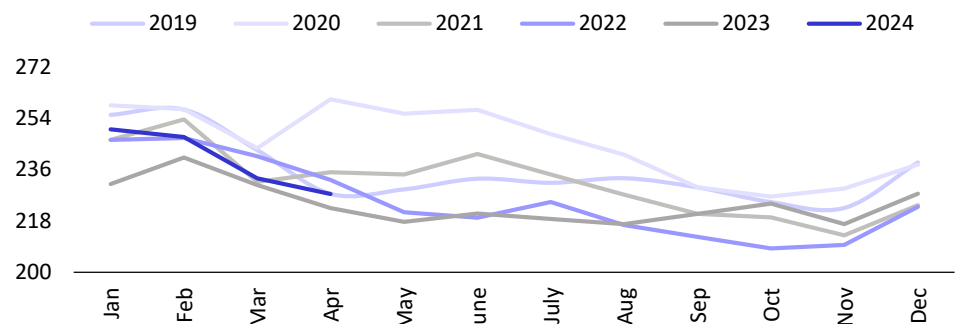
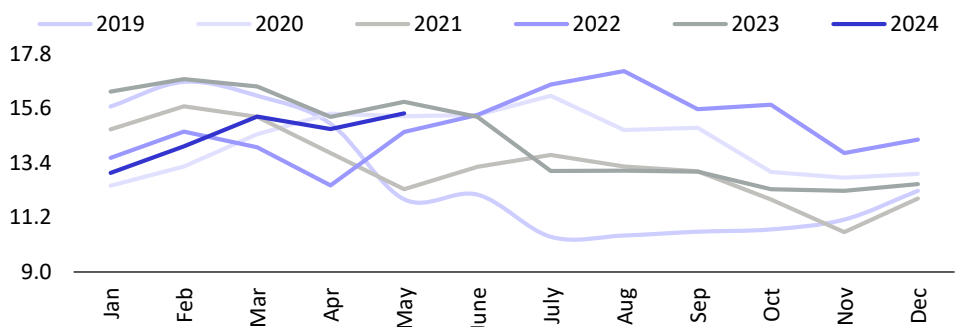
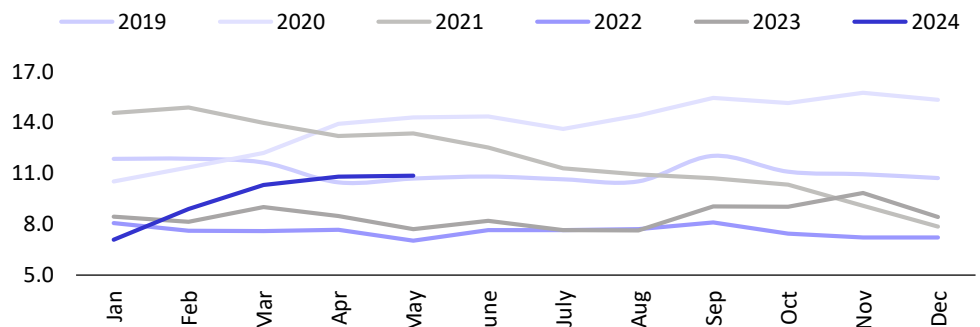
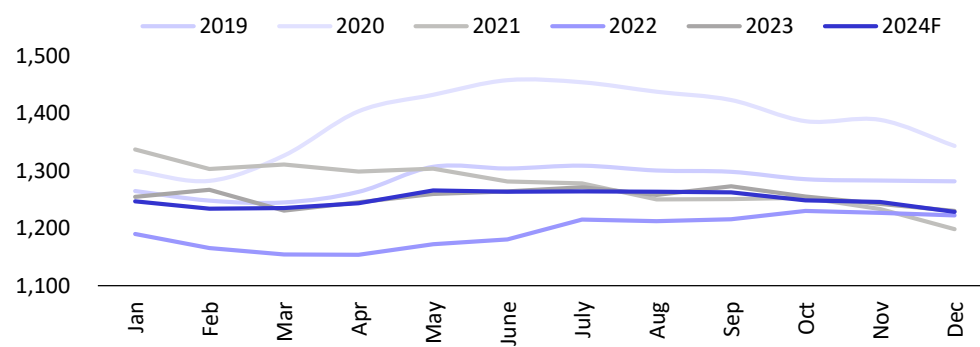
Exhibit 5: PE, PP and PX spreads over Naphtha**Exhibit 6: US crude inventory (mb)****Exhibit 7: US gasoline inventory (mb)****Exhibit 8: US gasoil inventory (mb)**

Exhibit 9: US motor gasoline inventory (mb)**Exhibit 10: Singapore light distillate inventory (mb)****Exhibit 11: Singapore middle distillate inventory (mb)****Exhibit 12: OECD and US Commercial Crude oil and other liquid inventories**

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BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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