Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Oil India Limited

High costs mar Q3; earnings to stay volatile

Oil & Gas	Sharekhan code: OIL	Result Update

3R MATRIX

	+	=	-
Right Sector (RS)		✓	
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Hold**	↔
CMP: **Rs. 116**	
Price Target: **Rs. 130**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

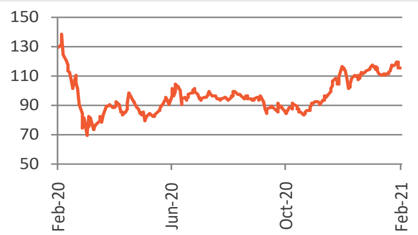
Company details

Market cap:	Rs. 12,590 cr
52-week high/low:	Rs. 139/66
NSE volume: (No of shares)	12.7 lakh
BSE code:	533106
NSE code:	OIL
Free float: (No of shares)	47.0 cr

Shareholding (%)

Promoters	56.7
FII	6.8
DII	19.6
Public & others	17.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1	25	22	-11
Relative to Sensex	-6	6	-15	-38

Sharekhan Research, Bloomberg

Summary

- Q3FY2021 adjusted operating profit of Rs. 406 crore (down 44.9% q-o-q) substantially lagged estimates due to higher operating cost and a rise in provisions. Adjusted PAT at Rs. 397 crore (up 6.3% q-o-q) aided by higher other income and tax gains.
- Operational performance was better than expected with oil/gas sales volume at 0.72mmt/0.59bcm, flat/up 6% q-o-q and 3.4%/6.4% ahead of our estimates. Oil realisation stood at $44.1/bbl (up 3.2% q-o-q),slightly below or estimate of $45.3/bbl.
- Gas business would continue making losses until there are APM gas pricing reforms and recent rally in crude oil prices may not hold if OPEC+ member countries roll back production cuts. Volatile oil/gas prices and weak production profile makes earnings recovery fragile.
- Hence, we maintain a Hold rating on Oil India with a revised PT of Rs.130 given limited upside potential and weak earnings profile. At CMP, the stock trades at 6.5x FY2022E EPS and 5.4x FY2023E EPS.

Oil India Limited (OIL) Q3FY2021 adjusted operating profit of Rs. 406 crore (down 62.9% y-o-y; down 44.9% q-o-q) substantially lagged our estimate of Rs. 706 crore. Operating profit missed estimates led by higher-than-expected operating costs (other expenses excluding one-time dry well write off rose 35% y-o-y) on higher cost of E&P services. We have adjusted reported operating loss of Rs. 94 crore for one-time dry well expenses of Rs. 500 crore (included in provisions of Rs. 650 crore versus only Rs21 crore in Q3FY2020). Operational performance was better-than-expected with oil/gas production at 0.75mmt/0.67bcm, flat/up5.5% q-o-q and beat of 5.4%/3.8% versus our estimate. Oil/gas sales volume at 0.72mmt/0.59bcm, flat/up 6% q-o-q and 3.4%/6.4% ahead of our estimates. Reported PAT stood at Rs. 904 crore (up 122.4% y-o-y; up 278.2% q-o-q) due to the benefit of one-time tax gain of Rs. 1,158 crore related to earlier periods under Vivaad Se Vishwaas scheme. Adjusting for tax reversal, an exceptional expense of Rs. 151 crore related to control of blowout at the Baghjan Oilfields and Rs. 500 crore for dry well expenses, the PAT at Rs. 397 crore (down 2.4% y-o-y; up 6.3% q-o-q) was above our estimate due to higher-than-expected other income and tax gains. We believe that a low domestic gas price would mean continued loss for the gas business until gas pricing reforms are taken up by the government. The recent rally in oil prices could fade if OPEC+ members roll back recent production cuts. Hence, we maintain our Hold rating on Oil India with a revised SoTP-based PT of Rs. 130 as earnings are expected to remain volatile with no meaningful upside to oil/gas production over FY2022E-FY2023E.At CMP, the stock is trading at 6.5x FY2022E EPS and 5.4x FY2023E EPS.

Key positives

- Better-than-expected oil/gas sales volume at 0.72mmt/0.59bcm, flat/up 6% q-o-q and 3.4%/6.4% above our estimates.

Key negatives

- EBIT loss of Rs. 60 crore in gas business due to a cut in domestic gas price to $1.79/mmBtu for H2FY2021.
- Higher-than-expected operating cost (other expenses excluding one-time dry well cost was up 35% y-o-y) due to rise in cost of E&P services.

Our Call

Valuation –Maintain Hold on Oil India with a revised PT of Rs. 130: We have lowered our FY2021 earnings estimates as higher oil price assumption gets more than offset by higher operating cost (cost of services to remain high for OALP blocks). We have increased our FY2022-FY2023 earnings estimate to factor higher oil price assumption of $55/$58 per barrel, partially offset by higher operating cost. Although Brent oil price has increased sharply above $60/bbl but the rally may fade if OPEC+ member countries roll back recent oil production cuts and potential increase in oil production from the US. Moreover, domestic gas prices are non-remunerative and upstream PSUs would continue to make losses in the gas business until the government takes up gas pricing reforms. A muted oil &gas production outlook given ageing fields, continued high capex of Rs. 4,000 crore amid weak operating cashflows and negative value creation from Mozambique E&P assets are key concerns for Oil India. Hence, we maintain our Hold rating on the stock with a revised SoTP-based PT of Rs. 130 (revision reflects rollover of valuation multiple to FY2023E EPS and upward revision in earnings estimate). At CMP, the stock is trading at 6.5x FY2022E EPS and 5.4x FY2023E EPS.

Key Risks

Prolonged weak oil & gas prices are key downside risks. Higher-than-expected oil & gas prices and any positive gas pricing reforms are key upside risks.

Valuation (Standalone) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	13,735	12,129	8,441	11,049	11,975
OPM (%)	39.9%	21.4%	24.0%	31.4%	33.6%
Adjusted PAT	3,617	3,208	913	1,946	2,315
y-o-y growth (%)	35.6%	-11.3%	-71.5%	113.2%	19.0%
Adjusted EPS (Rs.)	33.4	29.6	8.4	17.9	21.3
PE (x)	3.5	3.9	13.8	6.5	5.4
P/BV (x)	0.5	0.5	0.5	0.5	0.5
EV/EBDITA (x)	2.5	8.4	10.6	6.2	5.3
ROE (%)	13.0%	12.3%	3.7%	7.7%	8.8%
ROCE (%)	14.5%	7.3%	5.1%	8.8%	9.9%

Source: Company; Sharekhan estimates

Sharp miss in adjusted operating profit on higher cost & provision

Q3FY2021 adjusted operating profit of Rs. 406 crore (down 62.9% y-o-y; down 44.9% q-o-q) substantially lagged our estimate of Rs. 706 crore. Operating profit missed estimates led by higher-than-expected operating costs (other expenses excluding one-time dry well write off rose 35% y-o-y) on higher cost of E&P services. We have adjusted reported operating loss of Rs. 94 crore for one-time dry well expenses of Rs. 500 crore (included in provisions of Rs. 650 crore versus only Rs21 crore in Q3FY2020). Operational performance was better-than-expected with oil/gas production at 0.75 mmt/0.67 bcm, flat/up 5.5% q-o-q and beat of 5.4%/3.8% versus our estimate. Oil/gas sales volume at 0.72 mmt/0.59 bcm, flat/up 6% q-o-q and 3.4%/6.4% ahead of our estimates. Reported PAT stood at Rs. 904 crore (up 122.4% y-o-y; up 278.2% q-o-q) due to the benefit of one-time tax gain of Rs. 1,158 crore related to earlier periods under Vivaad Se Vishwaas scheme. Adjusting for tax reversal, an exceptional expense of Rs. 151 crore related to control of blowout at the Baghjan Oilfields and Rs. 500 crore for dry well expenses, the PAT at Rs. 397 crore (down 2.4% y-o-y; up 6.3% q-o-q) was above our estimate due to higher-than-expected other income and tax gains.

Q3FY2021 conference call takeaways

- **Production guidance:** The management targets to increase its oil production to 4mmt by CY2024-2025 from 3mmt currently and increase gas production to 10.5mmscmd. The increase in oil production would be driven by five fields – one in Rajasthan (Baghewala), 2 in Assam and 1 in Arunachal Pradesh.
- **Gas pricing outlook:** A committee has been formed to review domestic gas pricing and it has submitted recommendation to the government with respect to gas pricing. Final decision on the same will be taken by the government.
- **Baghjan blowout update:** The company has incurred total cost of Rs. 379 crore to control Baghjan blowout and the same is shown as exceptional expenses in the P&L. The management has indicated gas production potential of 5mmscmd for Baghjan as compared to 1.5mmscmd currently. The ramp-up in gas production would be visible after the infrastructure facilities are created.
- **Capex guidance:** FY2022 capex guidance of Rs. 4,000 crore. Out of which, 25% each would be spent on development and exploratory drilling, 15% on overseas projects (mainly Mozambique project which is expected to start first gas production from CY2024) and remaining on E&P equipment.
- **Cost of services to remain high:** The management has guided that cost of support services would remain high for next could of years due to higher exploration costs related to OALP blocks.
- **Dry well write-off:** The company's provisions included dry well write-off cost of Rs. 687 crore related to the KG basin and Mizoram wells. Out of this, Rs. 500 crore of dry well write offs are non-recurring.
- **Debt level:** Consolidated debt stood at $1.27 billion as of December 2020 and is totally related to Mozambique project. There is no debt for domestic operations.
- **Numaligarh refinery deal update:** Oil India is doing an internal assessment with respect to acquisition of stake in Numaligarh Refinery Limited and waiting for the government's final decision on the same.

Results Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Revenue	**2,126**	**2,952**	**-28.0%**	**2,169**	**-2.0%**
Total Expenditure	2,220	1,856	19.6%	1,432	55.1%
Reported operating profits	(94)	1,096	NA	737	NA
Adjusted operating profit	**406**	**1,096**	**-62.9%**	**737**	**-44.9%**
Other Income	371	135	174.2%	111	233.9%
Interest	122	122	0.4%	122	0.5%
Depreciation & prov	388	424	-8.6%	374	3.8%
Exceptional items	151	-	NA	134	NA
Reported PBT	**(384)**	**685**	**NA**	**219**	**NA**
Adjusted PBT	**267**	**685**	**-61.0%**	**353**	**-24.3%**
Tax	(1,288)	279	NA	(20)	NA
Reported Profit After Tax	904	406	122.4%	239	278.2%
Adjusted PAT	397	406	-2.4%	373	6.3%
Adj. EPS	3.7	3.7	-2.4%	3.4	6.3%
Margin (%)			**bps**		**bps**
OPMs	19.1%	37.1%	(1,802)	34.0%	(1,489)
PAT	18.7%	13.8%	489	17.2%	145

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Net oil realisation ($/bbl)	44.1	63.3	-30.3%	42.7	3.2%
Oil production volume (mmt)	0.75	0.75	0.1%	0.75	0.3%
Oil sales volume (mmt)	0.72	0.73	-0.4%	0.72	-0.1%
Crude oil business EBIT (Rs. crore)	-162	875	NA	428	NA
Crude oil business adjusted EBIT (Rs.crore)	338	875	-61.4%	428	-21.0%
Gas production volume (bcm)	0.67	0.70	-3.4%	0.64	5.5%
Gas sales volume (bcm)	0.59	0.60	-2.0%	0.55	6.0%
Gas business EBIT (Rs. crore)	-60	107	NA	51	NA

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Low gas prices, weak production outlook to keep earnings muted

We expect earnings of upstream PSUs to remain muted in near to medium term as weak domestic gas price of $1.79/mmBtu and mean continues losses in gas business and oil & gas production outlook also remains muted given maturing fields (requires high capex to sustain production level). The recent rally in oil price may not sustain in case major OPEC nations roll back recently announced oil production cuts and that could lead to weak and volatile earnings momentum. Any material improvement in earnings outlook for upstream PSUs would require APM gas pricing reforms and a sustained uptick in crude oil prices. Only in high price environment we can expect ramp-up of production from nomination blocks and new oil & gas discoveries.

■ Company outlook - Weak oil production profile given ageing oilfields; lower gas realisation to dent earnings

The company's oil & gas production remained muted with decline of 3.5% and 1.3% in the last five years. We expect oil production to remain muted given aging oilfields (natural oil production decline of 8-10% annually). The recent sharp cut in domestic gas prices has made the company's gas business incur losses. Moreover, the company's investment in Mozambique E&P assets is not expected to create any value for it given weak LNG prices.

■ Valuation - Maintain Hold on Oil India with revised PT of Rs. 130

We have lowered our FY2021 earnings estimates as higher oil price assumption gets more than offset by higher operating cost (cost of services to remain high for OALP blocks). We have increased our FY2022-FY2023 earnings estimate to factor higher oil price assumption of $55/$58 per barrel, partially offset by higher operating cost. Although Brent oil price has increased sharply above $60/bbl but the rally may fade if OPEC+ member countries roll back recent oil production cuts and potential increase in oil production from the US. Moreover, domestic gas prices are non-remunerative and upstream PSUs would continue to make losses in the gas business until the government takes up gas pricing reforms. A muted oil & gas production outlook given ageing fields, continued high capex of Rs. 4,000 crore amid weak operating cashflows and negative value creation from Mozambique E&P assets are key concernsfor Oil India. Hence, we maintain our Hold rating on the stock with a revised SoTP-based PT of Rs. 130 (revision reflects rollover of valuation multiple to FY2023E EPS and upward revision in earnings estimate). At CMP, the stock is trading at 6.5x FY2022E EPS and 5.4x FY2023E EPS.

One-year forward P/E (x) band

Source: Sharekhan Research

About company

Oil India is an Indian national oil company that explores, develops, and produces crude oil and natural gas, transports crude oil, and produces LPG. The companyis the second-largest E&P company in India in terms of production and reserves. More than 95% of Oil India's production comes from its upper Assam basin. The company holds domestic 2P (proved and probable) reserves of 75mmt for oil and 132bcm for gas as of March 31, 2020. The company's oil production stood at 3.1mmt and gas production stood at 2,801mmscm in FY2020.

Investment theme

The near to medium term earnings outlook for upstream PSUs remain weak given low domestic gas prices and declining oil/gas production given aging field. The bleak earnings outlook and continued high capex plan (despite weak operating cash flows) and negative value accretion from investment in Mozambique E&P assets (given low LNG prices) would remain an overhang on the stock in the near to medium term.

Key Risks

- Higher-than-expected oil and gas price and any positive gas pricing reforms are key upside risks.
- Prolonged weak oil & gas price are key downside risks.

Additional Data

Key management personnel

Sushil Chandra Mishra	Chairman & Managing Director
Harish Madhav	Director – Finance
P. Chandrasekaran	Director - Exploration & Development

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	12.1
2	Indian Oil Corp Ltd	4.9
3	Bharat Petroleum Corp Ltd	2.5
4	Hindustan Petroleum Corp Ltd	2.5
5	ICICI Prudential Asset Management	2.5
6	Nippon Life India Asset Management	2.4
7	BlackRock Inc	1.4
8	Vanguard Group Inc/The	0.9
9	WisdomTree Investments Inc	0.8
10	FMR LLC	0.3

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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