Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Oil India Ltd

Upstream PSUs key beneficiary of soaring oil & gas prices

Oil & Gas	Sharekhan code: OIL
Reco/View: **Buy** ↔	CMP: **Rs. 223** / Price Target: **Rs. 290** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 46.85

Updated Feb 08, 2022

Severe Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

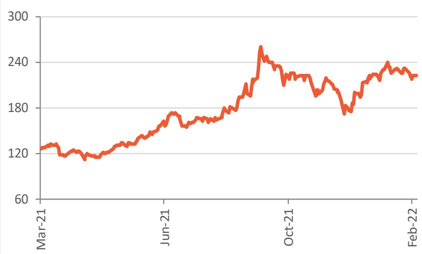
Company details

Market cap:	Rs. 24,193 cr
52-week high/low:	Rs. 268 / 112
NSE volume: (No of shares)	17.8 lakh
BSE code:	533106
NSE code:	OIL
Free float: (No of shares)	47.00 cr

Shareholding (%)

Promoters	56.7
FII	10.1
DII	17.9
Others	15.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5	4	24	76
Relative to Sensex	0	7	26	63

Sharekhan Research, Bloomberg

Summary

- The earnings environment has turned favourable for upstream PSUs given expectation of a ~2x hike in domestic gas price (to turn gas biz. profitable) and recent spike in crude oil to >$100/bbl on geopolitical tensions between Russia-Ukraine. We expect a robust 40% PAT CAGR over FY21-24E for OIL with possibility of upgrades in case the geopolitical crisis does not ease.
- OIL is also expected to benefit from a cyclical recovery in refining margin as it holds 70% stake in NRL, which has superior GRM given excise duty benefit. Additionally, NRL's 3x capacity expansion plan would create long-term value for OIL.
- Ambitious oil/gas production guidance of 3.4 mmt/4 bcm for FY23 versus FY22 annualised oil/gas production but a weak production track record makes us cautious and thus we model modest oil/gas production CAGR of 2%/4% over FY21-24E.
- We maintain a Buy rating on Oil India with an unchanged SoTP-based PT of Rs. 290 as upstream PSUs are best play on high oil & gas prices. The stock trades at 3.9x its FY2023E EPS (including earnings contribution from NRL).

Rising geopolitical tensions between Russia and Ukraine and a calibrated production increase by the OPEC is expected to keep oil price elevated in the near term while domestic gas price would also witness steep hike in FY23. This would benefit earnings of upstream oil & gas companies including Oil India. Earnings tailwinds from improving oil & gas realisation, sharp recovery in RoE, healthy dividend yield of 5-6% and long-term value creation from NRL (benefit of sustained recovery in refining margin) makes Oil India one of best bets in Indian oil & gas space. Hence, we maintain our Buy on Oil India with an unchanged PT of Rs. 290.

- **Gas business to turnaround from Q1FY23; oil business to see improved profitability given global geopolitical tensions:** The recent geopolitical tensions between Russia and Ukraine has further increased the international gas price and this bodes well for sustained hike in the India's domestic gas price (that is a combination of US Henry hub gas, NBP, Russia and Canada gas prices). Oil India's management guided for 98%/22% hike in APM gas price to $5.8/7 per mmBtu for H1FY23/H2FY23 and this would make gas business profitable from Q1FY23 and against EBIT loss of Rs. 543 crore/Rs. 906 crore in 9MFY22/FY21. Additionally, Brent crude oil prices have rallied by 30% in CY22YTD to ~$102/bbl on geopolitical tensions and thus profitability of upstream oil business would witness significant improvement in the coming quarters.
- **Impressive production guidance but poor track record makes us conservative:** The management has guided for impressive oil/gas production of 3.4 mmt/4 bcm for FY23, as compared to FY22 annualised oil/gas production of 3 mmt/2.7 bcm based on 9MFY22 performance. We believe that these targets are bit ambitious given a weak production track record and model oil/gas production volume CAGR of 2%/4% over FY21-24E and await actual delivery on production guidance to raise our assumptions.
- **Sustained GRM recovery bodes well NRL's profitability:** Singapore complex GRM has further increases to $7.7/bbl currently as compared to $6.1/bbl in Q3FY22 and Numaligarh Refinery Ltd (NRL) (Oil India holds a 70% stake) also enjoys excise duty benefits. Cyclical GRM recovery and planned capacity expansion to 9mtpa (an increase of 3x from current capacity of 3mtpa) by FY2024E-2025E would mean strong profitability at NRL and drive long-term value for Oil India.

Our Call

Valuation – Maintain Buy on Oil India with unchanged SoTP PT of Rs. 290: The recent sharp surge in crude oil prices and expectation of further steep hike in domestic gas prices from April 2022 would drive a 40% CAGR in OIL's standalone PAT over FY2021-FY2024E and improve RoE to 12.5% (versus only 5.4% in FY2021). Moreover, the recent stake increase in NRL could create long-term value for OIL. Hence, we maintain a Buy rating with an unchanged SoTP-based PT of Rs. 290. The stock trades at 3.9x its FY2023E EPS (including earnings contribution from NRL).

Key Risks

A sharp decline in international oil & gas prices and lower-than-expected production (In case of delayed ramp-up from new fields) could impact earnings outlook and valuation. Any unwarranted capex for overseas/domestic acquisition could raise capital allocation concerns.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	8,618	14,417	16,454	15,703
OPM (%)	14.7%	33.1%	35.8%	34.3%
Adjusted PAT	1,377	3,104	3,979	3,776
y-o-y growth (%)	*-57.1%*	*125.4%*	*28.2%*	*-5.1%*
Adjusted EPS (Rs.)	12.7	28.6	36.7	34.8
PE (x)	17.8	7.9	6.2	6.5
P/BV (x)	0.9	0.9	0.8	0.8
EV/EBDITA (x)	30.6	8.0	6.3	6.7
ROE (%)	5.4%	11.5%	13.9%	12.5%
ROCE (%)	4.3%	11.0%	13.2%	12.1%

Source: Company; Sharekhan estimates

Improved earnings outlook on higher oil & gas realisations

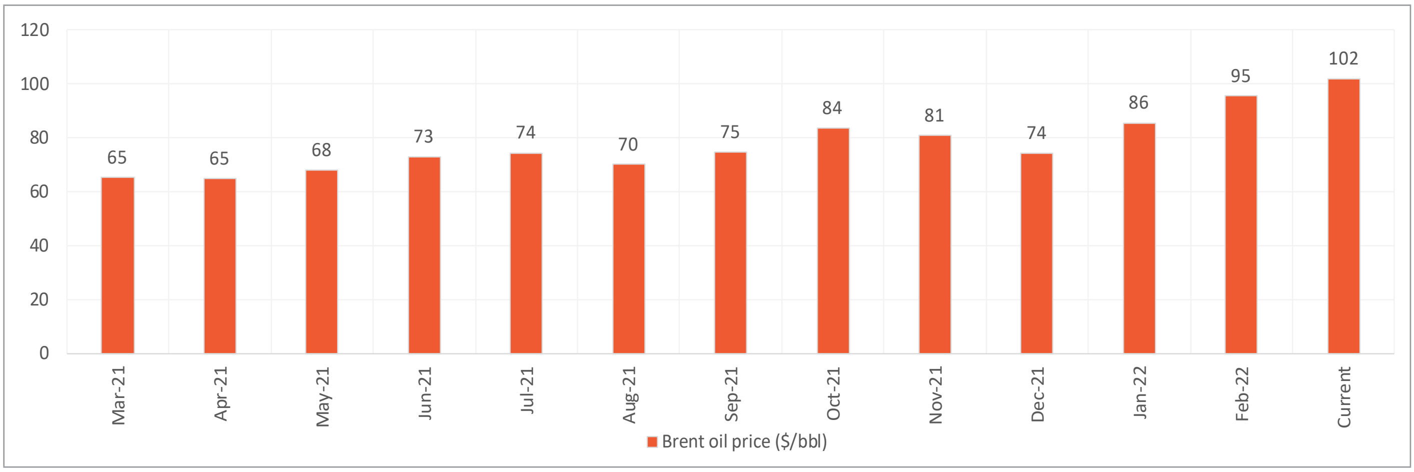
We expect OIL's net crude oil and gas realisation to rise sharply to $70-75/bbl and $6-5.5/mmBtu respectively over FY2023E-2024E as recent geopolitical tensions between Russia and Ukraine would keep global supply situation tight especially given OPEC production may not increase meaningfully to offset supply concerns. Additionally, Oil India's management has guided for impressive oil/gas production of 3.4 mmt/4 bcm as compared to FY22 annualised oil/gas production of 3 mmt/2.7 bcm based on 9MFY22 performance. Thus, we expect a robust CAGR of 40% over FY2021-FY2024E in OIL's standalone PAT to Rs. 3,776 crore by FY2024E.

Oil on boil on recent geopolitical situation – Brent oil price breach $100/bbl mark

Crude oil demand has bounced back strongly led by sharp pick-up in global economic activity and rising mobility as third wave of COVID-19 fades out. However, on the other hand oil supply could remain tight given recent tension between Russia and Ukraine and calibrated production hikes by the OPEC.

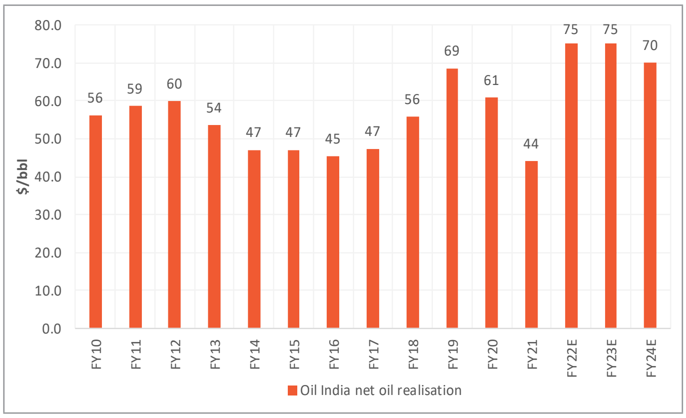
Sustained high oil price would mean best ever oil price realisation for Oil India at $75/$75/$70 per barrel in FY22E/FY23E/24E as compared to average net oil realisation of $53.4/bbl (impacted by oil subsidy) over FY11-FY21.

Brent oil price crossed ~$100/bbl mark



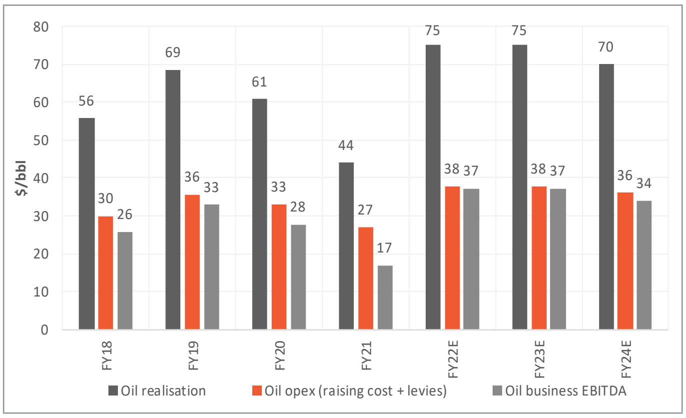
Source: Bloomberg; Sharekhan Research

OIL's oil realisation to recovery above FY19 level



Source: Company, Sharekhan Research

High oil price to improve profitability of oil business

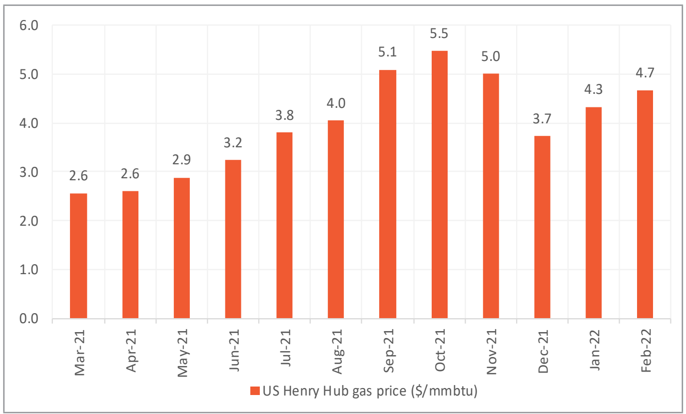


Source: Company, Sharekhan Research

Higher domestic gas price to turnaround gas business

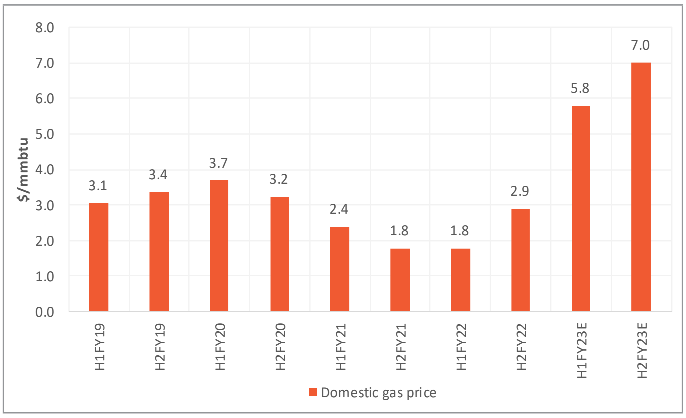
Domestic gas prices have started to see an upward revision as international gas price has started to recovery sharply and recent geopolitical tensions between Russia-Ukraine could further disturb the gas markets as Russia is key gas supplier to Europe. With the US Henry Hub gas prices at $4.7/mmBtu and other benchmark gas prices (for Europe, Russia and Canada) also increasing, we expect a steep upward revision in domestic gas price over H1FY23-H2FY23. Oil India's management expects domestic gas prices to rise steeply by 98%/22% for H1FY23/H2FY23 to $5.8/$7 per mmBtu respectively. We thus expect Oil India's gas business to turn profitable in FY23-FY24 from EBIT loss of Rs. 543 crore/Rs. 906 crore in 9MFY22/FY21.

US Henry hub gas price



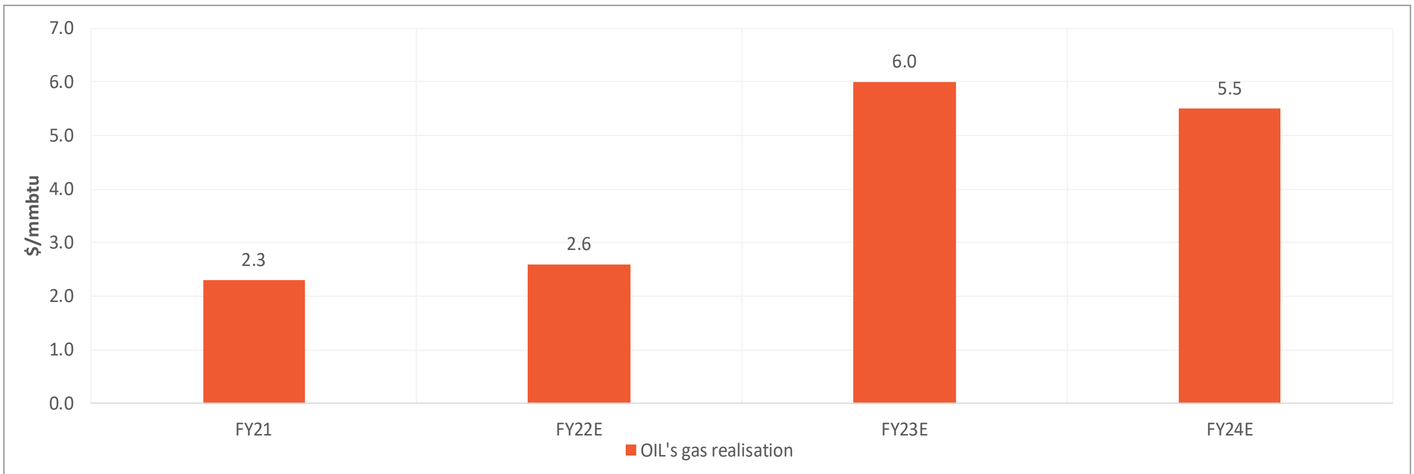
Source: Bloomberg; Sharekhan Research

Domestic gas price to rise sharply in FY23



Source: PPAC India; Sharekhan Research

OIL's gas realisation to improve considerable in FY23E



Source: Company; Sharekhan Research

NRL earnings to remain strong on GRM recovery; expansion to create long term value for Oil India

Singapore complex GRM has further increased to $6.7/bbl in Q4FY22 and averaged even higher at $7.4/bbl in February 2022. Given a higher refining margin and excise duty benefit (although expected to decline in coming years), we estimate NRL's EBITDA/PAT to increase by 2.1x/1.5x to Rs. 9,037 crore/Rs. 4,634 crore by FY2025E as compared to Rs. 4,347 crore/Rs. 3,116 crore in FY2021. Sustained high profitability and expansion at NRL would create long-term value for OIL and also result in consistent high dividend income from NRL.

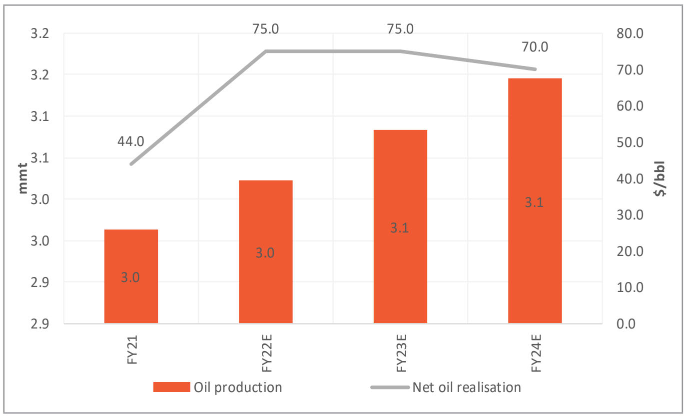
NRL profitability to remain strong over FY22-FY25E Rs cr

Particulars	FY21	FY22E	FY23E	FY24E	FY25E
Capacity (mmt)	3.0	3.0	3.0	3.0	9.0
Utilisation	90%	95%	95%	95%	80%
Throughput (mmt)	2.7	2.9	2.9	2.9	7.2
Reported GRM ($/bbl)	37.2	28.1	29.1	29.1	29.1
Excise duty benefit ($/bbl)	33.1	23.1	23.1	23.1	23.1
Core GRM ($/bbl)	4.1	5.0	6.0	6.0	6.0
EBITDA (Rs. crore)	4,347	3,423	3,577	3,577	9,037
PAT (Rs. crore)	3,116	2,405	2,490	2,468	4,634
Rs. /USD rate	74	74	74	74	74

Source: NRL; Sharekhan Research

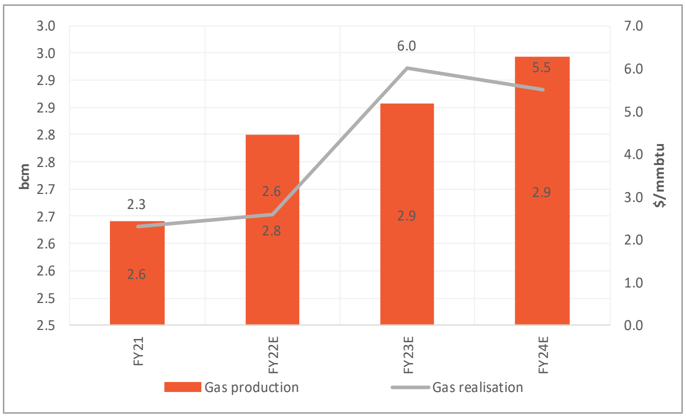
Financials in charts

Sharp recovery in oil realisation



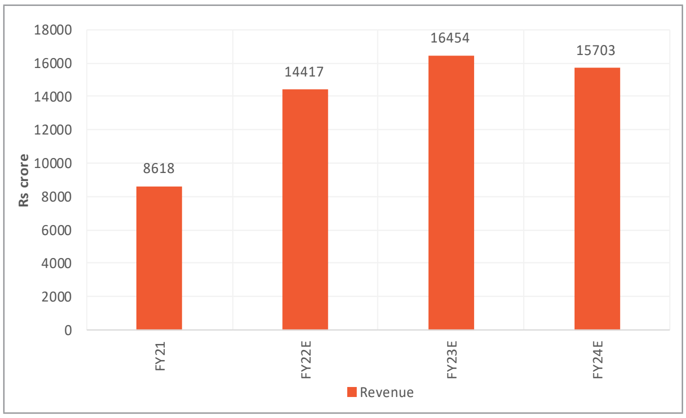
Source: Company, Sharekhan Research

Gas realisation to improve over FY22E-24E



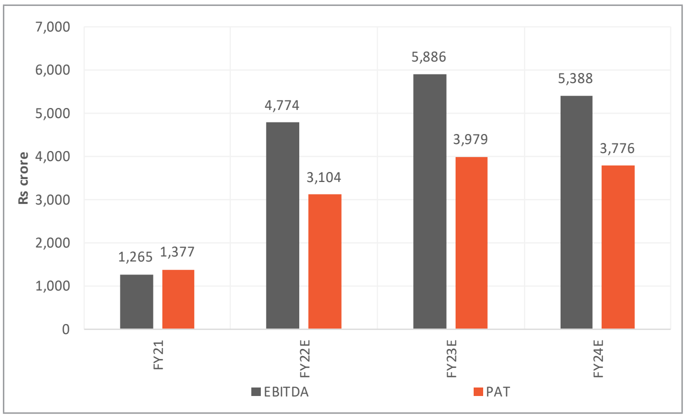
Source: Company, Sharekhan Research

Revenue to recover sharply led by higher realisation



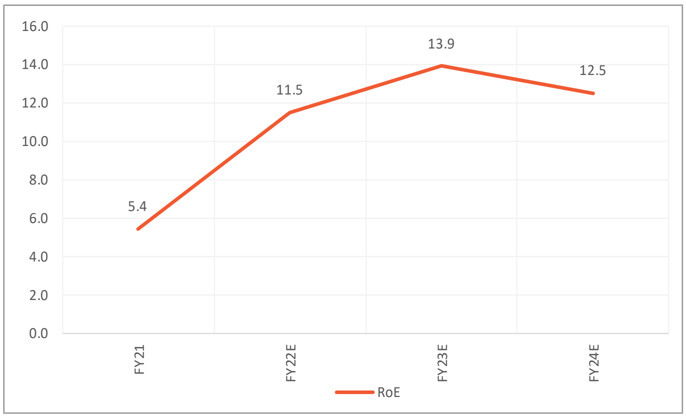
Source: Company, Sharekhan Research

EBITDA/PAT to clock 62%/40% CAGR over FY21-24E



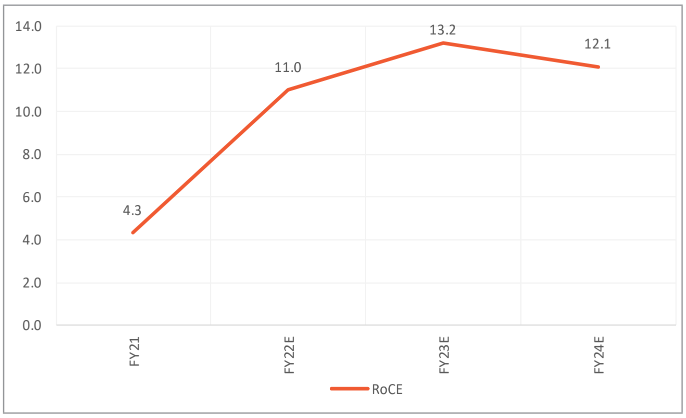
Source: Company, Sharekhan Research

RoE to improve with earnings recovery



Source: Company, Sharekhan Research

ROCE to witness sharp expansion



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view – Improving oil & gas price to drive strong earnings recovery for upstream oil companies

The earnings outlook for upstream PSUs has improved considerably given the recent rise in crude oil prices at >$90/bbl mark and expectation of a further steep hike in domestic gas price over H1-H2FY23 on current gas price of $2.9/mmBtu. High oil & gas prices would boost overall profitability of ONGC and OIL. However, oil and gas production are expected to recover gradually with majority of growth being back-ended (i.e. by FY2024E-FY2025E).

■ Company outlook – Recovery in oil and gas price improves earnings outlook

OIL's earnings outlook is improving given the recent sharp recovery in oil price and potential upward revision in domestic gas prices in FY23. Thus, we expect OIL's standalone EBITDA/PAT to report a CAGR of 62%/40% over FY2021-FY2024E and reach Rs. 5,388 crore/Rs. 3,776 crore by FY2024E along with a marked improvement in RoE to 12.5% by FY2024E versus only 5.4% in FY2021.

■ Valuation – Maintain Buy on Oil India with unchanged SoTP PT of Rs. 290

The recent sharp surge in crude oil prices and expectation of further steep hike in domestic gas prices from April 2022 would drive a 40% CAGR in OIL's standalone PAT over FY2021-FY2024E and improve RoE to 12.5% (versus only 5.4% in FY2021). Moreover, the recent stake increase in NRL could create long-term value for OIL. Hence, we maintain a Buy rating with an unchanged SoTP-based PT of Rs. 290. The stock trades at 3.9x its FY2023E EPS (including earnings contribution from NRL).

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 company is 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 191mtoe (oil + gas) as of March 31, 2021.

Investment theme

Earnings outlook for Oil India has improved considerably given recent shar rally in oil price and expectation of steep hike in domestic gas price over next one year as benchmark international gas price has increased sharply. Higher oil & gas realisation would help earnings recover to pre-pandemic level and improve return ratios. Moreover, NRL acquisition is earnings accretive and create long term value for OIL. Stock is trading at attractive valuation and offers decent dividend yield.

Key Risks

A sharp decline in international oil & gas price and lower-than-expected production (In case of delayed ramp-up from new fields) could impact earnings outlook and valuation. Any unwarranted capex for overseas/ domestic acquisition could raise capital allocation concerns.

Additional Data

Key management personnel

Sushil Chandra Mishra	Chairman & Managing Director
Harish Madhav	Director – Finance
Pankaj Kumar Goswami	Director - Operations

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	11.9
2	Indian Oil Corp Ltd	4.9
3	FMR LLC	2.9
4	Nippon Life India Asset Management Ltd.	2.7
5	Bharat Petroleum Corp Ltd.	2.5
6	Hindustan Petroleum Corp Ltd.	2.5
7	Vanguard Group Inc/The	1.0
8	ICICI Prudential Asset Management Co. Ltd	0.9
9	BlackRock Inc.	0.9
10	L&T Mutual Fund Trustee Ltd	0.4

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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