

Integrated oil and gas major

Possible options, benefits and concerns



Tyrannosaurus or T Rex, is the largest known land predator and most ferocious among all terrestrial animals.

Yesterday's announcement finally gives credence to an idea which we are told was first mooted when Mani Shankar Aiyar was the Minister of Petroleum and Natural Gas during 2004-06. While the intentions may be right, whether we will have a T Rex which is largely destructive, both for the industry and the investors or a herbivore and more social Brachiosaurus, only time will tell. We look at few options that come to our mind and their implications, all imaginary of course!



Brachiosaurus, a herbivore, has been described as harmless and largely a more social animal.

Option 1: Create a large 'integrated' downstream player; definitely a Brachiosaurus

Value Chain	Refineries, product pipelines and naphtha based petrochemical all form a downstream value chain.		
Companies that may be merged	<ul style="list-style-type: none"> Merge Indian Oil (IOCL IN), Bharat Petroleum (BPCL IN), Hindustan Petroleum (HPCL IN), Mangalore Refinery & Petrochem (MRPL IN) and Chennai Petroleum (MRL IN) 		
Market Cap (INR b)	Company	MCap (INRb)	Remarks
	IOCL	1,800	
	BPCL	998	
	HPCL	541	
	MRPL	178	HPCL has 17% stake in MRPL
	CPCL	49	IOCL has 52% stake in CPCL
	Total	3,510	Excluding the above mentioned cross-holdings
Benefits	<ul style="list-style-type: none"> Synergies could be there through rationalization of retail outlets, thereby improving profitability Huge benefits in procurement of crude oil because of the combined bargaining strength Rationalization of other marketing infrastructure like terminals, depots etc Larger availability of naphtha for petrochemical projects Although ROEs of the OMCs appear to converging in our forecasts, IOCL is still ~1-2% lower than that of BPCL but 1-2% higher than that of HPCL. The merger with removal of redundancies would result in better return ratios IOCL and BPCL would turn free cash flow positive in next 3-4 years while HPCL would burn cash. The merger would give better balance sheet strength for future expansions. 		
Concerns	<ul style="list-style-type: none"> Integration issues could crop up. Remember that although all are PSUs, BPCL and HPCL have been built on MNC lineage (HPCL was formed with assets of Esso & Caltex); BPCL was formed from assets of Shell. However, IOCL has been primarily an Indian PSU. Efficiencies & corporate governance have also been better in BPCL & HPCL. Removal of redundancies, especially in marketing would mean job cuts and strong employee unions may create obstacles, thus reducing the benefits of merger OPaL and BCPL may also be transferred to these entities, which might be a drag in initial years due to stabilization issues May result in poor capital allocation like expansion of NRL or Rajasthan refinery 		

Swarnendu Bhushan (Swarnendu.Bhushan@MotilalOswal.com); +91 22 6129 1529

Abhinil Dahiwal (Abhinil.Dahiwal@motilaloswal.com); +91 22 3980 4309

Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Total capacity of 134mmt		Combined capacity would build a total refining capacity of 134mmt. One could even add capacity of 15mmt of Bina and Bhatinda together. At this, the behemoth would still be a global competitor.	Some competition indeed!	
IOCL	70.0		ExxonMobil	315.0
BPCL	22.5		Shell	140.3
HPCL	14.8			
MRPL	15.0			
CPCL	11.5			
Total	133.8			

Option 2: Create a large 'integrated' upstream player, probably a Tyrannosaurus

Value Chain Services (seismic studies, drilling etc), exploration and production

Companies that may be merged ■ ONGC (ONGC IN), Oil India (OINL IN)

Market Cap (INR b)	Company	MCap (INRb)
	ONGC	2,620
	Oil India	269
	Total	2,889

Benefits

- Better utilization of assets like rigs etc
- Integrated data bank could be of help in prioritizing monetization of assets and capex plans
- ONGC has vast expertise in offshore while Oil India is largely onshore. Integration could help in imbibing better practices for various fields.

Concerns

- Oil India has presence mainly in the North East. There could be cultural issues.
- With hardly any presence of private players, any comparison with respect to profitability and efficiency would be difficult
- In most of the bids held so far, ONGC & Oil India have been participating independently. Post-merger, there may be more of single bids.

Production of 51.6mmtoe of oil & gas		The behemoth would probably be comparable with likes of Anadarko rather than the largest players	Far away from largest players!	
ONGC	45.6		ExxonMobil	320.0
OIL	6.0		Shell	147.0
Total	51.6			

Option 3: Create a large 'integrated' upstream & downstream player, definitely a Tyrannosaurus

Value Chain All downstream and upstream including GAIL

Companies that may be merged ■ ONGC, Oil India, IOCL, BPCL, HPCL, GAIL, MRPL, CPCL

Market Cap (INR b)	Company	MCap (INRb)	Remarks
	IOCL	1,800	ONGC has 13.77% stake, Oil India has 5% stake
	BPCL	998	
	HPCL	541	
	MRPL	178	HPCL has 17% stake in MRPL
	CPCL	49	IOCL has 52% stake
	ONGC	2,620	IOCL has 7.69% stake, GAIL has 2.4% stake
	Oil India	269	IOCL has 4.45%, BPCL & HPCL have 2.23% each
	GAIL	611	ONGC has 4.83% stake, IOCL has 2.41% stake
	Total	7,066	too complex, just adding all above

Benefits

- Some protection against volatility in crude oil prices
- Free cash flow from IOCL and BPCL could help in upstream acquisitions
- Synergies of refining assets as mentioned in Option 1
- Much larger balance sheet to compete for bids overseas

Concerns

- Upstream companies have ROEs 4-5% lesser than that of the OMCs. It could be value erosion for the OMCs.
- It would be difficult to manage a behemoth like this and overall efficiencies may come down
- Government would have better handle to manage 'subsidies' if crude oil prices were to rise higher; investors being at a loss
- Too many parts in the value chain could result in poor allocation of capital

NOTES

Disclosures

This document has been prepared by Motilal Oswal Securities Limited (hereinafter referred to as Most) to provide information about the company(ies) and/or its affiliated company(ies). This report is for personal information of the selected recipient/s and does not constitute to be any investment, legal or taxation advice to you. This research report does not constitute an offer, invitation or inducement to invest in securities or other investments and Motilal Oswal Securities Limited (hereinafter referred as MOSI) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your general information and should not be reproduced or redistributed to any other person in any form. This report does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, investors should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice. The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur.

MOST and its affiliates are a full-service, integrated investment banking, investment management, brokerage and financing group. We and our affiliates have investment banking and other business relationships with a some companies covered by our Research Department. Our research professionals may provide input into our investment banking and other business selection processes. Investors should assume that MOST and/or its affiliates are seeking or will seek investment banking or other business from the company or companies that are the subject of this material and that the research professionals who were involved in preparing this material may educate investors on investments in such business. The research professionals responsible for the preparation of this document may interact with trading desk personnel, sales personnel and other parties for the purpose of gathering, applying and interpreting information. Our research professionals are paid on the profitability of MOST which may include earnings from investment banking and other business.

MOST generally prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, MOST generally prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover. Our salespeople, traders, and other professionals or affiliates may provide oral or written market commentary or trading strategies to our clients that reflect opinions that are contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing among other things, may give rise to real or potential conflicts of interest. MOST and its affiliated company(ies), their directors and employees and their relatives may: (a) from time to time, have a long or short position in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein. (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions; however the same shall have no bearing whatsoever on the specific recommendations made by the analyst(s), as the recommendations made by the analyst(s) are completely independent of the views of the affiliates of MOST even though there might exist an inherent conflict of interest in some of the stocks mentioned in the research report.

Reports based on technical and derivative analysis center on studying charts company's price movement, outstanding positions and trading volume, as opposed to focusing on a company's fundamentals and, as such, may not match with a report on a company's fundamental analysis. In addition MOST has different business segments / Divisions with independent research separated by Chinese walls catering to different set of customers having various objectives, risk profiles, investment horizon, etc, and therefore may at times have different contrary views on stocks sectors and markets.

Unauthorized disclosure, use, dissemination or copying (either whole or partial) of this information, is prohibited. The person accessing this information specifically agrees to exempt MOST or any of its affiliates or employees from, any and all responsibility/liability arising from such misuse and agrees not to hold MOST or any of its affiliates or employees responsible for any such misuse and further agrees to hold MOST or any of its affiliates or employees free and harmless from all losses, costs, damages, expenses that may be suffered by the person accessing this information due to any errors and delays. The information contained herein is based on publicly available data or other sources believed to be reliable. Any statements contained in this report attributed to a third party represent MOST's interpretation of the data, information and/or opinions provided by that third party either publicly or through a subscription service, and such use and interpretation have not been reviewed by the third party. This Report is not intended to be a complete statement or summary of the securities, markets or developments referred to in the document. While we would endeavor to update the information herein on reasonable basis, MOST and/or its affiliates are under no obligation to update the information. Also there may be regulatory, compliance, or other reasons that may prevent MOST and/or its affiliates from doing so. MOST or any of its affiliates or employees shall not be in any way responsible and liable for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

This report is intended for distribution to institutional investors. Recipients who are not institutional investors should seek advice of their independent financial advisor prior to taking any investment decision based on this report or for any necessary explanation of its contents.

Most and its associates may have managed or co-managed public offering of securities, may have received compensation for investment banking or merchant banking or brokerage services, may have received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.

Most and its associates have not received any compensation or other benefits from the subject company or third party in connection with the research report.

Subject Company may have been a client of Most or its associates during twelve months preceding the date of distribution of the research report

MOST and/or its affiliates and/or employees may have interests/positions, financial or otherwise of over 1 % at the end of the month immediately preceding the date of publication of the research in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

Motilal Oswal Securities Limited is registered as a Research Analyst under SEBI (Research Analyst) Regulations, 2014. SEBI Reg. No. INH000000412

There are no material disciplinary action that been taken by any regulatory authority impacting equity research analysis activities

Analyst Certification

The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject securities or issues, and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations and views expressed by research analyst(s) in this report. The research analysts, strategists, or research associates principally responsible for preparation of MOST research receive compensation based upon various factors, including quality of research, investor client feedback, stock picking, competitive factors and firm revenues

Disclosure of Interest Statement

- Analyst ownership of the stock
- Served as an officer, director or employee

Companies where there is interest

No
No

A graph of daily closing prices of securities is available at www.nseindia.com and <http://economictimes.indiatimes.com/markets/stocks/stock-quotes>

Regional Disclosures (outside India)

This report is not directed or intended for distribution to or use by any person or entity resident in a state, country or any jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject MOSI & its group companies to registration or licensing requirements within such jurisdictions.

For U.S.

Motilal Oswal Securities Limited (MOSL) is not a registered broker - dealer under the U.S. Securities Exchange Act of 1934, as amended (the "1934 Act") and under applicable state laws in the United States. In addition MOSL is not a registered investment adviser under the U.S. Investment Advisers Act of 1940, as amended (the "Advisers Act") and together with the 1934 Act, the "Acts"), and under applicable state laws in the United States. Accordingly, in the absence of specific exemption under the Acts, any brokerage and investment services provided by MOSL, including the products and services described herein are not available to or intended for U.S. persons.

This report is intended for distribution only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the Exchange Act and interpretations thereof by SEC (henceforth referred to as "major institutional investors"). This document must not be acted on or relied on by persons who are not major institutional investors. Any investment or investment activity to which this document relates is only available to major institutional investors and will be engaged in only with major institutional investors. In reliance on the exemption from registration provided by Rule 15a-6 of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act") and interpretations thereof by the U.S. Securities and Exchange Commission ("SEC") in order to conduct business with Institutional Investors based in the U.S., MOSL has entered into a chaperoning agreement with a U.S. registered broker-dealer, Motilal Oswal Securities International Private Limited. ("MOSIPL"). Any business interaction pursuant to this report will have to be executed within the provisions of this chaperoning agreement.

The Research Analysts contributing to the report may not be registered /qualified as research analyst with FINRA. Such research analyst may not be associated persons of the U.S. registered broker-dealer, MOSIPL, and therefore, may not be subject to NASD rule 2711 and NYSE Rule 472 restrictions on communication with a subject company, public appearances and trading securities held by a research analyst account.

For Hong Kong:

This report is distributed in Hong Kong by Motilal Oswal capital Markets (Hong Kong) Private Limited, a licensed corporation (CE AYY-301) licensed and regulated by the Hong Kong Securities and Futures Commission (SFC) pursuant to the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) "SFO". As per SEBI (Research Analyst Regulations) 2014 Motilal Oswal Securities (SEBI Reg No. INH000000412) has an agreement with Motilal Oswal capital Markets (Hong Kong) Private Limited for distribution of research report in Hong Kong. This report is intended for distribution only to "Professional Investors" as defined in Part I of Schedule 1 to SFO. Any investment or investment activity to which this document relates is only available to professional investor and will be engaged only with professional investors." Nothing here is an offer or solicitation of these securities, products and services in any jurisdiction where their offer or sale is not qualified or exempt from registration. The Indian Analyst(s) who compile this report is/are not located in Hong Kong & are not conducting Research Analysis in Hong Kong.

For Singapore

Motilal Oswal Capital Markets Singapore Pte Limited is acting as an exempt financial advisor under section 23(1)(f) of the Financial Advisers Act (FAA) read with regulation 17(1)(d) of the Financial Advisers Regulations and is a subsidiary of Motilal Oswal Securities Limited in India. This research is distributed in Singapore by Motilal Oswal Capital Markets Singapore Pte Limited and it is only directed in Singapore to accredited investors, as defined in the Financial Advisers Regulations and the Securities and Futures Act (Chapter 289), as amended from time to time.

In respect of any matter arising from or in connection with the research you could contact the following representatives of Motilal Oswal Capital Markets Singapore Pte Limited:

Kadambari Balachandran

Email : kadambari.balachandran@motilaloswal.com

Contact : (+65) 68189233 / 65249115

Office Address : 21 (Suite 31), 16 Collyer Quay, Singapore 04931



Motilal Oswal Securities Ltd

Motilal Oswal Tower, Level 9, Sayani Road, Prabhadevi, Mumbai 400 025

Phone: +91 22 3982 5500 E-mail: reports@motilaloswal.com