

Outlet overkill

Public sector oil marketers have embarked on their largest outlet expansion plan. A case of spreading too thin?

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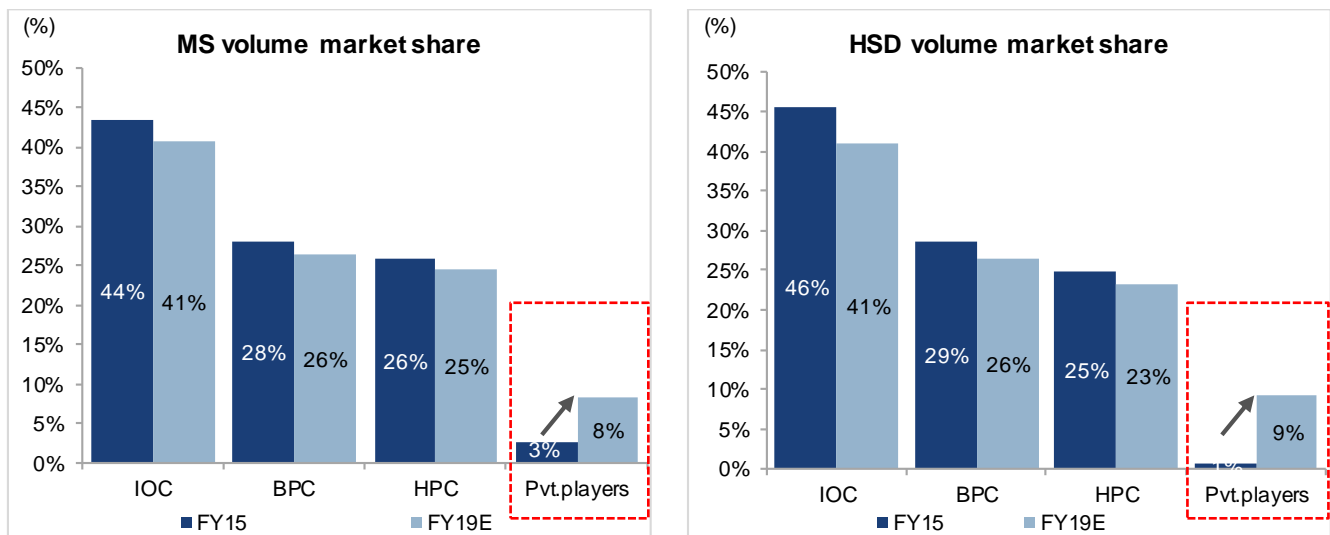


Will the doubling of fuel stations support pump economics?

India's oil retailing sector is set for a shake-up with public sector oil marketing companies (OMCs) deciding to set up over 78,000 new fuel pumps around the country, which would redefine the competitive landscape.

Public sector OMCs dominate the fuel retailing space, accounting for ~90% of the retail network.

Retail fuel market share %by volume



E: Estimated; IOC: Indian Oil Corporation Ltd; BPC: Bharat Petroleum Corporation Ltd; HPC: Hindustan Petroleum Corporation Ltd

Source: MoPNG, Industry, CRISIL Research

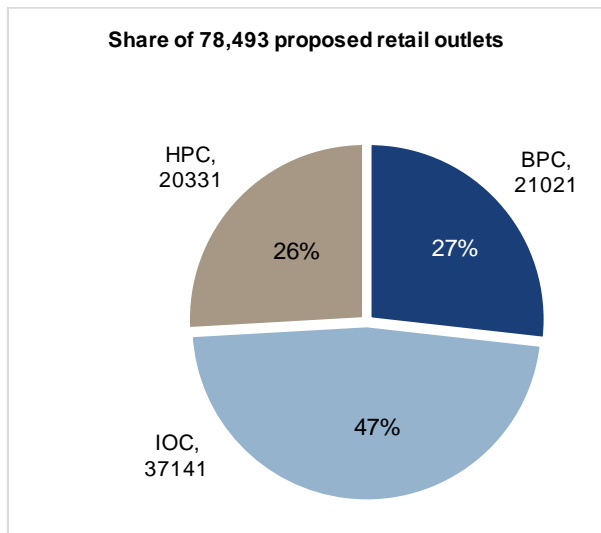
Following the tendering of over 78,000 petrol pumps by the OMCs, competition between them and with private sector players is expected to intensify. New players are also eyeing a piece of the fuel retail market, which would exacerbate competition.

Hence, the question that arises is whether the players will be able to maintain operational sustainability and profitability, and ensure a return on investment (RoI) with the more than doubling of pumps in the country.

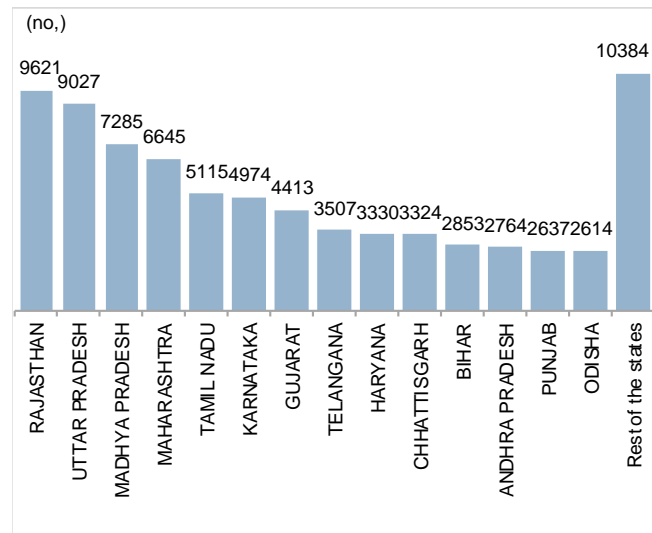
Expansion spree to impact throughput amid slowing fuel demand

In November 2018, the government allowed public sector OMCs to open new petrol pumps. Subsequently, the OMCs are looking to award tenders for 78,493 petrol pumps - ~68% belong to the regular category, i.e. highway and urban areas, and the remaining ~32% is in rural areas.

Company-wise proposed retail outlet share



State-wise proposed retail outlets



HPC: Hindustan Petroleum Corporation Ltd, BPC: Bharat Petroleum Corporation Ltd, IOC: Indian Oil Corporation Ltd

Source: Ministry of Petroleum and Natural Gas (MoPNG)

To put this figure into perspective, India currently has 64,624 fuel retail outlets.

Apart from expansion spree by public sector OMCs, private players are adding fuel retail outlets as well. The joint venture between Reliance Industries Ltd and BP Plc, and Nayara Energy Ltd (formerly Essar Oil Ltd) have plans to add 2,000 pumps each in the next three years, whereas Royal Dutch Shell Plc is slated to add 150-200 petrol pumps over the period as well. As the addition of pumps will also be followed by closures where throughputs are not at sustainable levels, private players are expected to effectively add 7,500-8,000 petrol pumps till fiscal 2030, based on their plans and the pump licenses they hold.

With so many petrol retail outlets proposed (78,000+ by PSUs and ~8,000 by private players), can the current level of throughput be sustained?

Mature fuel retail markets such as the US have ~150,000 petrol pumps, which is a sharp decline from the 202,800 pumps in 1994. Stagnating fuel demand and deteriorating pump economics led to the closure or consolidation of pumps. This has translated into higher throughput per outlet of over 300 kilolitre per month (KLPM). Moreover, over 80% of the petrol pumps are attached with convenience stores to keep the pump economics favourable amid slowing fuel demand. The current number of retail fuel outlets service 280-282 million vehicles. With increasing preference for alternate fuels and stagnating fuel demand, the number of outlets could reduce further.

In comparison, India’s throughput from 64,624 fuel retail outlets is ~160 KLPM, which is less than half of the US.

The average throughput for public sector OMCs is ~170 KLPM and while for private players, it is ~300 KLPM for RIL and Shell; however for NEL (Nayara Energy Limited), it is lower than PSU OMCs throughput.

The throughput for PSU OMCs is lower than private players, as private players are more concentrated on highways and urban areas. Public sector OMCs, on the other hand, also cater to the rural market, which have lower throughput.

So, is there economic merit in adding pumps when throughput is already low?

For private players, who primarily have retail outlets along highways, their share in sales of high speed diesel is projected to increase to ~15% over the next 4-5 years, from the current ~9.2%. Motor spirit's share, though, is expected to remain stable at current level, or increase only marginally. In fact, their future plans are aligned to strengthen their network and corner a higher share of highway product sales.

But in the case of public sector OMCs, ~32% of the proposed pumps are to be set up in rural areas. Hence, the added question is whether there is economic wisdom in a deepening rural push.

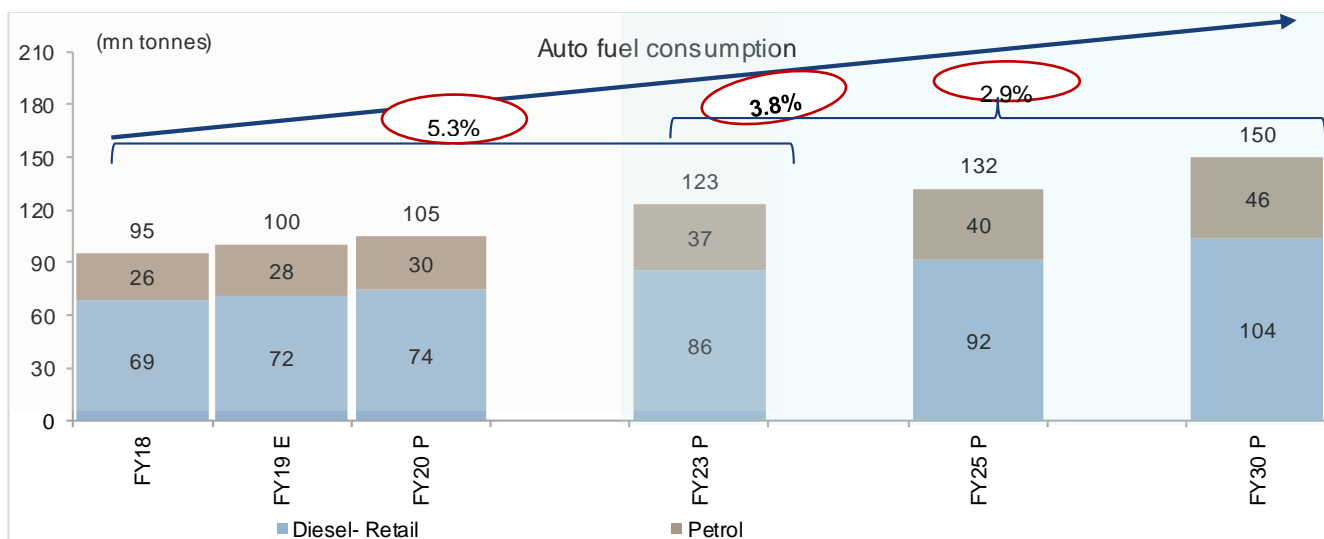
To be sure, the growth in demand for auto fuels in India will be on rising vehicle sales in tier-II and rural areas. In fact, there is considerable potential for car penetration levels in India to increase – car penetration in India is a mere 22 cars per 1,000 individuals vis-à-vis the US, the UK and China, where car penetration levels are 800+, 522+ and 170+ per 1,000 individuals, respectively.

However, the increase in demand for auto fuels in India is expected to be a moderate ~5% CAGR up to fiscal 2023 vis-à-vis ~6% CAGR between fiscals 2011 and 2018. In fact, up to fiscal 2030, auto fuel demand is projected to abate further to 3.8% CAGR to 132 million tonnes.

Also, substitution of petrol/diesel with compressed natural gas (CNG) is expected to increase in the coming years with the government aggressively pushing to develop gas infrastructure. The clear cost advantage of CNG over petrol/diesel in the transport segment would see traction towards CNG wherever the gas network is commissioned, especially from cab operators. In the recent city gas distribution (CGD) bidding rounds 9 and 10, 136 geographical areas were awarded. A few of these are expected to start operations in the next 2-3 years.

We expect diesel demand substitution with liquefied natural gas (LNG) in the heavy vehicles segment as well, though development of the infrastructure for LNG fuelling stations has been extremely slow and there have been procedural delays.

Blunting a higher fuel demand growth trajectory is also the entry of electric vehicles. The impact from electric vehicles will be visible post fiscal 2023, which is expected to see growth because of better cost of ownership vis-à-vis diesel/petrol vehicles, infrastructure availability, and government push in the form of incentives and subsidies.



Small- and mid-sized car segments are expected to witness a shift to petrol and other alternate fuels from diesel as well, as increased production cost associated with the implementation of Bharat Stage-VI diesel technology impacts viability of diesel vehicles for automobile manufacturers as well as for end customers.

Will retail fuel business remain lucrative for dealers?

Based on location/site and model type - company owned company operated (COCO), company owned dealer operated (CODO) and dealer owned dealer operated (DODO) - investments are undertaken by OMCs and dealers.

OMCs are responsible for providing the tanks and dispensing equipment, irrespective of location and model type. Typically, for a two tank, two dispensing equipment (island) configuration, the OMC has to invest Rs 2.0-2.2 million, with the capital expenditure for statutory clearances, no objection certificate, retail selling license, office building work (in some cases), etc borne by the dealers.

Also, dealers have to incur operating cost, which includes manpower cost (salary, provident fund, overtime, etc), stock loss cost, electricity and other utility bills (telephone, consumables, sundry expenses, etc), and working capital expenses.

Against their investment and operating costs, dealers are paid a margin per litre sale of petrol and diesel. Therefore, their ability to recover cost is entirely dependent on two parameters:

- I. Throughput of the pump
- II. Dealer margin fixed by OMCs

It should be noted that the dealer margin is linked to volume-wise slab. It is computed in such a way where pumps with lower throughput are given higher margins. This is done to incentivise dealers with pumps in areas where demand is poor and to avoid abnormal returns in high sales areas.

Apart from the two parameters, the returns of dealers can be enhanced from non-fuel retail such as operating CNG stations, from lubricant sales, and setting up food and beverage stores and ATMs. Dealers also earn lease rentals if they own the land.

Pump economics of DODO model

As OMCs and dealers have to invest in setting up the retail outlets, it is pertinent to understand the RoI and pump economics at different throughput levels and locations.

CRISIL Research has analysed the returns to dealers based on the DODO model as 60-65% of the proposed outlets are expected to come up on this model. The retail outlet's RoI is typically between 12-17% depending on whether it is along a highway, or in urban or rural areas, and assuming the dealer's share, throughput and fuel prices.

Particular		Urban/Highways/Rural
RoI - Fuel Retailing	%	12-17%
Payback period	Years	2.5-4.0
RoI- Fuel Retailing+ CNG+ Lubes	Years	2.7-3.2
	%	15-18%
Payback	Years	1.8-2.3

Source: CRISIL Research

In fact, the revenue potential of dealers increases by 3-5% in urban areas from non-fuel retail avenues such as CNG (dealers share their land with a CGD player for putting the CNG infrastructure), and from sale of lubricants.

The dealer and the OMCs have to undertake certain capital expenditure for the development of CNG infrastructure on the dealer's land. Further, operating costs for maintaining the pump, manpower cost and other expenses such as manpower, electricity, interest payment also increases for the dealer.

However, in return, the dealer earns margins on CNG sales volume from the CGD player, which gets distributed between the dealer and the OMCs, depending on their participation in the investment and other factors.

Room for only ~30,000 pumps if current throughput levels are to sustain

The analysis shows that the economics do not support the addition of 78,000+ petrol pumps. CRISIL Research is of the opinion that there is only room for less than half, i.e. ~30,000 fuel pumps, if the pumps are to maintain current throughput levels.

CRISIL Research has built scenarios, taking into account the investment for setting up a petrol pump and economics of the DODO model, to understand the number of outlets required to keep throughput at break-even levels.

If only 30% of the proposed petrol pumps are commissioned, i.e. ~30,000 fuel pumps, it would be able to meet break-even throughput over the next 12 years; pump throughput is expected to remain at current levels of 160+ KLPM, which will keep the dealer's returns stable at 12-15%.

However, at 50%, pump throughput could decline below break-even for a few years and recover towards the end of the forecast period, provided the OMCs do not add networks aggressively owing to already huge expansion in the previous years, and the absence of lucrative locations; throughput will decline to ~140 KLPM, but it will still be above break-even throughput, though returns will be affected to a certain extent.

So if all the proposed pumps are commissioned, the throughput of dealers will be significantly affected, and operating the pumps, for all intents and purposes, will become unviable.

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