

FIRST LIGHT

03 October 2019

RESEARCH

Oil & Gas

GRM surge on IMO may sustain for long

SUMMARY

Oil & Gas

The global transition to electric vehicles is a potent threat to oil demand growth over the long term, estimated to shrink oil consumption from road transportation at a ~0.5% CAGR over 2018-40. Nonetheless, we expect GRMs to stay resilient as (1) diesel demand is forecast to surge post IMO 2020 (leading to a 0.8mbpd supply deficit), (b) refining capacity additions are likely recalibrated to avoid a surplus (only ~50% of the 8mbpd planned through to 2040 is under execution), and (c) robust petrochemical demand shores up oil offtake.

[Click here for the full report.](#)

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	555
GAIL	Buy	200
ONGC	Buy	200
TCS	Add	2,360
HPCL	Buy	400

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,230
Future Supply	Buy	730
Greenply Industries	Buy	200
Laurus Labs	Buy	480
PNC Infratech	Buy	250

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.66	(2bps)	17bps	(142bps)
India 10Y yield (%)	6.70	(3bps)	14bps	(129bps)
USD/INR	70.87	(0.4)	0.8	2.8
Brent Crude (US\$/bbl)	60.78	(1.8)	0.6	(28.5)
Dow	26,917	0.4	1.9	1.0
Shanghai	2,905	(0.9)	0.7	3.0
Sensex	38,667	(0.4)	3.6	5.9
India FII (US\$ mn)	27 Sep	MTD	CYTD	FYTD
FII-D	(120.6)	(227.2)	4,020.0	3,475.3
FII-E	(42.6)	996.9	8,203.0	1,357.8

Source: Bank of Baroda Economics Research

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IMO 2020 to fuel GRM uplift...: We expect global diesel demand to spike by ~2.7mbpd in 2020 as interim consumption shifts to distillates on rollout of IMO regulations – this translates to a supply deficit of ~0.8mbpd, which will push up GRMs by US\$ 4-6/bbl for Indian refiners (that have ~40% diesel yields). As per industry experts, enforcement of IMO norms is unlikely to be delayed beyond 2020, nor will the terms be diluted. Instead, non-compliance at the local level (across countries) is the primary risk to effective rollout.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
RIL IN	1,305	1,500	BUY
IOCL IN	149	265	BUY
BPCL IN	494	535	ADD
HPCL IN	309	400	BUY

Price & Target in Rupees

...which looks long-term sustainable: Industry estimates of a 2.4mbpd surplus in refining capacities by 2025 look overstated, given that only ~3.8mbpd of the planned additions (totalling ~8mbpd) are in the execution stage against ~5mbpd of incremental oil demand forecast over 2020-25. This leaves scope for recalibration of the balance 50% of expansion plans based on global economic trends and actual electric vehicle (EV) sales. Amid demand volatility, refiners globally are more likely to opt for sustainable GRMs over volumes.

Accelerating EV adoption a threat post 2030: We expect EVs to form ~30% of global passenger vehicle stock by 2040. EVs could attain cost parity with internal combustion cars by 2022/23, when battery costs are estimated to halve to ~US\$ 100/kWh. Our estimates extrapolate a ~25% CAGR in EV stock over 2018-40, based on automaker (OEM) projections of touching ~100mn units in 2025. Led by this paradigm shift, we forecast a 0.5% CAGR decline in oil demand from road transport, muting overall demand growth at ~0.3% CAGR as against global estimates of ~0.6%.

RIL, IOCL best picks to play cyclicals business: RIL's high refining complexity (~21) gives it an edge in IMO norm compliance. While OMCs may lag on GRMs, we prefer Indian Oil (IOCL) and Hindustan Petroleum (HPCL) on improvement in marketing business valuations post BPCL privatization.



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BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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