

RESEARCH

Oil & Gas | Q3FY20 Preview

Pressure on cyclical earnings

SUMMARY

Oil & Gas: Q3FY20 Preview

Cyclical business fundamentals aggravated in Q3FY20 – Singapore GRMs crashed to US\$ 1.63/bbl (-75% QoQ), and petrochemical cracks declined ~20% QoQ. However, earnings for RIL and OMCs could still improve on higher complex GRMs and some improvement in marketing margins. Upstream PSU profitability could be impacted on the domestic gas price cut, despite stable Oil prices (+1% QoQ). Sustained low spot LNG prices at ~US\$5/mmbtu levels (+10% QoQ) could lift volumes for all gas utilities.

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	570
ONGC	Buy	210
Petronet LNG	Buy	400
Reliance Industries	Buy	1,860
TCS	Add	2,230

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,290
Future Supply	Buy	680
Greenply Industries	Buy	210
Laurus Labs	Buy	480
PNC Infratech	Buy	245

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.82	1bps	(2bps)	(91bps)
India 10Y yield (%)	6.55	(2bps)	(11bps)	(98bps)
USD/INR	71.83	0.2	(0.9)	(2.3)
Brent Crude (US\$/bbl)	68.27	(0.9)	6.0	16.3
Dow	28,584	(0.4)	2.0	20.2
Shanghai	3,105	0.7	6.6	22.9
Sensex	40,869	0.5	1.0	13.6
India FII (US\$ mn)	6 Jan	MTD	CYTD	FYTD
FII-D	(474.1)	(844.5)	(844.5)	2,099.6
FII-E	(2.6)	381.8	381.8	7,771.0

Source: Bank of Baroda Economics Research

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GRMs crash: Singapore GRMs averaged US\$ 1.63/bbl for Q3FY20 due to crash in fuel oil spreads to -US\$19/bbl (from -US\$0.5/bbl QoQ), while light distillate cracks remained under pressure. However, upside from IMO led impact seems to have faded, as Diesel cracks (~US\$14\$/bbl) still look some distance away from levels anticipated post IMO (>US\$20/bbl), and risks from a global economic slowdown look potent enough to restrict further upsides on diesel cracks. We prefer to wait until Q4FY20 before raising our long-term GRM estimates.

Slowdown concerns visible in petrochemicals: Per unit polymer and polyester margins have been trending lower, by ~25% QoQ in Q3FY20. A visible slowdown in industrial activity across China, Europe and the US has hurt petrochemical product demand. Consequently, we expect RIL's integrated petchem margins to fall ~10% QoQ. GAIL's petchem margins for the quarter could be affected by lower PE prices (down ~11% QoQ).

LNG prices remain muted: Spot LNG prices, although have marginally recovered to ~US\$5/mmbtu (+10% QoQ) in Q3, continue to expand the gap with long-term LNG volumes from Qatar (averaging ~US\$ 9/mmbtu). Gas demand across segments continue to improve (India consumption expected to improve by ~5mmscmd QoQ), which could imply gains on both margins and volumes across gas utilities.

Cyclicals offer value: We expect marketing margins to remain flattish QoQ for all three OMCs despite. Among OMCs, we prefer IOCL and HPCL, given improvement in marketing business valuations (post privatization roadmap for BPCL) and GRM recovery. RIL remains the primary beneficiary of IMO, and hence offers value if GRMs were to surge above our estimates.

KEY RECOMMENDATIONS

Ticker	Rating
RIL IN	BUY
ONGC IN	BUY
GAIL IN	BUY
PLNG IN	BUY
GUJGA IN	BUY



Disclaimer

Recommendations and Absolute returns (%) over 12 months

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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