

April 22, 2020

Difficult times...

US benchmark WTI prices traded in the negative territory for the first time on April 20 with May future contracts for WTI oil crashing to historic low of -US\$37.6/bbl, ahead of expiry day. Due to the Covid-19 outbreak, oil consumption has declined drastically, which led storage capacities in the US to get almost full. As WTI contracts get settled physically on expiry, there was such a historic collapse in oil prices. Currently, WTI June oil prices are trading at ~US\$12.7/bbl while July oil prices are trading at ~US\$20.4/bbl. In case of India, Brent oil prices are more relevant. They are trading at ~US\$18.6/bbl for June and ~US\$23.2/bbl for July.

Opec+ output cut deal not enough; oversupply to continue

From the start of 2020, Brent oil prices have declined ~60% while WTI oil prices went below zero. In March, a disagreement between Opec and Russia regarding production cut led to a price war in the global market. This led Brent oil prices to drop to ~US\$30/bbl. In April, finally Opec+ announced a deal to reduce oil output by 9.7 million barrels per day (mbpd). As per IEA, global oil demand could drop by ~23 mbpd in Q1FY21E amid spread of Covid-19, which meant that even if a 9.7 mbpd output cut takes place in May, there will still be oversupply of oil in the international market. Hence, the new Opec deal also failed to boost prices as the proposed output cut was not sufficient. With demand declining to ~77 mbpd and global oil supply at ~90 mbpd with current arrangements, oil surplus is expected to remain in the global market in Q1FY21E even if the US oil output reduces in May. With regard to oil prices in the short-term, global oil storage will be a key determinant till Covid-19 crisis gets over.

ONGC's profitability highly sensitive to change in oil prices

The Indian crude basket has not declined as much as WTI oil prices. Brent prices are more relevant for the Indian basket. Accordingly, it has declined in proportion to Brent prices. ONGC's profitability will be affected if oil prices remain at lower levels. We estimate oil prices at US\$37.5/bbl for FY21E with profit at ₹3777.6 crore. If prices remain at US\$20/bbl for FY21E, ONGC will report losses at ₹6596.7 crore.

Valuation & Outlook

Considering the extremely volatile global market, it is difficult to make an assessment of the current situation. Upstream companies fundamentals as well as petrochemicals business and profitability of companies like Gail will be negatively impacted as oversupply will continue to be an overhang on oil prices. We change our rating of ONGC from HOLD to **REDUCE** with price target of ₹ 65 while maintaining our **HOLD** rating for Gail with a target price of ₹ 80.

Key Highlights

- US WTI prices traded in negative for the first time with May future crashing to -US\$37.6/bbl
- Brent crude oil prices, which are more relevant for India are trading at ~US\$18.6/bbl for June and ~US\$23.2/bbl for July
- With regard to oil prices in the short-term, global oil storage will be a key determinant till Covid-19 crisis gets over.
- We change our rating on ONGC from HOLD to REDUCE with a target price of ₹ 65 while maintaining our HOLD rating for Gail with a target price of ₹ 80

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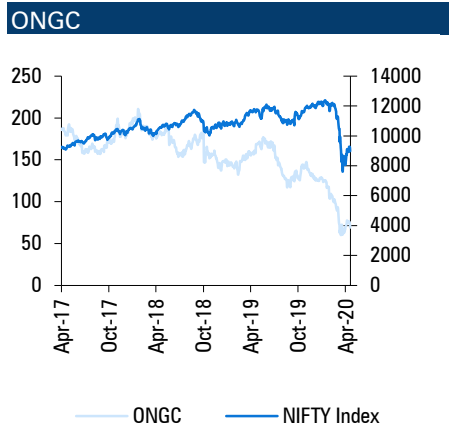
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Exhibit 1: Region wise storage capacity at end of March 2020

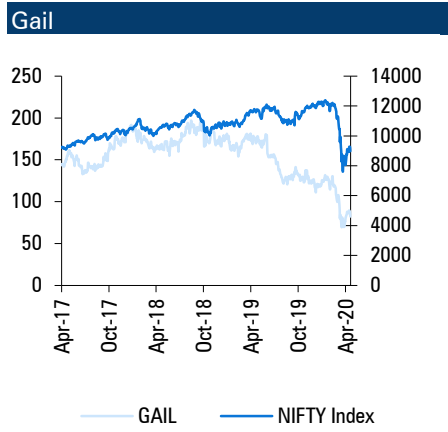
Region	Current Storage (Million barrels)	Maximum Capacity (Million barrels)	% of storage capacity filled
North America	1111.0	1287.0	86%
China	803.0	920.0	87%
Northeast Asia	484.0	567.0	85%
Rest of World	374.0	508.0	74%
Middle East	253.0	296.0	85%
Northwest Europe	181.0	233.0	78%
Mediterranean	144.0	191.0	75%
South & Central America	103.0	135.0	76%
Total	3453.0	4137.0	83%

Source: Company, Media Reports, ICICI Direct Research

Exhibit 2: Price Charts(LHS = stock price RHS = Nifty Index)



Source: Bloomberg, ICICI Direct Research



Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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