INDIAN OIL AND GAS SECTOR: UPSTREAM

Muted response from E&P companies for small discovered fields auction

Corporate Ratings

K. Ravichandran
+91 44 4596 4301
ravichandran@icraindia.com

Anoop Bhatia
+91 124 4545 315
anoopb@icraindia.com

Prashant Vasisht
+91 124 4545 322
prashant.vasisht@icraindia.com

Ankit Patel
+91 79 4027 1509
ankit.patel@icraindia.com

Sai Krishna
+91 44 4596 4304
sai.krishna@icraindia.com

January 2017

What's inside?

Executive Summary

Muted response from E&P companies for small discovered fields auction

During May 2016, the GoI decided to auction 67 discovered small oil & gas fields, under the Discovered Small Field (DSF) Bid Round 2016, offering 46 contract areas distributed across nine sedimentary basins. The DGH, in November 2016, announced the bids received for the contract areas offered. Despite the incentives offered by the GoI, the response for the auction has been muted primarily due to prevailing low crude oil and gas prices, low reserve potential and challenging geology. It is to be noted that although bids were received for all the onshore contract areas and on an average 4.6 bids were received per contract area, the response for offshore area was weak as only eight out of 20 contract areas received bids with average 1.8 bids per contract area receiving the bid. Thus, 12 offshore areas including four of KG basin which was perceived as prolific earlier did not attract any bids. Further, 14 contract areas received single bid leaving no option for the GoI to choose from and reflected lack of interest from E&P companies. Indian and global oil majors like Reliance Industries Ltd (RIL), BP Plc, Exxon Mobil, Chevron did not participate in the bidding process primarily due to soft oil and gas prices and small size of acreage being put on offer and the overhead cost required to bring them to production thereby making them unattractive. Of the 42 bids by firms, 5 are PSUs and their subsidiaries, 32 are Indian private firms, and 5 are foreign firms. The existing major oil and gas players which participated in the bidding are Cairn India, HOEC, IOC, GAIL (India), Oil India, and Bharat Petro Resources. Many companies which participated in the bidding process have nil or negligible experience in the E&P sector.

Despite recent spike in crude oil prices following OPEC deal, GURs may decrease in FY2017 due to soft prices in H1 and gradual increase in prices of kerosene and LPG (domestic)

GURs to be ~Rs. 170-190 billion in FY2017 at crude oil prices of US$50-60/bbl for the rest of the year

ICRA projects GURs of OMCs to decrease to ~Rs. 180 billion for FY2017 (with average Indian basket crude oil price of US$55/bbl and INR/US$ of 68 for the rest of FY2017). After staying range-bound at US$40-50/bbl in April to November 2016, the Indian Basket crude oil prices have increased by ~15% since the announcement by OPEC to cut crude oil production. Despite recent spike in crude oil prices, the GURs would fall due to lower prices in first 8M FY2017, gradual monthly increase in prices of kerosene and LPG, DBTL leading to cancellation of fake accounts, surrender of LPG subsidy under the GiveItUp campaign and secular decline in allocation of SKO to the States under PDS. Sustained increase in crude oil prices and INR/US$ would be key sensitivities for GURs.

Existing under-recovery sharing formula, low crude prices and gradual increase in prices of kerosene to result in nil under-recovery burden for PSU upstream companies until crude oil price of US$55-60/bbl

Boost in profits expected for PSU upstream players without any under-recovery burden up to the crude oil prices of US$55-60/bbl

The GoI capped its share under-recovery burden up to Rs. 12/litre (against current under-recovery of Rs. 10.26/litre for the second fortnight of December 2016) on SKO (PDS), while the balance is to be shared by upstream oil companies for kerosene. The GoI has directed the OMCs to increase the retail prices of subsidised SKO by 25 paisa (Rs. 0.25) per litre every fortnight up to April 2017 (post price hike of 25 paisa every month in July and August 2016). As per ICRA's previous estimates, the subsidy on kerosene was expected to be in the range of Rs. 90-125 billion per annum assuming crude oil price to be in the range of US$40-50/bbl. The move to increase retail prices of subsidised kerosene would lead to overall reduction in gross under-recoveries on kerosene by ~Rs. 30 billion in FY2018. As kerosene under-recoveries beyond Rs. 12/litre are expected to be borne by PSU upstream companies, the upstream companies would be major beneficiaries of the reform, especially at higher level of crude oil prices. Earlier, at an Indian Basket crude oil price of ~US$45/bbl, the kerosene subsidy was to be around Rs. 12/litre, implying no subsidy burden on PSU upstream players. At crude oil prices beyond US$45/bbl, the upstream companies would have had to bear the kerosene under-recoveries. Post the planned hike in kerosene prices up to April 2017, the PSU upstream companies may not have to bear any under-recovery on account of SKO up to crude oil price of US$55-60/bbl. Thus, in a scenario of crude oil prices rising up to US$55-60/bbl, the upstream companies' net realisation and cash accruals will improve due to the above steps in the medium term, albeit ad-valorem cess will cap the upside beyond $55/bbl.

Upside to crude oil production expected in the medium term

Marginal upside in crude oil production from ONGC commercialising its fields and EOR/IOR of OIL and ONGC even as CIL's production is expected to remain flat in FY2017

Over the medium term, an upside to crude oil production is expected to be driven by Cairn ramping up production of its Rajasthan asset, ONGC commercialising its marginal fields in addition to enhanced oil recovery/improved oil recovery (EOR/IOR) initiatives of ONGC and OIL. However even after factoring in the increase in production, dependence on import of crude oil is expected to remain high, given the large demand–supply gap and the growth in domestic consumption of petroleum products.

Outlook for Indian upstream sector is negative due to anticipated soft crude oil prices in the near to medium term despite modest increase post OPEC deal

The outlook for the Indian upstream segment is negative due to the challenging environment for the upstream and oilfield services in view of the soft crude oil prices notwithstanding the recent moderate increase in prices post OPEC deal. Organization of the Petroleum Exporting Countries (OPEC), on November 30, 2016, agreed to cut total crude oil production of its member countries by 1.2 million barrels per day (mbpd) from January 2017. The decision by the OPEC has led to spike in global crude oil prices by ~15-20% with Benchmark Brent Crude futures hovering US$54-57/bbl. The deal by OPEC also includes coordination with Russia, a large crude oil producer but not an OPEC member. Any further rise in crude oil prices and sustainability at higher levels would depend upon actual cut in production by different OPEC members and Russia up to their commitment levels. Notwithstanding that, oversupply in global crude oil market may persist in the medium term with higher crude oil prices giving pricing power to US shale oil producers to raise production levels. Thus, with rebalancing of the market, global crude oil prices may not increase significantly over the medium term. Apart from lower crude oil prices, fall in the domestic gas price in FY2017 would adversely impact profit levels of the upstream players. However, PSU upstream companies are likely to benefit with a nil under-recovery sharing burden as per the existing subsidy-sharing formula. ICRA believes the reforms announced by the GoI are positive for the upstream sector fundamentals for the long-term; however, the impact of the same in the near-term may not be significant as the reforms take time to play out. A sustained recovery in crude oil prices would be a key sensitivity for the prospects of the upstream sector in the medium term.

Please contact ICRA to get a copy of the full report

CORPORATE OFFICE
Building No. 8, 2nd Floor,
Tower A, DLF Cyber City, Phase II,
Gurgaon 122002
Ph: +91-124-4545300, 4545800
Fax; +91-124-4545350

REGISTERED OFFICE
1105, Kailash Building, 11th Floor,
26, Kasturba Gandhi Marg,
New Delhi – 110 001
Tel: +91-11-23357940-50
Fax: +91-11-23357014

CHENNAI
Mr. Jayanta Chatterjee
Mobile: 9845022459
Mr. Kalaivanan
Mobile: 9894204551
5th Floor, Karumuttu Centre,
498 Anna Salai, Nandanam,
Chennai-600035.
Tel: +91-44-45964300,
24340043/9659/8080
Fax:91-44-24343663
E-mail: jayantac@icraindia.com
p.kalaivanan@icraindia.com

HYDERABAD
Mr. M.S.K. Aditya
Mobile: 9963253777
301, CONCOURSE, 3rd Floor,
No. 7-1-58, Ameerpet,
Hyderabad 500 016.
Tel: +91-40-23735061, 23737251
Fax: +91-40- 2373 5152
E-mail: adityamsk@icraindia.com

MUMBAI
Mr. L. Shivakumar
Mobile: 9821086490
3rd Floor, Electric Mansion,
Appasaheb Marathe Marg, Prabhadevi,
Mumbai - 400 025
Ph : +91-22-30470000,
24331046/53/62/74/86/87
Fax : +91-22-2433 1390
E-mail: shivakumar@icraindia.com

KOLKATA
Ms. Vinita Baid
Mobile: 9007884229
A-10 & 11, 3rd Floor, FMC Fortuna,
234/ 3A, A.J.C. Bose Road,
Kolkata-700020.
Tel: +91-33-22876617/ 8839,
22800008, 22831411
Fax: +91-33-2287 0728
E-mail: Vinita.baid@icraindia.com

PUNE
Mr. L. Shivakumar
Mobile: 9821086490
5A, 5th Floor, Symphony,
S. No. 210, CTS 3202,
Range Hills Road, Shivajinagar,
Pune-411 020
Tel : +91- 20- 25561194,
25560195/196,
Fax : +91- 20- 2553 9231
E-mail: shivakumar@icraindia.com

GURGAON
Mr. Vivek Mathur
Mobile: 9871221122
Building No. 8, 2nd Floor,
Tower A, DLF Cyber City, Phase II,
Gurgaon 122002
Ph: +91-124-4545300, 4545800
Fax; +91-124-4545350
E-mail: vivek@icraindia.com

AHMEDABAD
Mr. Animesh Bhabhalia
Mobile: 9824029432
907 & 908 Sakar -II, Ellisbridge,
Ahmedabad- 380006
Tel: +91-79-26585049/2008/5494,
Fax:+91-79- 2648 4924
E-mail: animesh@icraindia.com

BANGALORE
Mr. Jayanta Chatterjee
Mobile: 9845022459
'The Millenia', Tower B,
Unit No. 1004, 10th Floor,
Level 2, 12-14, 1 & 2, Murphy Road,
Bangalore - 560 008
Tel: +91-80-43326400,
Fax: +91-80-43326409
E-mail: jayantac@icraindia.com

CORPORATE OFFICE
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300; Fax: +91 124 4545350
Email: info@icraindia.com, Website: www.icra.in

REGISTERED OFFICE
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50; Fax: +91 11 23357014

Branches: **Mumbai**: Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 **Chennai**: Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 **Kolkata**: Tel + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008, Fax + (91 33) 2287 0728 **Bangalore**: Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 **Ahmedabad**: Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 **Hyderabad**: Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 **Pune**: Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 553 9231

© Copyright, 2017 ICRA Limited. All Rights Reserved.

All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies, while publishing or otherwise disseminating other reports may have presented data, analyses and/or opinions that may be inconsistent with the data, analyses and/or opinions in this publication. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.