Indian Oil & Gas Sector-Refining & Marketing

Despite recent spike in crude oil prices following OPEC deal, gross under-recoveries will be under control in FY2017 and lower as compared to FY2016

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Annexure
Annexure-I: Trends in Crude Oil Prices, Light-Heavy Differentials and Crack Spreads

Executive Summary

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

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)

The gross under-recoveries (GURs) of public sector oil marketing companies (OMCs) declined by 64% (YoY) to ~Rs. 274 billion (including cash reimbursement under DBTL) in FY2016 from Rs. 763 billion in FY2015 in line with lower Indian Basket crude prices at US$46/bbl in FY2016 against US$84/bbl in FY2015. 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). The Indian Basket crude prices largely remained around US$40-50/bbl during April to November 2016; however the same have increased by ~15% since the announcement by OPEC to cut crude oil production. Despite recent spike in crude oil prices, the GURs would fall as compared to FY16 due to the steps taken by the GoI like gradual monthly increase in prices of kerosene and LPG, DBTL leading to cancellation of fake accounts and surrender of LPG subsidy under the GiveItUp campaign. Sustained increase in crude oil prices and INR/US$ would be key sensitivities for GURs

Demand of petroleum products reported growth of 9.3% (YoY) in H1 FY2017 on the back of high growth rates in consumption of petrol (10% YoY growth), pet coke (45%), LPG (11%), ATF (11%) and FO (18%)

Domestic demand growth continues to be healthy in H1 FY2017; moderates from multi-year high level of FY2016

India's petroleum products demand registered a growth of 10.9% (YoY) in FY2016, the highest level since 2000 and more than double of the cumulative average growth (CAGR) level of 4% (achieved during FY2005-15). Despite moderation from the level of FY2016, the petroleum products demand growth continued to be healthy at 9.3% (YoY) in H1 FY2017 with an increase in consumption to 96.70 MMT in H1 FY2017 from 88.47 MMT in H1 FY2016 in line with high growth in consumption of petrol, pet coke, LPG, ATF, FO and bitumen. Although the consumption growth for most of petroleum products has moderated in H1 FY2017 from the high levels achieved in FY2016, the same continues to be at healthy levels, much higher than the long-term averages. The healthy demand growth is primarily driven by economic recovery and higher demand on the back of lower crude oil prices. The impact of lower crude oil prices is reflected by the fact that the demand for products like naphtha and FO, with decline in consumption by 2.3% pa and 7.9% pa during FY2005-FY2015, reported an increase of 20.9% (YoY) and 11.9% (YoY) in FY2016 and 1.5% (YoY) and 18.0% (YoY) in H1 FY2017, primarily due to their increased cost competitiveness against R-LNG.

Demand outlook healthy for the medium term; demonetisation and rise in prices of crude oil and petroleum products post OPEC deal would moderate the growth rates in the near-term

The demand for petroleum products is expected to be higher than the long-term average over the medium term, following prospects of increased economic activity over the medium term. However, recent rise in crude oil prices following OPEC deal is likely to have a moderating impact on the demand of liquid fuels especially industry fuels like naphtha and FO. Further, the demonentisation of high value currency notes leading to lower consumption of products in various sectors may also lead to slowdown in the demand of crude oil derivatives in the near term; however, the effect of the move on auto-fuels has been positive due to acceptance of old notes which was allowed till December 2, 2016.

Light distillate cracks weakened even as middle distillate cracks remained strong in Q2 FY2017; outlook on GRMs remains positive in the medium term

Light distillate crack spreads declined in Q2 FY2017 vis-à-vis Q1 FY2017

Light distillate crack spreads declined in Q2 FY2017 vis-a-vis Q1 FY2017. Naphtha crack spreads weakened in Q2 FY2017 vis-à-vis Q1 FY2017 owing to soft demand for gasoline blending and widening of LPG/naphtha spread which incentivized feedstock switching for petrochemicals. Gasoline crack spreads declined in Q2 FY2017 vis-à-vis Q1 FY2017 due to supply glut and high exports from China even as imports by Indonesia reduced. In the middle of the barrel, gasoil cracks improved in Q2 FY2017 over Q1 FY2017 owing to healthy demand from South East Asian countries amid higher maintenance activity. Jet/kero crack spreads remained stable in Q2 FY2017 as against Q1 FY2017 due to strong demand in Asia and Middle East. At the bottom of the barrel, fuel oil crack spreads improved in Q2 FY2017 vis-à-vis Q1 FY2017 due to higher demand for power generation from Asia and the Middle East and firm bunker fuel demand amid lower supply from Russia. Additionally, with the international prices of crude oil rising from US$48/barrel as on September 30, 2016 to US$56/barrel as at December 2016 end, gross refining margins (GRMs) of domestic refineries would be buoyed by inventory gains in Q3 FY2017.

Global supply additions, net of closures, likely to match demand growth

Demand growth of petroleum products expected to remain moderate due to slowdown in Americas and China

Globally, GRMs are expected to remain healthy in the medium term due to additions to global refinery capacity, net of closures matching the demand growth. The demand for petroleum products is forecast to ease in 2017 owing to slowdown in Americas and China. Additionally the Brexit vote increases the economic, political, and institutional uncertainty, which is projected to have negative macroeconomic consequences; however, it is difficult to quantify its potential repercussions. Delays in commissioning of some of the proposed projects and closure of unviable refinery capacities would support GRM levels over the medium term.

Outlook for domestic refining and marketing industry is stable

GRMs expected to remain healthy with demand growth matching global capacity additions

The global refinery capacity additions are expected to match the demand growth over the medium term owing to which GRMs are expected to remain healthy. Notwithstanding the recent increase in crude oil prices following OPEC deal, moderate crude oil prices could continue to support the demand growth, despite modest global economic prospects. In India, the demand growth would be healthy in line with improving economic activity. Overall, despite certain moderation from high levels reported in FY2016, the crack spreads of most of petroleum products are expected to be healthy, leading to high GRMs in the near to medium term. However, volatility in crude oil prices may lead to inventory gains or losses for the refiners. The marketing margins are expected to be healthy due to lower prices of petroleum products apart from anticipated healthy demand growth. Despite the recent rise in crude oil prices, the oil marketing companies (OMCs) are likely to continue to share low or nil burden in gross under-recoveries on sensitive petroleum products, which are anticipated to be at moderate levels. Apart from brownfield expansion/debottlenecking projects, the new investments in the sector are still in the planning stages. The investment in auto-fuel retailing is the major area of interest for private companies in the near to medium term. Overall the credit outlook for companies in the refining and marketing sector remains stable owing to expectation of healthy GRMs, strong demand growth of petroleum products, high capacity utilizations of domestic refiners, decline in gross under recovery levels of OMCs and reduced delays in subsidy receipts from GoI.

Please contact ICRA to get a copy of the full report

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