Equity Research
April 6, 2020
BSE Sensex: 27591

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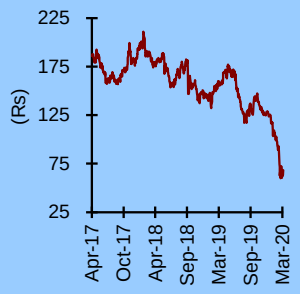
Sector update

Oil & Gas and Petrochemicals

ONGC (HOLD)
Target price: Rs66

Price chart



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INDIA

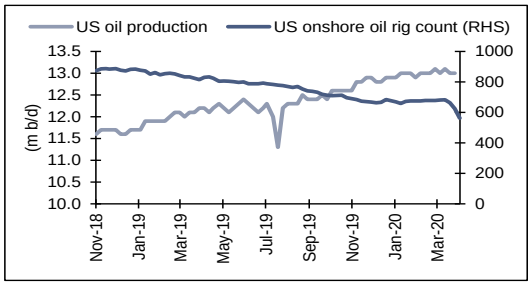
Oil upstream

Mixed news flow on proposed expanded OPEC+ output cut deal

An extraordinary virtual meeting of OPEC+ has been delayed from 6-Apr'20 to 9-Apr'20, but Alberta and Norway plan to join the meeting and are ready to cut output. US cutting oil output is crucial to any deal; news flow on output cut by US is mixed. US has threatened tariff imposition on oil imports if OPEC+ do not cut output. US has made available 30m bbls of storage capacity to US oil companies. Texas oil regulator plans a virtual public hearing on pro-rata production cuts on 14-Apr'20 with a decision likely on 21-Apr'20. Proposed output cut of 10m b/d may still mean global supply surplus (15m b/d as per IEA) in Q2CY20 due to steeper demand decline. However, implementation of a deal may stabilise and put a floor under the oil price, which would be encouraging for ONGC.

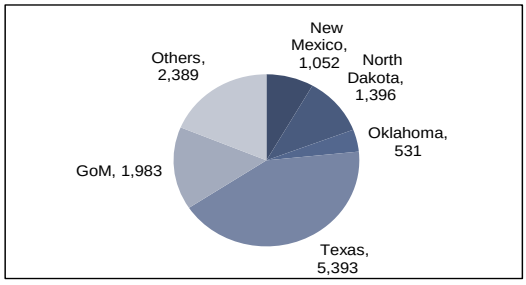
- **OPEC+ meeting delayed to 9-Apr'20; Alberta and Norway to join meeting:** An extraordinary virtual meeting of OPEC+ has been delayed to 9-Apr'20 from 6-Apr'20. **The delay together with the blame game between Saudi Arabia and Russia for the collapse in oil prices and for targeting US Shale may lead to correction in oil price**. Alberta, which accounts for 80% of Canada's 4.7m b/d production, and Norway (output 1.4m b/d in CY19 and 1.76m b/d in Dec'19) plan to join the OPEC+ meeting, which is open to all oil producing countries. They are also ready to cut output.
- **US may impose tariffs on oil imports if OPEC+ does not cut output; storage made available to oil companies**: There was no talk of output cuts at the meeting US president and Republican senators had with oil & gas CEOs on 3-Apr'20. The senators expressed their disappointment with ally Saudi Arabia for flooding the market with oil and bringing down oil prices to levels, which threaten jobs in the US oil industry. Some threatened to bring legislation that stops military aid to Saudi Arabia if they do not cooperate with the US in reviving oil prices. US president has indicated that imposing tariffs on oil imports was not plan-A, but "if US is not treated fairly" (i.e. OPEC+ does not cut output), it was an option he would exercise to protect US oil companies and jobs. On 2-Apr'20, department of energy made available to US oil companies storage capacity of 30m bbls and promised 47m bbls later; this will enable them to continue production instead of cutting output due to inadequate capacity.

US oil rig count down 18% in last 3 weeks; output finally set to fall now



Source: EIA, I-Sec research

Texas-Oklahoma have mechanisms that allow output cut; 1.2m b/d if 20% cut



Source: CME, I-Sec research

- **Texas oil regulator to decide on output cut on 21-Apr'20; output in other states to be hit by demand fall, inadequate storage and low oil price:** Texas oil regulator has fixed hearing on 14-Apr'20 (on complaint by two independent companies) to consider pro-rata output cuts given the likely oversupply due to demand collapse. Decision is likely on 21-Apr'20. One of Texas regulator's three commissioners is in favour of an output cut and cut would be imposed if one more comes to the same conclusion. Oklahoma has a similar mechanism for cuts. **20% cut in Texas and Oklahoma (46% of US output) would imply 1.2m b/d output cut.** Sharp decline in demand, inadequate storage and far lower prices than benchmark WTI could mean output cuts in some other states like North Dakota (Bakken). Fall in US onshore oil rig count by 18% (121) in the last three weeks also suggests output decline is imminent.

US cutting output crucial to a deal; Texas may cut

Russia-Saudi Arabia spat may not be a deal breaker

Russia blames Saudi Arabia for oil price collapse & targeting US shale

The Russian president in a televised video conference on 3-Apr'20 with domestic oil producers agreed to cut oil output along with other oil producing nations by 10m b/d. However, he blamed the oil price collapse on the demand collapse due to coronavirus, Saudi Arabia pulling out of OPEC+ deal, boosting output, offering discounts and accused it of trying to eliminate competition from US shale.

Saudi blamed Russia for OPEC+ talks failure and its output boost

Saudi Arabia responded by saying failure of 6-Mar'20 OPEC+ talks was due to Russia's refusal to accept OPEC's deal to deepen output cut. Saudi Arabia also pointed out that it was the Russian energy minister who first said to the media that no output cuts would apply from Apr'20, which led to Saudi Arabia raising its output.

Saudi said Russian oil company CEOs were hostile to US shale

Saudi Arabia also expressed surprise at Russia's accusation that Saudi Arabia was trying to eliminate US shale and reminded that it was particularly Russian oil company CEOs (Rosneft) who made statements hostile towards US shale. Saudi Arabia pointed out that it was a major investor in the US energy sector. **Saudi Arabia stressed that it still welcomes anyone who wants to find solutions to the challenges of the oil market, and that the urgent meeting called by it of OPEC+ and other countries was in line with its commitment to cooperation.**

Russia may want removal of sanctions on Rosneft imposed by US

We believe that the Russia-Saudi spat may not be a deal breaker. Some press reports suggest that Russia may want the US to withdraw sanctions imposed on Rosneft for doing business with Venezuela as a quid pro quo for cutting oil output.

Texas oil regulator may invoke existing powers to cut output

Russia and Saudi Arabia want US to cut output; Texas may cut

OPEC+ including Saudi Arabia and Russia want even the US to cut output. US participating in cuts may thus be crucial to having an expanded OPEC+ output cut deal. Texas is the US state, which can cut output in line with a process it has in place since the 1930s and which it used last in the early 1970s. One of the Texas oil regulator's commissioners Ryan Sitton spoke to the Russian energy minister recently and press reports suggest that the commissioner has also been invited for virtual meeting of OPEC+ now scheduled for 9-Apr'20. He discussed with the Russian energy minister production cuts of 10m b/d with US, Russia and Saudi Arabia each cutting by 2m b/d and the balance by other oil producers.

TRCC may invoke a power to cut output not used since the early 1970s

Texas Railroad Commission (TRRC), the Texas oil regulator, has powers to force oil producers to cut production through a process called pro-rationing, but it has not used

this power for almost 50 years. Following a slump in the oil market in 1931, TRRC started periodically implementing pro-rationing to bolster prices. That ended in the early 1970s, just as OPEC, which had modeled itself on the commission, was rising to a dominant position in the oil market. One of the three commissioners of the TRCC is in favour of cutting production until demand remains hit by coronavirus pandemic; the other two commissioners have not made their view public on the issue. Production cuts would be implemented if two of the three commissioners favour cuts. Pioneer Natural Resources and Parsley Energy, the second and tenth largest oil producers in the state of Texas, filed a complaint with TRCC on 30-Mar'20. TRCC has convened a hearing on 14-Apr'20 based on their complaint and a decision is likely on 21-Apr'20. Indications are that oil major Exxon may oppose the output cuts.

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