Regional Energy

Regional Oil and Gas

Refer to important disclosures at the end of this report

DBS Group Research . Equity — 9 Mar 2020

OPEC+ fails to deliver

- Lack of consensus on production cuts between OPEC and Russia raises risks of higher supplies in near term
- Moreover, with wider COVID-19 spread in recent days, we now expect oil demand to decline in 2020
- Cut our oil price forecast by ~US$10/bbl; we now project Brent crude oil price to average between US$47-52/bbl in 2020 and US$50-55/bbl in 2021
- Volatility to reign; expect more downside to already depressed O&G stocks in the near term

OPEC+ no deal sends oil prices crashing. On Friday, oil prices (Brent) fell by around 10% to c. US$45 per barrel (bbl) – lowest since 2017 – as the OPEC general meeting in Vienna, followed by the meeting of OPEC and its non-OPEC allies including Russia on 5-6 March, failed to produce any consensus on further production cuts beyond 31 March 2020. This was a completely unexpected outcome, as the market had expected further production cuts of between 0.5-1.0 million barrels of oil per day (mmbpd) to come through on top of the existing production cuts getting extended till the end of 2020.

Saudi could get into an all-out price war in coming weeks; a double whammy to the already bleak demand outlook as COVID-19 spreads. Saudi may now resort to opening the taps wider from April and engage in a price war in coming months to bring Russia back to the negotiating table. The recent rapid spread of the COVID-19 virus worldwide also leads to a bleaker demand outlook for oil.

Revised down our average Brent crude oil price forecast by ~US$10/bbl. We now expect Brent crude oil price to average between US$47-52/bbl in 2020. For 2021, inventory overhang caused by wide supply-demand gap in 2020 would continue to weigh on oil prices and we expect Brent crude oil price in 2021 to average only about 10% higher than 2020 at US$50-55/bbl in 2021.

More downside in near term likely. We expect Brent to test the US$40/bbl floor or even decline towards the US$30/bbl mark if the Saudi-Russia standoff intensifies. While it is likely that oil prices will bounce off rather quickly from those levels given that US shale supplies will be severely affected, the next few months could be a period of high uncertainty and volatility for the oil market. Under such circumstances, bargain hunting for upstream stocks might still be a while away. We have downgraded earnings, TPs and Recommendations of most of the E&P companies under our coverage.

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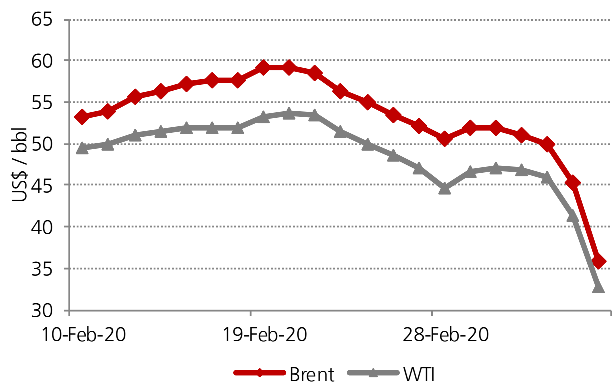
STOCKS

	Price LCY	Mkt Cap US$m	12-mth Target Price LCY	Performance (%) 3 mth	Performance (%) 12 mth	Rating
CNOOC	10.62	61,040	11.50	(6.0)	(20.5)	HOLD
PetroChina	3.01	8,176	3.20	(15.9)	(41.7)	HOLD
China Petroleum & Chem (Sinopec)	3.93	12,908	4.30	(9.7)	(41.2)	HOLD
Medco Energi Internasional TBK	665	834	700	(9.5)	(25.7)	HOLD
Hibiscus Petroleum Berhad	0.71	270	0.82	(19.8)	(33.0)	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 6 Mar 2020

1-month oil price chart



Source: DBS Bank

ed: JS/ sa: AS PY, CS

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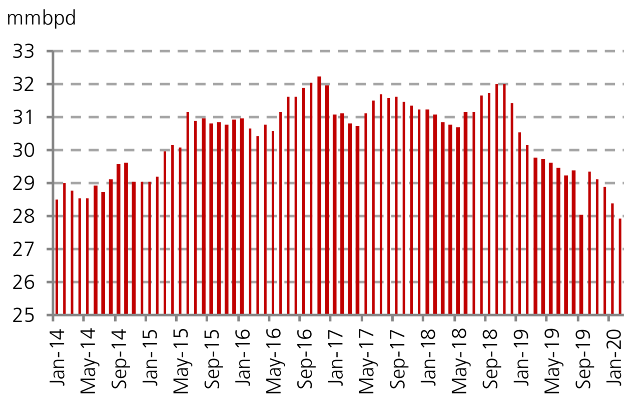
OIL MARKET FACING DOUBLE WHAMMY

OPEC+ no deal sends oil prices crashing. Oil prices fell on Friday by around 10% to US$45/bbl levels (Brent) – lowest since 2017 – as the OPEC general meeting in Vienna, followed by the meeting of OPEC and its non-OPEC allies including Russia on 5-6 March, failed to produce any consensus on further production cuts beyond 31 March 2020. This was a completely unexpected outcome, as the market had expected further production cuts of anywhere between 0.5mmbpd and 1.0mmbpd to come through on top of the existing production cuts getting extended till the end of 2020.

Existing production cuts not extended beyond March. While the OPEC meeting on Thursday, 5 March initially recommended additional production cuts of 1.5mmbpd till the end of 2020 – at the top end of market expectations – with cuts of 1.0mmbpd from OPEC and 0.5mmbpd to be shared by non-OPEC members led by Russia, the talks fell through next day as Russia did not agree to this quantum of further cuts. This has put the future of the OPEC+ alliance in turmoil, as not only were the additional cuts not agreed upon, even the existing production cuts expiring on 31 March 2020 leaves members free to produce as they wish beyond this.

OPEC oil production on a declining trend since Jan 2019 could reverse direction from Apr 2020



Source: Bloomberg Finance L.P., DBS Bank

Saudi could get into an all-out price war in coming weeks. We had highlighted earlier that Russia had more tolerance to lower oil prices than Saudi Arabia and other OPEC countries and may not be agreeable to a large production cut, especially since the current oil market crisis was more demand driven owing to COVID-19. Oil prices are unlikely improve materially from supply side efforts unless and until demand side improvements are seen, likely from 2H-2020. But the breakdown of talks between Russia and Saudi Arabia has now added a sizeable supply side specter to the already weak demand scenario in 1H-2020. Saudi may now resort to opening the taps wider from April and engage in a price war in coming months to bring Russia back to the negotiating table. Already, Saudi has increased discounts on its oil for European buyers to win market share from Russia. 2Q20 thus could be even worse for oil prices than 1Q20.

Oil demand scenario looks bleak – Chinese oil demand to be hit significantly in 1H2020. We had recently revised down our oil demand growth assumptions in light of the COVID-19 situation in China. Looking back at the SARS crisis in 2003, Chinese oil demand had been hit by around 10% in one quarter – 2Q13 – when the infections peaked. This time around, with stricter regulations on travel and quarantine measures, coupled with Chinese New Year lull in activity getting extended, we believe the demand impact could be closer to 20% of Chinese demand, or around 3.0mmbpd. Jet fuel and petrol/ diesel demand would be hurt the most, in addition to some industrial demand. However, this peak demand destruction would likely be for only around 1 month, and the full demand impact on 1Q from China would be closer to 1.5mmbpd, with another 0.5mmbpd in 2Q20.

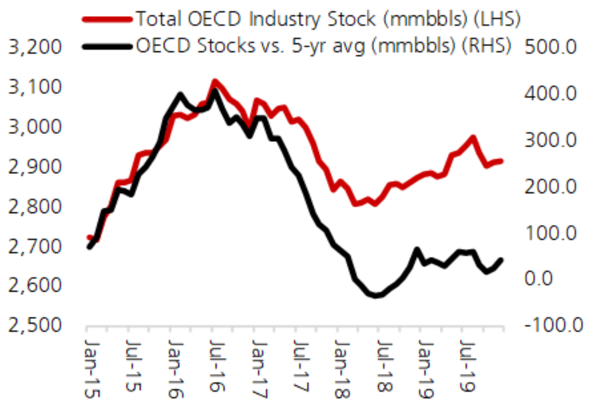
Global spread of COVID-19 dampens demand estimates further. The rapid spread of the COVID-19 virus worldwide in the last few days prompts us to lower our oil demand assumptions further, and we go into bear case scenario for oil demand. The spread of the virus in Italy and other parts of Europe is particularly worrying and will likely dampen demand in OECD countries as well. In addition to impact from China, we expect 1.0mmbpd demand impact from rest of the world in 1H20. Thus, we now expect overall global oil demand to decline in 2020, down by around 0.25mmbpd, compared to our earlier assumption of 0.5mmbpd growth. On the other hand, supply could be up by more than 1.0mmbpd in 2020, as OPEC production cuts no longer apply after 1Q20 and situation thereafter remains uncertain.

Thus, double whammy impact on our numbers. We are revising our oil price forecasts downwards for the second time in as many weeks in view of the OPEC+ no deal, which opens up the supply side of the equation, and the rapid spread of the COVID-19 virus worldwide, which dampens demand estimates further.

We cut our average Brent crude oil price forecast by around US$10/bbl, and now expect Brent crude oil price to average between US$47-52/bbl in 2020. For 2021, we now expect demand to rebound by around 1.4mmbpd after the fall in 2020. But the inventory overhang caused by the wide supply-demand gap in 2020 will continue to weigh on oil prices. We expect Brent crude oil price in 2021 to average only about 10% higher than 2020 at US$50-55/bbl in 2021.

More downside to oil prices in near term likely. In the near term, we expect Brent to test the US$40/bbl floor and will not be shocked if oil prices move towards the US$30/bbl mark if the Saudi-Russia standoff intensifies. While it is likely that oil prices will bounce off rather quickly from those levels as we saw in early 2016, given that US shale supplies will be severely affected, nevertheless we still expect the next few months to be a period of high uncertainty and volatility for the oil market. Under such circumstances, bargain hunting levels for upstream stocks might still be a while away.

Global oil inventory levels will resume upward trajectory



Source: International Energy Agency (IEA), DBS Bank

Quarterly oil price forecasts - DBS

(US$ per barrel)	1Q20F	2Q20F	3Q20F	4Q20F	1Q21F	2Q21F	3Q21F	4Q21F
Average Brent crude oil price	52.5	44.0	52.5	53.5	52.5	52.5	56.0	55.5
Average WTI crude oil price	47.0	40.0	48.5	49.5	48.5	48.5	52.0	51.5

Source: DBS Bank

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DOWNGRADING O&G STOCKS

Revised down oil majors' earnings. We are downgrading earnings of oil majors under our coverage (refer to table below).

E&P segment's earnings forecasts are slashed after factoring in US$10/bbl lower oil price assumptions to average US$50/bbl and US$54/bbl in 2020/2021.

Chinese refinery & petrochemical businesses are particularly hit by lower yield and Gross Refining Margin (GRM) due to COVID-19 outbreak that has affected demand and production.

Please click for refinery outlook report: [Regional Energy: China Refining & Petrochemical Sector: Feeling under the weather]

Downgrade CNOOC, Sinopec, PTTEP and Medco to HOLD. **Sinopec's [TP HK$4.30]** operations are among the worst hit by the COVID-19 outbreak. **CNOOC's [TP HK$11.50]** production has been the least affected by the China lockdown given its offshore operations. However, the expected oil price collapse will take a toll on earnings and sentiment ahead. Hence, we are downgrading the stock to HOLD. Nevertheless, **CNOOC remains one of the best proxies when oil price sentiment turns.**

Similar to CNOOC, **PTTEP [THB104]** is another pure E&P play that will be hit hard by the oil price collapse.

For **Medco**, our target price is lowered to **Rp700** after halving earnings and result in a downgrade in rating to HOLD.

Summary of revisions in earnings, TPs and recommendations of oil majors under our coverage

Company	CY20F Net Profit			CY21F Net Profit			Target Price			Rec	
	Old	New	Chg	Old	New	Chg	Old	New	Upside	Old	New
CNOOC	8,877	4,881	-45%	9,203	6,183	-33%	HKD 16.00	HKD 11.50	8%	BUY	**HOLD**
Petrochina	7,894	5,206	-34%	8,283	6,108	-26%	HKD 4.20	HKD 3.20	6%	HOLD	HOLD
Sinopec	8,325	4,837	-42%	8,325	6,063	-27%	HKD 6.00	HKD 4.30	9%	BUY	**HOLD**
Hibiscus	44	32	-29%	50	38	-25%	MYR 1.10	MYR 0.82	15%	BUY	BUY
Medco	176	75	-57%	308	156	-49%	Rp1,150	Rp850	28%	BUY	**HOLD**
PTTEP	1,491	994	-33%	1,618	963	-41%	THB159	THB104	-2%	BUY	**HOLD**

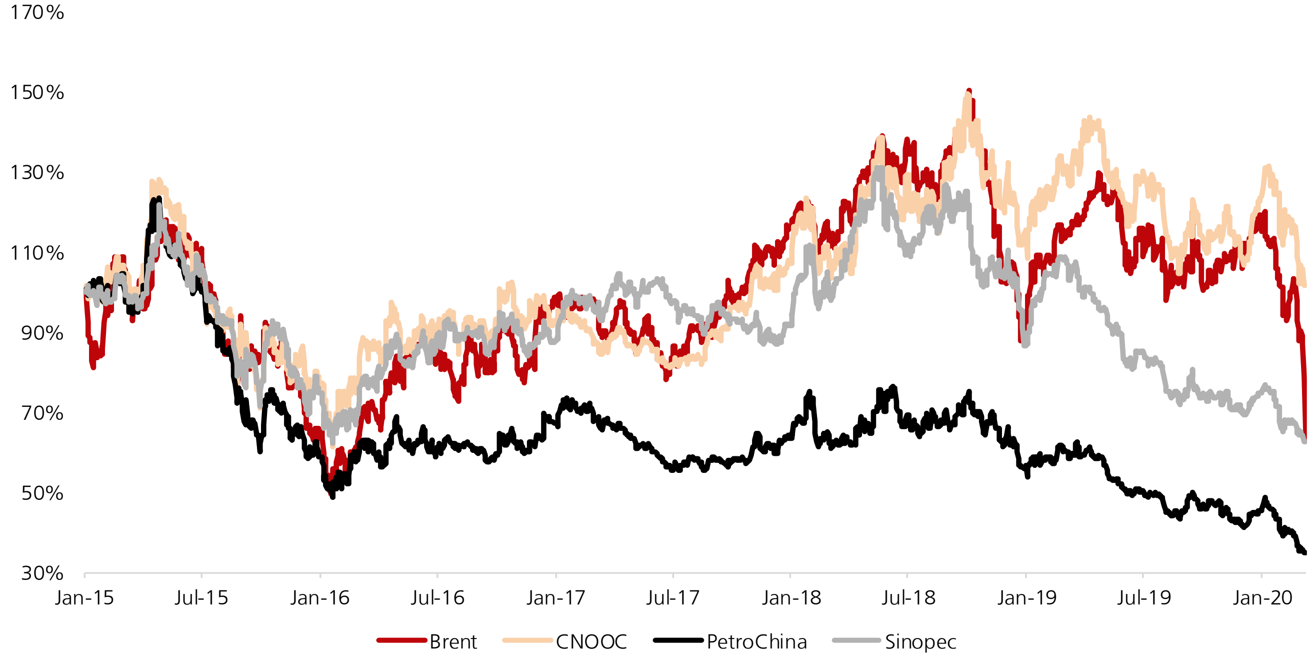
Source: DBS Bank

Peer comparisons

Company	Share price (local)	Market cap (US$m)	P/E		EV-to-EBITDA		P/B		ROE (%)		Div yld
			CY20F	CY21F	CY20F	CY21F	CY20F	CY21F	CY20F	CY21F	CY20F
Integrated & Upstream											
CNOOC	11.1	63,911	7.9x	6.9x	3.6x	3.3x	0.9x	0.9x	12.5%	12.9%	6.3%
Sinopec	4.1	77,863	8.5x	7.4x	3.3x	2.9x	0.6x	0.6x	7.3%	7.7%	7.9%
PetroChina	3.1	128,667	10.3x	8.8x	4.2x	4.1x	0.4x	0.4x	4.1%	4.5%	5.2%
PTT Group	40.3	5,742	10.5x	8.5x	6.6x	5.6x	0.6x	0.6x	6.0%	7.1%	5.3%
PTT Exploration & Production	107.0	13,507	9.8x	10.0x	2.9x	2.9x	1.1x	1.0x	11.1%	10.5%	5.0%
Medco Energi	625.0	792	3.7x	2.6x	4.7x	4.0x	0.2x	0.2x	7.0%	3.6%	2.3%
Hibiscus Petroleum	0.7	280	5.2x	5.2x	1.5x	1.4x	0.9x	0.8x	15.7%	13.8%	nm
Downstream refinery & petrochemical											
Bangchak Corp	23.7	1,023	9.3x	8.2x	7.4x	7.0x	0.6x	0.6x	7.1%	7.5%	5.8%
Thai Oil	41.3	2,676	9.1x	7.9x	7.9x	8.3x	0.7x	0.6x	7.6%	8.0%	5.0%
Indorama Ventures	26.3	4,686	9.9x	8.1x	7.6x	7.3x	1.0x	0.9x	10.5%	11.3%	4.0%
PTT Global Chemical	40.3	5,742	10.5x	8.5x	6.6x	5.6x	0.6x	0.6x	6.0%	7.1%	5.3%
Star Petroleum Refining	7.4	1,020	11.2x	8.3x	4.5x	3.6x	0.9x	0.9x	9.2%	10.2%	5.3%
Oilfield services/equipment manufacturer											

Source: Bloomberg Finance L.P. , DBS Bank

Oil price vs Chinese oil majors' share price; CNOOC as pure E&P player might get the hardest hit



Source: Bloomberg Finance L.P. , DBS Bank

Oil price vs ASEAN oil majors' share price

Source: Bloomberg Finance L.P. , DBS Bank

DBS Bank recommendations are based on an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

**Share price appreciation + dividends*

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