THE COMPASS

Conflicting trends for energy sector stocks

Upcoming state elections only add to the uncertainty for public sector companies

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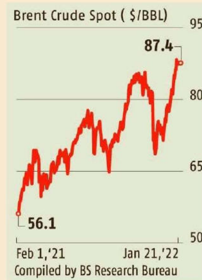
There have been wild gyrations in crude oil and gas prices, with contradictory trends for markets to process. There is the fear factor caused by tensions around the Russia-Ukraine situation and the recent drone terrorist attack in West Asia. The Omicron wave may lead to downgrades for global growth, which in turn would mean downgrades to energy demand. This could mean downward price pressure. But there are also advisories saying demand hasn't been affected.

There are contradictory assessments of supply-demand equations. There's slightly higher consensus that supply would remain tight but strong minority opinions that supply will outstrip demand. Prices shot to multi-year highs in mid-January, followed by sharp corrections. Nevertheless, benchmark prices remain close to peaks and benchmark Brent is up 55 per cent in 12 months. There are advisories that prices may test $100 per barrel before supply-demand normalises.

The last quarter (Oct-Dec 2021) saw higher crude prices through October and November with some moderation in December. The Indian crude basket cost $82 per barrel in October, $80.64 in November and $73.3 in December. The averaged Apr-Sep price was $69.8, so Q3 was definitely the most expensive quarter. The gas trends were similar, with geopolitical tensions adding to the upwards pressure caused by seasonal heating demands.



Compiled by BS Research Bureau

Downstream, gross refining margins (GRM) remained high due to shutdowns of some global refining capacity. But petrochemical margins tightened. So refiners producing petrol, kerosene (ATF), diesel, naptha, would have strong margins. But those producing polymers, olefins, etc., would have seen a margin dip.

In India, ONGC and OIL are the two main producers, which should have seen sharp improvements in their realisations in Q3. GAIL, which trades for gas as well as markets it, may have seen some rise in profitability.

The oil-marketing PSUs would have benefited in Q3FY22 from a combination of good GRMs and positive inventory revaluation, which would have added to their bottom line. Petrochemicals producers may have seen declines in bottom lines.

What do we make of the price gyrations and likely trends in Q4? One point to note is the political factor. PSUs are normally allowed to pass through price increases at the retail pump. But the controlling shareholder is the Government of India and due to impending Assembly elections, they cut prices. It is likely they will not be allowed to hike prices again, until the elections end in March. This means, PSUs may have to bear the brunt of higher prices and take a hit on margins.

The best guess for Q3 is that ONGC and OIL will have done well and, given that crude and gas prices remain strong post-corrections, both will continue to do well in Q4. The OMCs — IOC, BPCL and HPCL — could declare reasonably good results in Q3. But they would be under pressure in Q4.

On the stock market, IOC, BPCL and HPCL have negative price movements in the past three months. But HPCL and IOC have excellent 12-month returns of 44 per cent and 22 per cent, respectively. ONGC has returned 63 per cent in the last 12 months. OIL has returned 92 per cent in the last year but negative in the last three months. Gujarat Gas also has a strong 12-month return of over 80 per cent.