"Refining and Marketing Industry – Industry to witness a challenging phase going ahead"

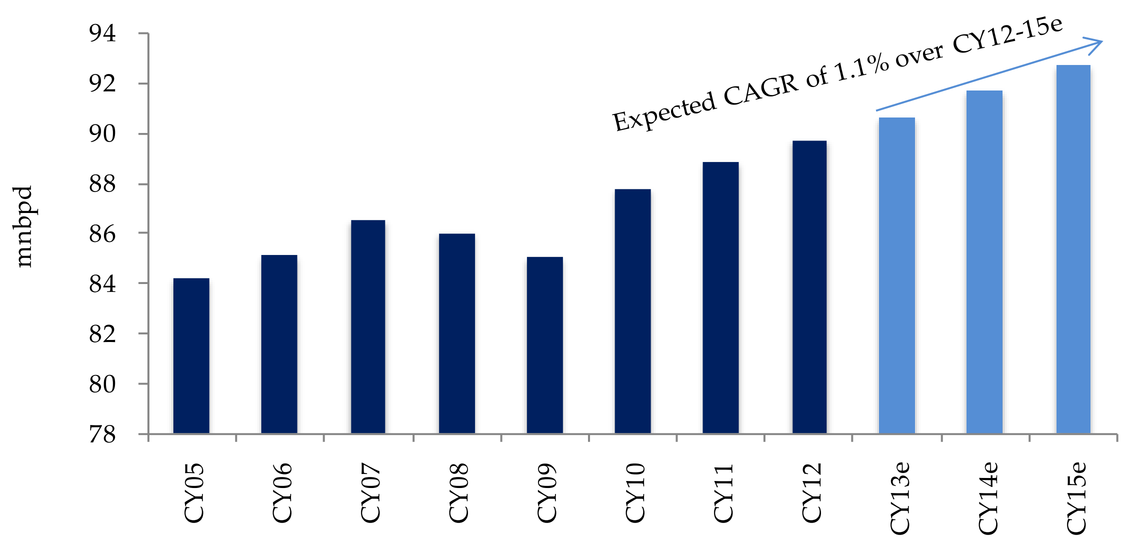
International refining industry is likely to witness significant refining capacity addition during CY13-15. However, due to weak petroleum product demand and surplus refining capacity, utilisation rates of the refining industry is expected to remain subdued; thereby impacting refining margins.

Global oil demand – share of BRIC nations to rise

In the medium term, economic growth will remain the key factor to drive oil demand globally while in the long term; the impact of government policies, technologies and demographics will become influential to drive the oil demand.

World oil demand grew at a CAGR of 1.4 per cent in the last decade (CY02-12) with an average increase of 1.1 mnbpd every year. The growth was driven by the BRIC (Brazil Russia China India) nations mainly China and India. On the other hand, developed nations like the US, Europe and others have seen a structural de-growth in oil demand since CY05 and are expected to witness a decline in oil consumption. CARE Research expects an incremental oil demand of 2.9 mnbpd globally till CY15 in addition to oil consumption of around 89.8 mmbpd in CY12. The growth would be mainly driven by BRIC nations on account of favourable demographics, urbanisation and industrialization in these nations. However, CARE Research expects a downside risk to the oil demand given the widening uncertainties over global macroeconomic scenario.

Global oil demand forecast



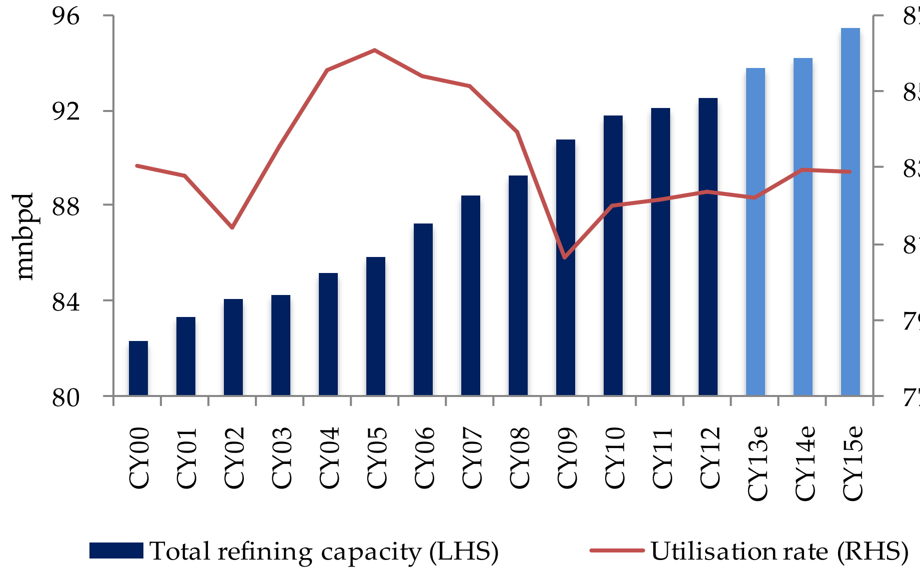
Source: IEA and CARE Research

Refining industry - to be hit by surplus capacity and weak demand

During the period CY06-10, about 5.9 mnbpd additional refining capacity was commissioned worldwide whereas increase in oil demand was only 3.6 mnbpd. This resulted into drop in refinery utilization rate. Due to Euro zone crisis and weak economic scenario worldwide, many companies have delayed the refining projects plans. Many of the new refineries scheduled for CY11 and CY12 have been delayed to CY13 and beyond. In CY12, the utilization rate stood at 82.4 per cent against the last 5-year average of 82.8 per cent.

Going forward, CARE Research believes that in next three years, the refining capacity addition is likely to be about 3 mnbpd, which would outpace oil demand growth due to overall weak global economy. CARE Research expects the refining capacity utilisation to remain under pressure in next 2-3 years on the back of incremental up-coming refining capacity, implying pressure on refining margins.

World refining capacity utilization to remain subdued

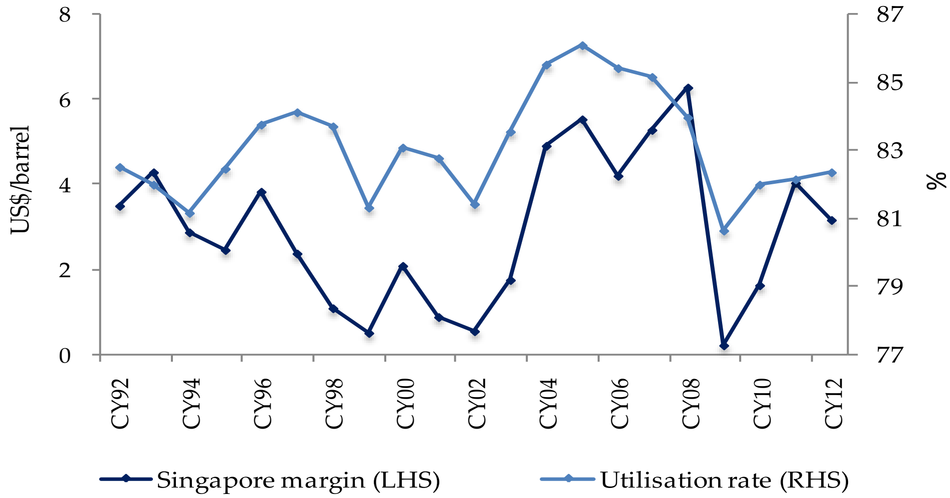


Source: BP Statistical Review and CARE Research

Gross refining margins to remain under pressure

Historically, it is evident from the following chart that gross refining margins (GRM) have closely followed global refinery utilisation. The global refining utilisation level is expected to remain below 83 per cent, implying pressure on refining margins in next 2-3 years. CARE Research expects Singapore GRM, which is a benchmark GRM for all Asian refiners, to remain weak owing to wide gap between demand and supply of petroleum products. Margins are not expected to improve until there are some signs of improvement in economic conditions or delays in refinery capacity expansion projects.

GRM and refining capacity utilization trend

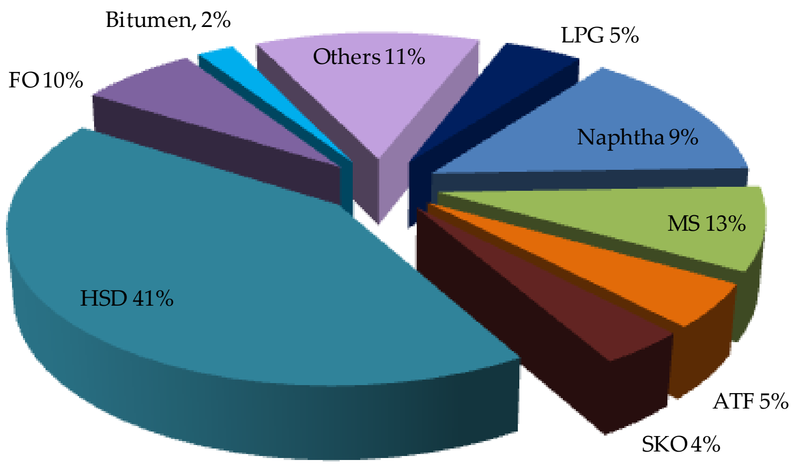


Source: BP Statistical Review and CARE Research

Indian Scenario - POL demand likely to increase marginally

Domestically, with almost 21 mmtpa of additional refining capacity coming on-stream, the total refining capacity is expected to reach 236 mmtpa by FY16. CARE Research expects domestic petroleum production to grow at a CAGR of 2.4 per cent during the period FY14-16 while the annual domestic demand is expected to reach about 160 mmt in FY16. Thus, India is expected to remain a net exporter of petroleum products. However, CARE Research believes that India would remain deficit in LPG and remain a net exporter of naphtha, MS and HSD.

Product slates of Indian refineries in FY13



Source: PPAC and CARE Research

Under-recoveries on petroleum products to continue

The government in an unprecedented move announced to partially deregulate the diesel prices in January 2013 thereby allowing the Oil Marketing Companies (OMCs) to raise diesel prices by Rs 0.5/l every month. The government also approved bulk diesel pricing to be market driven. This was aimed to reduce the overall subsidy burden. However, due to sharp devaluation of the rupee against US dollar, under-recoveries on diesel increased to Rs 10.2/l as on 15th October 2013. While the under recoveries on SKO and LPG stood at Rs 38.3/l and Rs 532.9/cylinder as against Rs 30.6/l and Rs 490.5/cylinder, respectively in January 2013.

However, CARE Research believes that this policy action by the government towards solving the problem of burgeoning under-recoveries plaguing the OMCs and resulting rise in fiscal deficit is expected to prove beneficial in the long run.

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