Energy Sector

Thought Piece

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Duong Dinh
Senior Manager
duong.dinh@vcsc.com.vn
+848 3914 3588 ext. 140

Tram Ngo
Senior Analyst
tram.ngo@vcsc.com.vn
+848 3914 3588 ext. 135

Nam Hoang
Senior Analyst
nam.hoang@vcsc.com.vn
+848 3914 3588 ext. 124

Thanh Nguyen
Senior Analyst
thanh.NguyenDac@vcsc.com
+848 3914 3588 ext. 173

Duc Le
Analyst
duc.LePhuoc@vcsc.com.vn
+848 3914 3588 ext. 196

Lower growth and coronavirus weigh on oil prices

We cut our oil price base case for 2020F and maintain our forecasts for 2021-2023F. We reduce our average Brent crude oil price assumption by 7.7% from USD65/bbl to USD60/bbl for 2020F and maintain USD65/bbl for 2021-2023F period. The International Monetary Fund (IMF) cut its 2020 global growth forecast from 3.5% to 3.3% in its January report. Furthermore, the consensus is that the coronavirus outbreak could have a negative short-term impact on global GDP and therefore weigh on global oil consumption. In particular, according to Bloomberg and experts knowledgeable about China's energy industry, China's oil demand has dropped by about three million bpd – or 20% of China's total consumption – as coronavirus has impacted the country's economy. OPEC+ is considering to conduct a meeting without yet understanding the impact of coronavirus on oil demand and how much further the oil production cuts cut could be.

Brent oil price plunged 20% over the past month. The price of Brent crude oil plunged by approximately 20% to USD55/bbl in January, which was mainly due to the impact of coronavirus.

Lower oil prices have hurt five oil & gas stocks while benefitting fertilizer and power plants. With our new oil price base case, we see downside risk to GAS and upside risk to DPM. Furthermore, we see limited negative impact on PVD, PVS, PLX and BSR, limited positive impact on POW and NT2 and almost no impact on PVT. *We are not adjusting earnings forecasts or target prices for now, but we will factor in our revised oil price forecasts in our forthcoming company updates following Q4 2019 results.*

Lower oil prices also benefit aviation stocks as fuel costs account for 30-40% of airlines' total costs. However, we believe this effect is will only last for the short term due to intensified competition in the industry. Moreover, with the outbreak of coronavirus in China, HVN and VJC have temporarily shut down all routes connecting to destinations in mainland China. According to the Civil Aviation Administration of Vietnam (CAAV), VJC and HVN have 87 regular routes to destinations in China with a frequency of 401 flights per week. We believe the impact of coronavirus will be significant for these two airlines, especially in Q1 2020, pending a fuller review. Tire manufacturers are another beneficiary of lower oil prices as the prices of key input materials (e.g., black carbon and synthetic rubber) are highly correlated with oil prices.

Figure 1: Impact of oil price forecast changes on stocks under our coverage

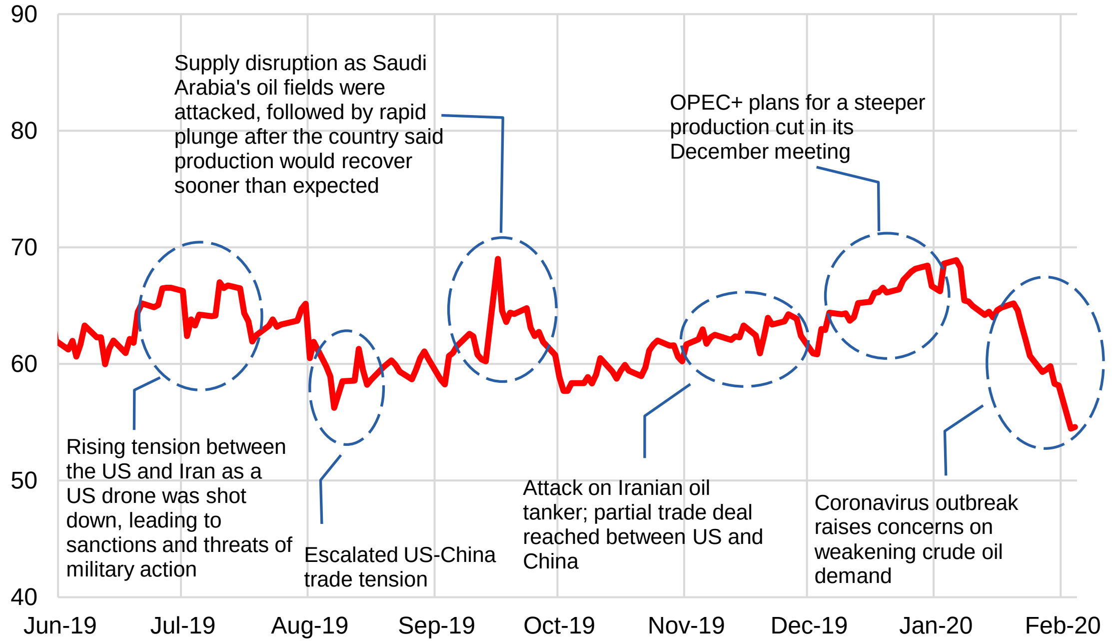
Ticker	Sector	Current share price (VND/sh)	Current target price (VND/sh)	Upside/downside risk	Dividend yield %	Projected TSR %
GAS	Gas trading & distribution	82,000	109,500	Downside risk	7.9%	41.5%
PVD	Oil & gas service provider	12,200	16,500	Slight downside risk	0.0%	35.2%
PVS	Oil & gas service provider	15,700	25,300	Slight downside risk	6.4%	67.5%
BSR	Refinery	7,700	11,100	Slight downside risk	4.5%	48.7%
PLX	Petroleum distributor	50,700	68,600	Slight downside risk	5.9%	41.2%
PVT	Crude oil & petroleum transporter	12,700	21,700	No impact	7.9%	78.7%
VJC	Aviation	129,000	160,800	Insignificant upside risk	3.9%	28.5%
HVN	Aviation	26,700	40,000	Insignificant upside risk	3.7%	53.6%
POW	Gas & coal-fired power	9,500	16,300	Slight upside risk	3.2%	74.8%
NT2	Gas-fired power	19,000	27,200	Slight upside risk	12.1%	55.3%
DPM	Fertilizer (urea producer)	11,550	15,000	Upside risk	8.7%	38.5%
DRC	Rubber	22,500	24,400	Upside risk	2.2%	10.7%

Source: VCSC

Oil prices deteriorated in January due to coronavirus outbreak

In December 2019, oil prices surged thanks to a steeper production cut made by OPEC+ in addition to escalating tensions between the US and Iran, which both threatened supply. In contrast, oil prices plunged by approximately 20% during January, which was mainly due to Coronavirus.

Figure 2: Historical Brent crude oil price movements (USD/bbl)



Source: Bloomberg, VCSC

Worsening global economic growth outlook poses threat to global oil demand

Recently, there have been several developments that signal a weakening crude oil demand outlook.

Firstly, in January 2020, the IMF revised down its global growth forecasts for 2020 and 2021. Specifically, the IMF cut its 2020 global growth forecast to 3.3% from its previous forecast of 3.5% that was made in its October 2019 report. Moreover, Brexit being officially entered into force on January 31, 2020, could also have a negative impact on global growth. While the UK and European Union have started to negotiate a new free trade deal, 2020 has become a transition year with rising uncertainties regarding lower business and consumer confidence, supply chain reassessments, declining investments and a direct reduction of trade.

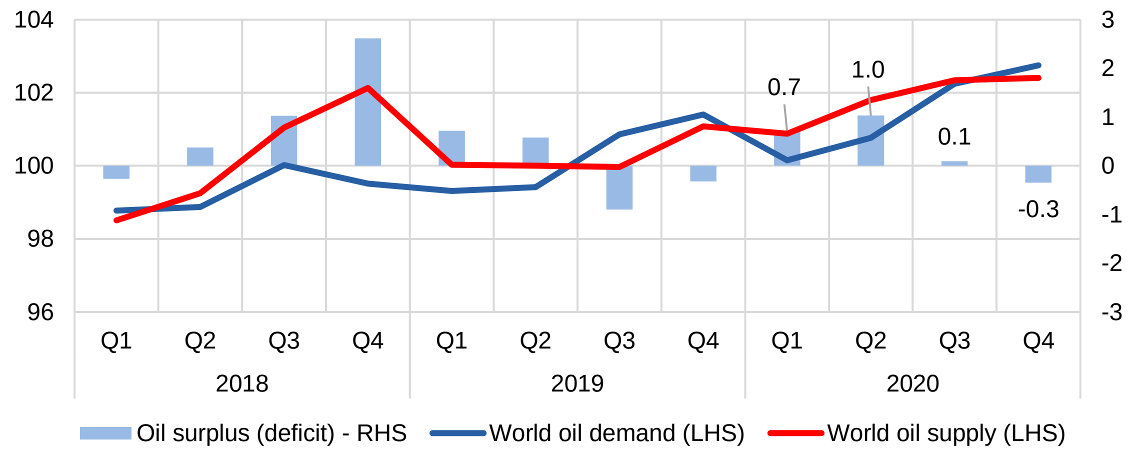
Secondly, the crude oil demand outlook has also been threatened by the recent coronavirus outbreak that has spread from China to around 20 other countries. Disruptions in the supply chain and travel suspensions are expected to weigh on the Chinese economy. In late January 2020, Goldman Sachs said the coronavirus outbreak will likely hit China's economic growth by 0.4 ppt in 2020 while also potentially dragging the US economy. Goldman Sachs forecasts that the outbreak could cut China's oil demand by more than 250,000 barrels per day (bpd) – or 0.025% of total global oil demand – in the first quarter of 2020. In early February, according to Bloomberg and experts knowledgeable about the Chinese energy industry, China's oil demand has dropped by about three million bpd – or 20% of China's total consumption – as coronavirus has impacted the country's economy. Meanwhile, Nomura International Ltd predicts that coronavirus may slash China's GDP growth by more than two ppts from the 6.1% recorded in 2019.

We note that on January 15, 2020, China's Vice Premier Liu He and US President Donald Trump signed the US–China Phase One trade deal in Washington, DC, which could partially help oil price demand.

On the supply side, Saudi Arabia has opened discussion about moving an upcoming policy meeting to early February from March in order to address the impact of coronavirus on crude demand. On December 6, 2019, OPEC and Russia agreed to cut oil production further by 500,000 bpd; this cut is effective from January 1, 2020 to the end of March 2020. The additional cut brings the total production cut agreement to 1.7 million bpd (~1.7% of global supply). In addition, Saudi Arabia has also promised to continue its voluntary cut for an additional 400,000 bpd, bringing the total potential cut to 2.1 million bpd.

We believe that oil prices will remain under negative pressure in H1 2020, not only due to coronavirus, but also due to global oversupply that was projected by the International Energy Agency (IEA) in December 2019.

Figure 3: Global oil supply and demand (mb/d)



Source: IEA's Oil Market Report December 2019

Oil price consensus

Our new 2020F oil price base case is 6.3% lower than the consensus, which we attribute to these oil price forecasts not yet factoring the impact of recent signs of weakening global crude oil demand. Meanwhile, we maintain an oil price of USD65 for the 2021-2024F period as we expect coronavirus to have a short-term impact on global crude oil demand.

Figure 4: Average Brent oil price consensus (USD/bbl)

Institutions	2020F	2021F	2022F	2023F	2024F	Forecasts as of
Bloomberg consensus	63	63	62	66	63	Feb-20
Reuters poll	63					Jan-20
S&P Global Platts Survey	68					Mar-19
International Energy Agency (IEA)	65	68				Jan-20
World Bank	58	59	60			Oct-19
J.P. Morgan	64	60	60	60		May-19
Goldman Sachs	63					Dec-19
Wood Mackenzie	68					Aug-19
Average of consensus	**64**	**63**	**61**	**63**	**63**	
VCSC's old oil price base case	**65**	**65**	**65**	**65**	**65**	
VCSC's new oil price base case	**60**	**65**	**65**	**65**	**65**	
Change (%)	-7.7%	0.0%	0.0%	0.0%	0.0%	

Source: Institutions in table, VCSC

Lower oil prices hurt five oil & gas stocks while benefitting fertilizer, power plant and aviation stocks

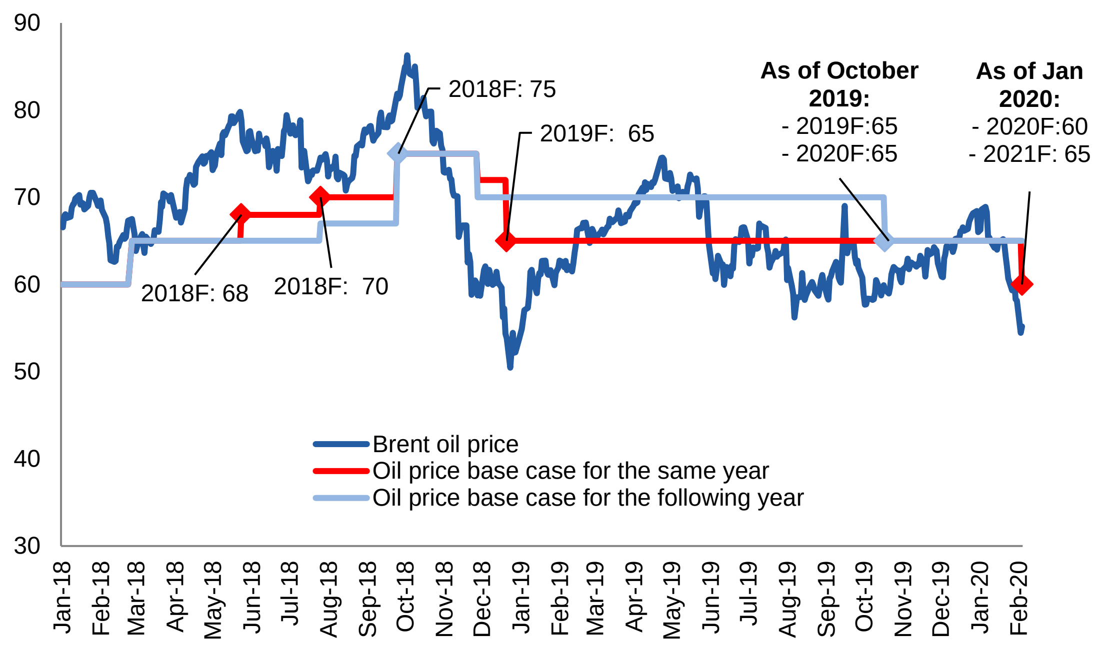
Figure 5: Current target prices and expected impact on companies under our coverage

Ticker	Current target price (VND/share)	Upside/downside risk to our forecast	Explanation
GAS	109,500	Downside risk	Direct impact. Lower oil prices imply lower output gas prices for GAS as output gas prices are linked to fuel oil prices (FO), which have a strong correlation with crude oil prices.
PVD	16,500	Slight downside risk	Indirect impact. Lower oil prices could slow down exploration and production activities and lead to a slower pace of recovery for jack-up day rates.
PVS	25,300	Slight downside risk	Indirect impact. Lower oil prices would affect PVS as it could lower service prices as well as lead to fewer signed contracts. We note that PVS is less linked to oil prices than PVD due to its diversified business portfolio that includes ships, ports, floating oil storage and mechanics & construction, among other business areas.
BSR	11,100	Slight downside risk	Lower input crude oil prices will lead to lower output prices across products, and vice versa. In theory, a change in crude oil prices should not impact BSR; however, high volatility in crude oil prices has previously had a negative impact on BSR. In addition, BSR has a smaller competitive advantage from a reduced difference between domestic and imported gasoline prices. Currently, imported gasoline is taxed 10% while BSR's gasoline is not taxed.
PLX	68,600	Slight downside risk	Theoretically, if oil prices drop, then it will negatively affect PLX due to a lagged effect between 30-day inventory and the 15-day selling price adjustment. However, the impact of oil price volatility also largely depends on the company's ability to manage input sources/inventory. Therefore, we currently foresee slight downside risk.
PVT	21,700	No impact	PVT's exposure to oil prices is limited as its bunker expense is passed through to clients thanks to long-term contracts with BSR.
VJC	160,800	Insignificant upside risk	Fuel costs account for around 40% VJC's total costs. As a result, lower oil prices would have a positive impact on the company's profitability. However, we think the impact of the coronavirus outbreak in China on the airline sector may be a net negative as VJC temporarily shut down routes to destinations in mainland China.
HVN	40,000	Insignificant upside risk	Around 30% of HVN's total costs are jet fuel costs. Therefore, HVN should be a beneficiary of lower oil prices. Nevertheless, temporary cancelations of routes to cities in mainland China as coronavirus may bring a net negative impact to the company.
POW	16,300	Slight upside risk	POW benefits from our lower oil price assumptions, but the impact is limited as 70-80% of Nhon Trach 1 & NT2's sales volume is still contracted with 100% gas costs being passed through to buyers.
NT2	27,200	Slight upside risk	Lower oil and LNG price assumptions have minimal positive impact on NT2 given: (1) 70%-80% of NT2's sales volume in 2020-2023 is still contracted volume with 100% of gas costs being passed through to buyers; and (2) as a lower LNG assumption positively affects NT2's earnings forecast – however, the impact only comes from 2023.
DPM	15,000	Upside risk	Direct impact. Input costs are directly pegged to oil prices, so DPM is positively impacted by cheaper input costs given a lower oil price forecast. However, urea prices are also indirectly influenced by oil prices in the longer term, which should partially offset the impact of lower input costs.
DRC	24,400	Upside risk	DRC's main materials – black carbon and synthetic rubber – account for around 14% and 10% of its total production cost, respectively, and are highly correlated with oil prices. As a result, lower oil prices could help the company to maintain its current high profitability.

Source: VCSC estimates.

Historical oil price forecasts

Figure 6: VCSC's historical oil price base case forecasts (USD/bbl)



Source: Bloomberg, VCSC

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Stock ratings are set based on projected total shareholder return (TSR), defined as (target price – current price)/current price + dividend yield, and are not related to market performance.

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VIET CAPITAL SECURITIES

Contacts

Corporate

www.vcsc.com.vn

Head Office
Bitexco Financial Tower, 2 Hai Trieu Street
District 1, HCMC
+84 28 3914 3588

Hanoi Branch
109 Tran Hung Dao
Hoan Kiem District, Hanoi
+84 24 6262 6999

Transaction Office
10 Nguyen Hue Street
District 1, HCMC
+84 28 3914 3588

Transaction Office
236-238 Nguyen Cong Tru Street
District 1, HCMC
+84 28 3914 3588

Research

Research Team: +84 28 3914 3588
research@vcsc.com.vn

Alastair Macdonald, Head of Research, ext 105
alastair.macdonald@vcsc.com.vn

Banks, Securities and Insurance
Long Ngo, Associate Director, ext 123
- Nghia Dien, Senior Analyst, ext 138
- Anh Dinh, Analyst, ext 139
- Truc Ngo, Analyst, ext 116

Macro
- Luong Hoang, Senior Analyst, ext 364
- Nguyen Truong, Analyst, ext 132

Consumer and Pharma
Phap Dang, Associate Director, ext 143
- Dao Nguyen, Manager, ext 185
- Ha Dao, Analyst, ext 194
- Vinh Bui, Analyst, ext 191

Oil & Gas and Power
Duong Dinh, Senior Manager, ext 140
- Tram Ngo, Senior Analyst, ext 135
- Thanh Nguyen, Senior Analyst, ext 173
- Duc Le, Analyst, ext 196

Real Estate, Construction and Materials
Hong Luu, Senior Manager, ext 120
- Vy Nguyen, Senior Analyst, ext 147
- Duc Pham, Analyst, ext 174

Industrials and Transportation
- Nam Hoang, Senior Analyst, ext 124
- Dang Thai, Analyst, ext 149

Retail Client Research
Duc Vu, Senior Manager, ext 363
- Nghia Le, Analyst, ext 181
- Tra Vuong, Analyst, ext 365
- Trung Nguyen, Analyst, ext 129

Institutional Sales and Brokerage

& Foreign Individuals
Dung Nguyen
+84 28 3914 3588, ext 136
dung.nguyen@vcsc.com.vn

Retail & Corporate Brokerage

Ho Chi Minh City
Quynh Chau
+84 28 3914 3588, ext 222
quynh.chau@vcsc.com.vn

Hanoi
Quang Nguyen
+84 24 6262 6999, ext 312
quang.nguyen@vcsc.com.vn