

SECTOR UPDATE

Oil & Gas – Thailand

Earnings To Recover In 2020; Still Prefer Refinery Plays

Sector earnings should bottom out in 2019 and rise in 2020 on higher GRM due to no maintenance shutdown as well as the IMO2020 implementation. The sector is trading at an undemanding valuation of 11.2x 2020 PE, slightly below its five-year forward core PE mean of 12x PE. We still prefer refinery plays and our top picks are SPRC and TOP. Maintain OVERWEIGHT.

WHAT'S NEW

- Expect Dubai oil prices at US\$55-65/bbl in 2020.** PTT Group expects Dubai oil prices to move within US\$55-65/bbl in 2020 (9M19: US\$63.80). Oil demand has dropped due to the global economic slowdown and higher US crude supply from pipeline capacity expansion but this should be partially offset by lower crude production from the OPEC and some non-OPEC countries. Key factors to watch out for include: a) the resolution of the US-China trade war; b) continued rise in US oil production; c) debottlenecking of the Permian pipeline in the US to be gradually completed from 3Q19 till end-20; and d) geopolitical unrest. We assume Dubai crude assumption of US\$65/bbl in 2020.
- Thai refiners' GRM should be better yoy in 2020.** Gross refining margins (GRM) for Thai refiners should increase yoy in 2020, backed by: a) no planned and unplanned maintenance shutdown; and b) the IMO2020 implementation. Regarding the new IMO2020 regulation to limit sulphur content for all marine fuel starting 1 Jan 20, this should lead to wider diesel margins and narrower high sulphur fuel oil (HSFO) spreads. Some refiners like TOP, PTTGC and ESSO either produce low-sulphur fuel oil (LSFO) by adjusting its crude intake mix to use more light crudes in the process or blend HSFO with diesel. However, refiners like SPRC are maximising gasoline yield. SPRC believes gasoline spread will increase due to limited supply of feedstock that is used to upgrade gasoline products, as the feedstock will be used to produce LSFO instead. Also, SPRC's HSFO products can be turned into bitumen products which will see solid demand from road infrastructure works in the Asia Pacific. Some refiners like BCP and IRPC normally produce LSFO. Note that BCP will have a major maintenance shutdown in Sep 20 for 45 days.

PRODUCTION YIELD FOR THAI REFINERIES

(%)	BCP	ESSO	IRPC	PTTGC	SPRC	TOP
LPG	3	5	5	0	5	4
Platformate	0	13	0	7	0	11
Naphtha	0	0	17	0	0	0
Gasoline	19	17	11	0	24	15
Jet	12	9	5	13	7	23
Diesel	51	37	43	53	35	34
Fuel oil/VGO	15	11	4	15	10	13
Other	0	4	15	10	19	0

Source: Respective companies, UOB Kay Hian

PEER COMPARISON

Company	Ticker	Rec.	Last Price (Bt)	Target Price (Bt)	Upside Downside (%)	Market Cap (US\$m)	PE			CAGR 2018-20 (%)	PEG 2019F (x)	P/B 2019F (x)	Yield 2019F (%)	ROE 2019F (%)
							2018 (x)	2019F (x)	2020F (x)					
Bangchak Petroleum	BCP TB	BUY	23.30	35.0	50.2	1,050	13.0	12.4	7.6	30.8	2.3	0.7	4.5	5.5
Esso (Thailand)	ESSO TB	HOLD	6.85	8.8	28.5	776	10.7	n.a.	5.5	39.7	na	0.9	n.a.	(2.4)
IRPC	IRPC TB	BUY	3.22	4.6	42.9	2,154	8.5	n.a.	9.8	(7.0)	na	0.8	5.3	(0.2)
Indorama Ventures	IVL TB	BUY	31.25	46.0	47.2	5,743	6.6	18.5	8.1	(9.8)	(0.3)	1.1	2.6	6.1
PTT	PTT TB	BUY	43.25	58.0	34.1	40,437	10.5	12.7	11.8	(6.0)	(0.7)	1.2	4.6	7.0
PTTEP	PTTEP TB	BUY	117.00	175.0	49.6	15,204	12.8	9.9	9.8	14.5	0.3	1.1	4.5	11.3
PTTGC	PTTGC TB	HOLD	51.75	55.0	6.3	7,638	5.8	16.5	10.8	(26.7)	(0.3)	0.8	2.7	4.6
Siam Cement	SCC TB	HOLD	384.00	370.0	(3.6)	15,083	10.3	13.4	13.6	(12.8)	(0.6)	1.6	3.9	10.3
Star Petroleum Refining	SPRC TB	BUY	9.40	14.0	48.9	1,334	18.0	32.4	6.8	63.2	(0.7)	1.1	1.9	3.3
Thai Oil	TOP TB	BUY	67.00	81.0	20.9	4,474	13.5	23.8	10.8	11.8	(0.5)	1.1	1.8	4.5
Vinythai	VNT TB	BUY	23.50	30.7	30.7	912	9.1	8.0	6.4	19.5	0.6	1.3	5.0	17.7
						94,805	10.4	13.4	11.2			1.2	4.0	7.6

Source: UOB Kay Hian

OVERWEIGHT

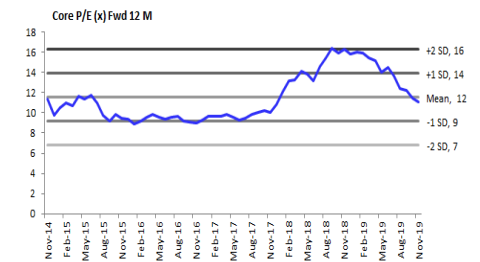
(Maintained)

STOCK PICKS

Company	Rec	Share Price (Bt)	Target Price (Bt)
SPRC	BUY	9.40	14.00
TOP	BUY	67.00	81.00

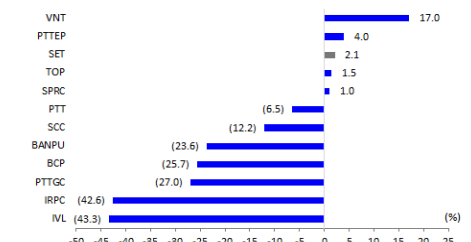
Source: UOB Kay Hian

O&G SECTOR – FORWARD CORE PE BAND



Source: Bloomberg, UOB Kay Hian

SHARE PRICE PERFORMANCE (%YTD)



Source: Bloomberg, UOB Kay Hian

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- PE outlook remains challenging.** There will be new polyethylene (PE) supply in Southeast Asia, coming mainly from Petronas' RAPID project with PP capacity of 900,000 tonnes/year and high-density polyethylene (HDPE) of 400,000 tonnes/year which will start commercial run in 4Q19. The uncertainty from the US-China trade tension is also another factor pressuring HDPE spread. However, the downside risk for HDPE spread should be limited as the spread is now below naphtha cracker's cash cost (US\$350-400/tonne). Producers of high-cost naphtha are likely to cut their operating rates. PTT Group expects HDPE spread at US\$440-550/tonne in 2020 vs the current US\$303/tonne.
- Poor aromatics spread to continue.** The market believes the aromatics market will remain weak in 2020 due to huge capacity addition in the Asia Pacific and the Middle East (eg Zhejiang unit#2 and Aramco). New paraxylene (PX) supply in 2020 is expected to rise by 9.1m tpa (2019: +6.4m tpa) vs.0.9m tpa of PX demand in 2020 (2019: +2.2m tpa). New benzene (BZ) supply, should increase by 3.3m tpa in 2020 (2019: +2.2m tpa) vs 1.2m tpa of BZ demand (2019: +1.5m tpa). With the current PX spread over gasoline at US\$124/tonne, producers of high-cost PX are likely to cut their operating rates as the spread is now below the breakeven cost of US\$150-170/tonne.
- Expect minimal impact from TFRS 9 and TFRS 16.** All Thai companies must adopt the new accounting standard TFRS 9 (related to financial instruments to measure derivatives at fair value) and TFRS 16 (related to lease transaction) starting 1 Jan 20. TFRS 16 has more impact on the financials of every O&G company. Under TFRS16, the lessee needs to recognise assets and liabilities for all leases on its balance sheet, resulting in a higher debt-to-equity ratio. Depreciation cost related to the lease assets and interest cost on the lease liability is also booked in. We preliminarily assume the impact from both accounting standards on O&G's earnings should be limited.

ACTION

- Maintain OVERWEIGHT.** The O&G sector is now trading at undemanding valuation of 11.2X 2020 PE, slightly below its five-year forward core PE mean of 12x. Among O&G stocks, we prefer refinery stocks as we expect them to see better GRM in 2020, thanks to the IMO2020 implementation to drive gasoline and diesel spreads. Our top picks for refiners are Star Petroleum Refining (SPRC TB/BUY/Target: Bt14.00) and Thai Oil (TOP TB/BUY/Target price: Bt81.00).

Star Petroleum Refining (SPRC TB/BUY/Target: Bt14.00)

- During the maintenance shutdown in 4Q19, SPRC will remove the bottleneck and introduce other productivity enhancements to the refinery, which will raise its refinery capacity by 10% to 175kbd from Jan 20. After restarting the refinery in Jan 20, SPRC guided operating cost would be lower at US\$1.80/bbl vs US\$1.95/bbl currently. Utilisation rate should be back to 100%. We expect SPRC to post core profit of Bt6.0b for 2020.
- Maintain BUY and target price of Bt14.00,** based on 10x 2020F PE, which is at a discount to regional peers (SPRC is a pure refinery). Our target price implies 1.4x 2020F P/B, or its 4-year historical P/B mean. SPRC is now trading at only 0.9x 2020F P/B. Note that we also expect an impressive dividend yield of 7.4% for 2020.

Thai Oil (TOP TB/BUY/Target price: Bt81.00)

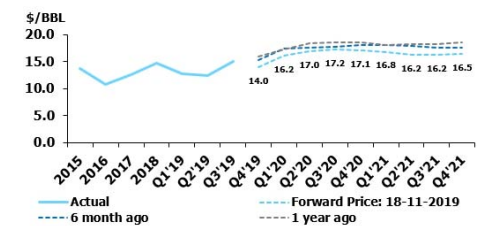
- We expect core profit to soar 196% yoy to Bt12.7b in 2020 due to the stronger GRM backed by the positive impact from the IMO2020 as well as an absence of major maintenance shutdown at its refinery and aromatics plant in 2020.
- Maintain BUY and target price of Bt81.00,** based on the regional refinery sector's 5-year PE mean of 13x. TOP remains one of our top picks in the O&G segment as it is one of the key beneficiaries of IMO2020. The stock is trading at an undemanding 10.8x 2020F PE vs the regional mean of 13x.

PRICES AND SPREADS DATA AND ASSUMPTIONS

	4Q18	9M19	4Q19 (qtd)	UOBKH 2019F	2020F
Brent price (US\$/bbl)	68.6	64.8	60.6	69.3	71.7
Dubai price (US\$/bbl)	67.4	63.8	59.4	65.0	65.0
Refinery (US\$/bbl)					
Gasoline spread	4.7	7.6	15.0	8.0	9.0
Jet spread	15.6	13.6	14.8	14.0	17.0
Diesel spread	14.8	13.5	15.1	14.0	17.0
Fuel oil spread	1.3	-0.3	-15.8	-4.0	-14.0
Aromatic Spread (US\$/tonne)					
PX - ULG95	528	325	152	280	150
BZ - ULG95	81	22	3.2	40	60
PX - Condensate	569	383	270	360	360
BZ - Condensate	115	87	120	75	75
Olefins (US\$/tonne)					
HDPE Price	1,207	1,041	865	1,000	950
HDPE Spread	639	511	345	480	430
PP Price	1,215	1,118	1,073	1,108	1,108
PP Spread	647	600	554	588	588

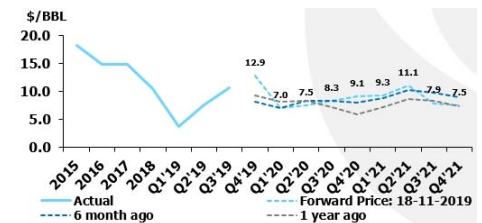
Source: Bloomberg, UOB Kay Hian

FORWARD CURVE GAS OIL 500PPM SPREAD



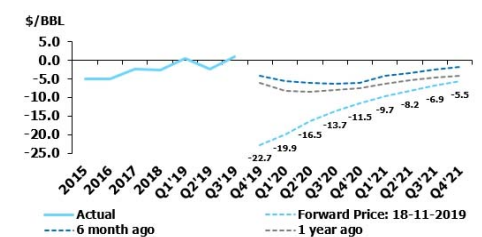
Source: TOP, UOB Kay Hian

FORWARD CURVE GASOLINE SPREAD



Source: TOP, UOB Kay Hian

FORWARD CURVE HIGH SULPHUR FUEL OIL SPREAD



Source: TOP, UOB Kay Hian

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