PRESS RELEASE

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Upstream producers continue to bleed as domestic gas prices remain low: ICRA

- ***Domestic gas price remains at its lowest level since the institution of the modified Rangarajan formula***
- ***Gas production remains a loss-making proposition for most fields for the Indian upstream producers***

The domestic gas price notified at $1.79/mmbtu (GCV basis) for the period H1 FY2022 remains the lowest since the institution of the modified Rangarajan formula. While this is unfavourable for domestic producers, it will benefit gas consumers. The consumers will also benefit in the long run from the expectations of continued supply overhang. As per an ICRA note, at such low gas prices, gas production remains a loss-making proposition for most fields for the Indian upstream producers notwithstanding some decline in oil field services/equipment costs. However, the depreciation of Indian Rupee (INR) against US$, would aid the realisations of the gas producers but only to an extent.

Elaborating further, **Mr. Sabyasachi Majumdar**, Senior Vice-President & Group Head, Corporate Sector Ratings, ICRA, said, *"Going forward, the supply glut is expected to keep prices of domestic gas low in the near to medium term leading to poor returns even as domestic gas producers such as ONGC and RIL-BP ramp up gas production significantly. The absence of a floor and sustained low prices as has been seen in the past few years post implementation of the modified Rangarajan formula make exploration and production unviable even for benign geologies. Accordingly, low natural gas prices remain negative for the Upstream sector adversely impacting revenues, profitability and cash accruals and the incumbents have petitioned the GoI to provide a floor price for gas prices."*

Spot LNG prices had breached $30/mmbtu in February 2021 due to increase in oil prices, unplanned outages at export facilities in several countries, multiple cold waves, high shipping rates and delays in the Panama canal. Though spot prices have come down to $6-6.5/mmbtu levels however low inventory levels as winter ends are set to support prices, as well as demand, as North Asia and Europe look to refill gas storage. Nevertheless, the supply overhang remains with about 37.6 MTPA liquefaction capacity added in 2019 and 27.8 MTPA in 2020, besides which capacity additions till 2025 would be in excess of incremental demand which will weigh on gas prices.

Additionally, the ceiling on price for gas produced from deep water, ultra deepwater, high temperature and high-pressure fields has also been announced at $3.62/mmbtu for the period H1 FY2022 which is 10.8% lower than the price ceiling of $4.06/mmbtu for the period H2 FY2021 which would dampen the development of such projects.

From the consumers' perspective, the low domestic gas price is a positive. The continuation of the low domestic gas prices would lead to a competitive cost of generation for the domestic gas-based power generation projects. Given the cost-plus nature of the PPAs tied-up by the gas-based power projects, the benefit is expected to be passed on to the customers, mainly the state distribution utilities (discoms). However, the extent of the benefit would be limited for the discoms, given the subdued utilisation of the gas-based power plants in the country with annual average PLF of 22-25% for the gas-based capacity at all India level, amid the inadequate supply of domestic natural gas. During 11M FY2021, the gas supply from domestic sources remained low at 22% of the allocated quantity for gas-based power generation units as per the data from Central Electricity Authority. Moreover, with the uptick in spot LNG prices, the spot LNG consumption by gas-based power projects has reduced from the 11.85 MMSCMD in October 2020 to 2.62 MMSDCM in February 2021. For every US$ 1 /mmbtu variation in gas price, the cost of generation would vary by 60-65 paise per unit for gas-based power generation projects at prevailing rupee dollar exchange rate.

For the fertiliser sector, nearly 36% of the gas requirement of the fertiliser sector is met through domestic gas while the remaining is met through R-LNG imports. Moreover, the industry is supplied gas at pooled pricing, which takes into account the weighted average of the domestic and R-LNG prices. With no change in the domestic gas price, the pooled gas price will not witness any upward bias although term LNG prices have risen over the last couple of months with the strengthening of the crude oil prices. However, the overall pool price is expected to remain in the range of $9.5-10/mmbtu for FY2022 if the crude oil prices sustain at current levels. As per ICRA estimates, for every $1/mmbtu rise in the pooled price, the subsidy requirement for the urea sector rises by around Rs. 4500-5000 crore. With pooled prices at these levels, the subsidy budget for the urea sector will be adequate to meet the subsidy requirement for urea in FY2022.

As regards the impact on the city gas distribution (CGD) sector, **Mr.Prashant Vasisht**, Vice President and Co-Group Head, Corporate Ratings, commented "*Sales volumes for CGD players have reached pre-Covid levels in Q4FY2021 supported by strong growth in CNG volumes. This has been supported by resumption in economic activity as well as the rising prices of auto-fuels which have resulted in higher preference of CNG vehicles. Commencement of new CNG stations in recently awarded cities is also contributing to growth. Amidst all this, the continuation of low gas prices is a positive. CGD players are likely to keep prices unchanged for their CNG and domestic PNG consumers. The benefit for these end consumers from conversion economics perspective remains intact. In fact it has only improved in recent months as auto-fuel prices have increased significantly which gas prices have remained stable. At current prices, the payback for petrol vehicle conversion to CNG is 6-7 months. Further, PNG (domestic) would continue to be cheaper than LPG by about 35-40% in terms of energy cost and thus maintain its competitiveness*."

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