Gas Pricing Recommendation: Legacy-Field Gas Producers may lose ₹23k cr in FY24

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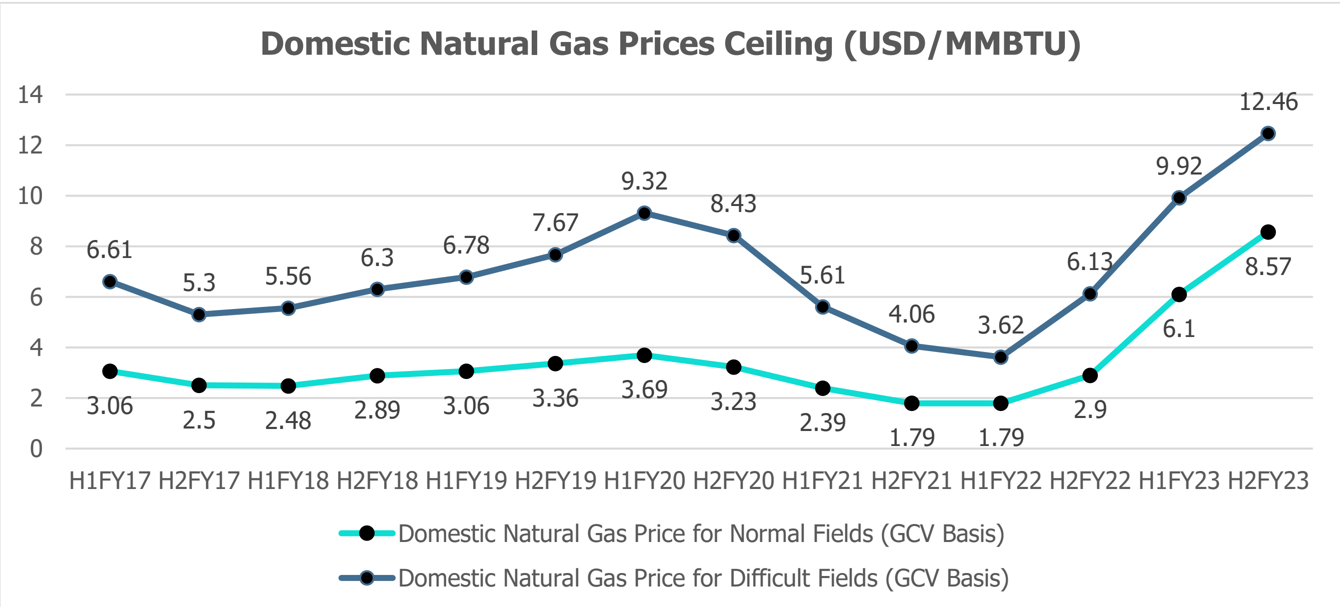
Synopsis

In this report, CareEdge Ratings has analysed the impact of revision in the domestic gas pricing formula basis the recommendations of the Kirit Parikh committee released today.

- CareEdge Ratings believes recommendations of the Kirit Parikh committee as a great balancing act to safeguard the interest of gas consumers, city gas distribution companies and gas producers from difficult fields.
- It shall boost the use of natural gas and shall help the Government to contain high inflation.
- Free pricing of domestic gas from difficult fields would attract sizeable investment from upstream companies which could lead to higher domestic gas production in the long run.
- However, producers of domestic gas from legacy fields under APM pricing mechanism may stand to lose around ₹23,000 cr in FY24.

Sharp Increase in Natural Gas Prices as per the existing formula

Prices of domestically produced natural gas as per the existing formula are decided on a half-yearly basis by the New Domestic Natural Gas Pricing Guidelines, 2014, issued by the Ministry of Petroleum and Natural Gas (MoPNG). The pricing formula takes into consideration the volume-weighted average price of natural gas for the trailing twelve months with a gap of one quarter from the four sources in international hubs i.e., Henry Hub (USA & Mexico), Alberta (Canada), National Balancing Point (European Union) and Russian natural gas.

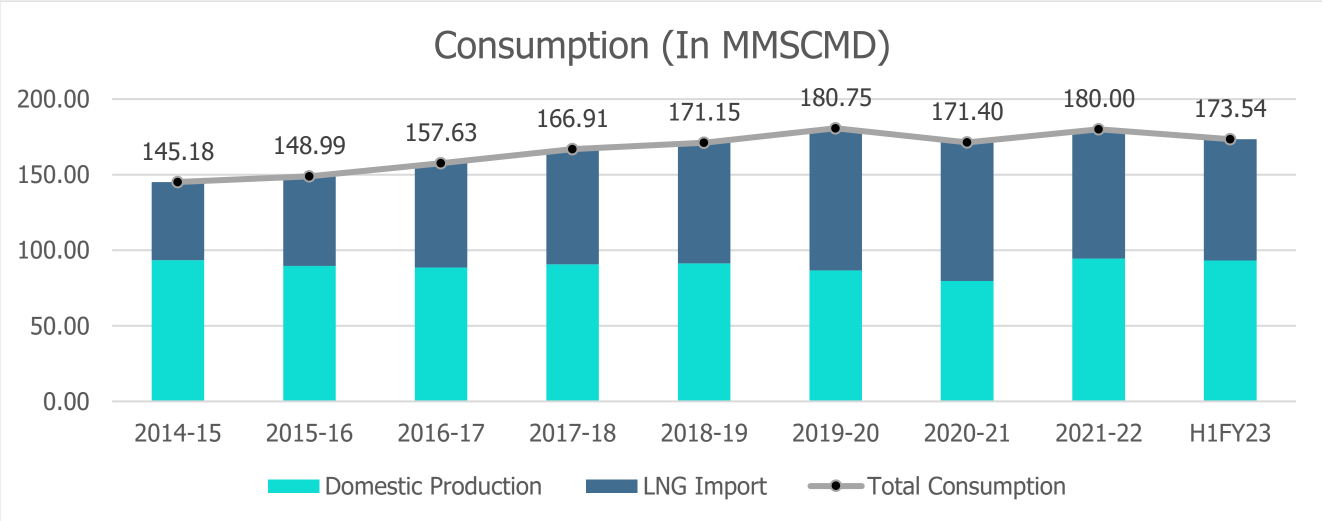


Source: Petroleum Planning and Analysis Cell; mmBtu: metric million British thermal units

Till FY22, prices of domestic natural gas basis the existing formula was moving largely in tandem with crude prices. However, prices of domestic natural gas surged significantly for H1FY23 & H2FY23 which was mainly because of a sharp increase in natural gas prices in the global markets on the back of economic recovery post-pandemic and short supply of natural gas by Russia due to the Russia-Ukraine war situation. The natural gas prices in the spot market went up to even more than $60/mmbtu at times in H1FY23 breaching its correlation with crude prices. In turn, prices of natural gas in India for domestic production also went up significantly without a correspondingly similar increase in exploration and production costs. It resulted in supernormal profits for gas producers on one side whereas it led to high inflation, demand for natural gas was impacted by industries and Govt.'s subsidy budget for the fertilizer sector went up. Accordingly, to balance the impact on both producers and consumers, necessitated the formation of the Kirit Parikh committee to review the pricing mechanism for domestically produced natural gas.

Domestic Gas Production, Imports & Consumption

Historically, India's consumption of natural gas has been significantly higher than its domestic production. The difference is met through imports. In FY22, the total consumption of natural gas in India stood at 180 million standard cubic metre per day (MMSCMD), of which 95 MMCMD was met through domestic production and 85 MMSCMD through imports. During FY22, domestic production of natural gas improved upon the commencement of production by Reliance and BP from some of their discoveries in the KG-D6 block. Further, around 12 MMSCMD of additional natural gas from the MJ field in the KG -D6 block is likely to be available by the end of FY23, which could further improve India's domestic natural gas production in FY24. For India's total domestic production in FY22, the majority of producers were ONGC, Oil India Limited, Reliance and Vedanta.



Source: PPAC

There had been growing consumption of natural gas in India over the past many years. Domestic consumption moderated in FY21 due to the pandemic and again got impacted in H1FY23 due to high prices wherein industrial consumers started to switch to alternate fuels. Going forward, demand for natural gas in India is expected to increase significantly on the back of the large size of capex undertaken by city gas distribution companies.

Key recommendations of Kirit Parikh committee

- Domestic gas produced from legacy fields where the cost has long been recovered should have a floor price of $4/mmbtu and a cap price of $6.50/mmbtu
- Pricing of gas from such legacy fields should be linked to crude and above-said floor and the cap should apply
- Pricing of gas from such legacy fields should be under free pricing w.e.f. January 01, 2027
- Existing pricing mechanism should continue for the domestic gas production from difficult fields with a price cap being decided on a half-yearly basis
- Pricing of gas from difficult fields should also be under free pricing w.e.f. January 01, 2026

CareEdge Ratings' View

Basis the recommendations of the Kirit Parikh committee, the price of domestic natural gas from legacy fields would be linked to crude prices with an applicable floor of $4/mmbtu and cap of $6.50/mmbtu. CareEdge Ratings expects, according to the existing formula, the price of domestic gas would otherwise have been at $10/mmbtu for FY24. The revision in the pricing mechanism is likely to result in a lower realisation of at least $3.50/mmbtu for domestic gas production from legacy fields. Accordingly, CareEdge Ratings believes that domestic gas producers of legacy fields could have the lower realisation of natural gas to the extent of ₹23,000 crore in FY24.

"The revised pricing formula suggested by the committee is expected to be more prudent wherein prices of natural gas would be linked to crude and in turn to the cost of production. Also, it would ensure full recovery of exploration costs even in the scenario of depressed gas prices in the international market. Keeping the difficult fields out of the purview of the revised gas pricing mechanism and allowing free pricing should attract sizeable investment in the sector. Further, it would help to contain high inflation and improve demand for gas from the industries. The revision is likely to be well accepted by upstream gas producers similar to the windfall tax imposed on locally-produced crude. However, this policy change could impact the producers of gas from legacy fields" said Hardik Shah, Director, CareEdge Ratings.

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