April 7, 2023

Domestic gas prices set to be revised downwards

The Government of India has accepted several key recommendations made by the Kirit Parikh Committee with respect to the pricing of natural gas produced from APM fields (that are legacy fields and largely held by PSUs like ONGC). With the implementation of this pricing, APM gas prices would be subjected to a floor and ceiling price of US$4/mmbtu and US$6.5/mmbtu, respectively (earlier APM price being US$8.57/mmbtu). The pricing formula for HPHT fields like that of Reliance Industries has not been changed while the price for April 1-October 1, 2023 is at US$12.1/mmbtu (from US$12.5/mmbtu earlier). Prima facie, the step would be beneficial for domestic gas consuming companies like IGL and MGL (80%, 85% volumes sourced from APM, respectively), while GGL would benefit up to a limit (~25% of volumes largely sourced from APM). On the other hand, upstream companies would see immediate correction in their realisation although they still remain above historical averages. The new gas pricing will come into effect from April 8, 2023.

Improvement in cash flow certainty in oil & gas companies

- The APM gas price for October 1, 2022 to April 1, 2023 was US$8.57/mmbtu. Earlier, these prices were determined on a bi-annual basis in October and April based on the weighted average natural gas prices of the US, Canada, Russia and the UK. Going by this formula, due to the geopolitical conflict prices were anticipated to rise to US$10-11/mmbtu. This would have led to an increase of ₹ 4-7/scm in sourcing cost for CGDs, which would have further impacted their margins and volumes
- Under the new pricing mechanism, the pricing of gas will be linked to 10% of India's average monthly crude import basket. There would also be a floor price of US$4/mmbtu and a ceiling price of US$6.5/mmbtu. This pricing would be in place for another two years after which the floor and ceiling would increase by US$0.25/mmbtu per year. The prices will now be revised every month, going forward, instead of bi-annual revision. With this pricing coming into effect, we expect sourcing costs to go down by at least ₹ 6/scm
- The step would ease pressure on CGDs as their margins were impacted by earlier sharp rise in domestic gas prices. The move is more positive for IGL and MGL as their segmental revenues are dominated by CNG and domestic PNG volumes, which are prioritised for the use of APM gas. The cash flow certainty for these companies would also improve, going ahead
- Gujarat Gas is also likely to benefit even though this sector contributes only ~25% of its volumes. Its industrial and commercial PNG segment (~75%) uses LNG gas, whose prices have fallen from highs of US$35/mmbtu in Q3 to lows of US$13/mmbtu in Q4. Along with this, the increase in crude prices would make gas a preferred choice to alternate fuels like LPG, which help the company gain its industrial/commercial consumers
- On the upstream front, a revision in gas prices would reduce both ONGC and Reliance Industries' gas realisation when compared to the previous six months but is still remarkably higher than what they were earning historically. This pricing mechanism would provide stability to their realisations as well

Source: PNGRB, ICICI Direct Research

Recent event & key risks

- **Key Risk:** (i) Lower than expected volume growth (ii) Sharp fall in crude oil prices

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Sector Update

ICICI Securities – Retail Equity Research

Valuation and Outlook

We maintain **BUY** rating on IGL at ₹ 550/share (i.e. 17x P/E on FY25 EPS and ₹ 50 for its investments). Similarly, for MGL, we maintain our **BUY** rating with a target price of ₹ 1180/share i.e. ~14x P/E on FY25E EPS. We revise our rating on Gujarat Gas from HOLD to **BUY** with a target price of ₹ 550 i.e. 18x P/E on FY25E EPS. For upstream companies, we maintain our **BUY** rating on ONGC with a target price of ₹180 (i.e. ₹150 for core oil & gas business and ₹ 30 for its subsidiaries and other investments). Similarly, for Reliance Industries, we maintain our **BUY** rating with a target price of ₹ 3050 on an SoTP basis.

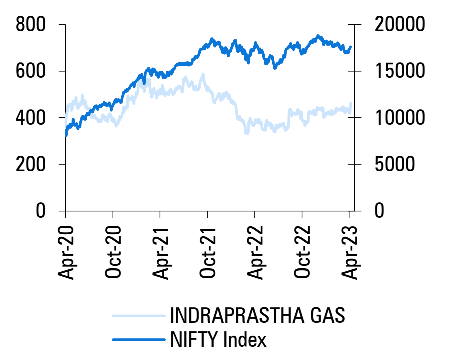
Exhibit 1: Valuation

Company	Rationale	CMP	Target Price	Upside	Rating
ONGC	The decline in APM prices would reduce ONGC's net realisation by US$2/mmbtu (₹6/scm) but would still continue to remain above historical averages.	151	180	19%	BUY
Reliance	The decline in HPHT prices on Apr 1st would reduce RIL's net realisation by US$0.35/mmbtu (₹1/scm) but would still continue to remain above historical averages.Also, as per media sources, currently there has been no mention of giving marketing freedom to its gas pricing which was also a key recommendation made by KPC	2,340	3,050	30%	BUY
IGL	Revision in gas pricing would reduce IGL's gas sourcing cost by ₹6/scm. Assuming the company passes on this benefit to the customers, we expect their volumes to grow going ahead.	463	550	19%	BUY
MGL	This new prcicing would reduce MGL's gas sourcing cost by ₹6/scm. The company has already announced a ₹2.5/kg cut in its CNG price. Assuming the company continues to pass on this benefit to the customers, we expect their volumes to grow going ahead.	980	1,180	20%	BUY
Gujarat Gas	Gujarat Gas is also likely to be benfited from this price revision to a certain extent, but the company being a key beneficiary of decline in LNG prices and increase in crude prices, we expect its industrial volumes to increase going forward.	465	550	18%	BUY

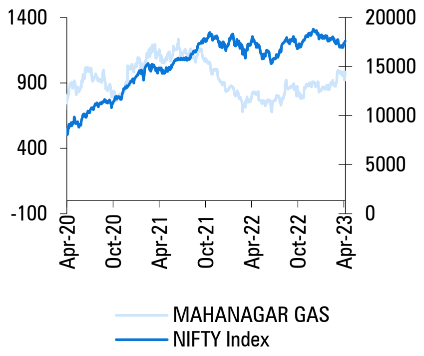
Source: Company, ICICI Direct Research

Exhibit 2: Price Charts

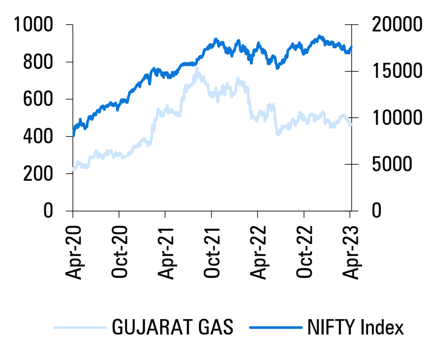
Price Chart (IGL)



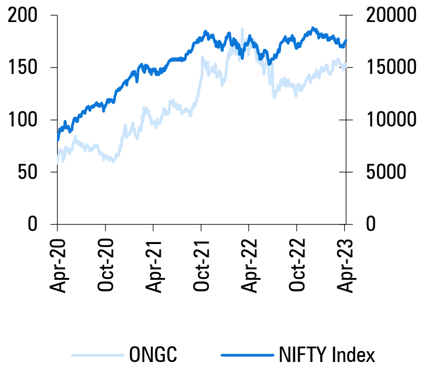
Price Chart (MGL)



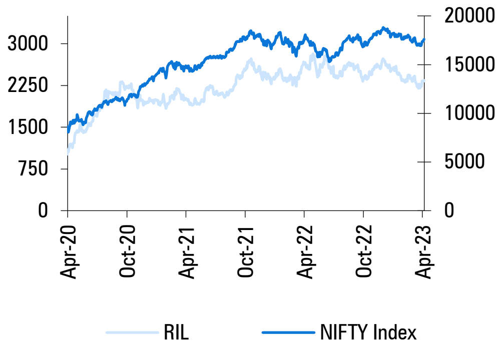
Price Chart (Gujarat Gas)



Price Chart (ONGC)



Price Chart (Reliance Industries)



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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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