

Kirit Parikh committee's recommendations on gas pricing

Positive for upstream companies, negative for CGDs

- The Kirit Parikh Committee has recommended a dynamic ceiling and a fixed floor for current gas production from the APM fields of ONGC and OINL. The floor has been fixed at USD4/mmBtu. The first ceiling has been set at USD6.5/mmBtu. The ceiling is to be raised by USD0.5/mmBtu annually.
- Around 10% of last month's Indian crude basket will be priced similar to the current production of APM gas.
- The recommendations will raise gas prices for the CNG segment of companies and will hence be negative. ONGC and OINL will be guaranteed a minimum USD4/mmBtu for their APM gas. This provides a big relief to ONGC and OINL as they had to produce gas below the cost of production for quite a long time. The recommendations will be positive for ONGC and OINL and negative for CGDs like IGL and MAHGL, which will be the most adversely impacted.

Background

- As a result of ongoing European crises, domestic APM gas price has risen to USD8.6/mmBtu for Oct'22-Mar'23 period.
- CNG turned expensive in a few cities as compared with dirtier alternate fuels like petrol and diesel. To encourage the shift to CNG (a cleaner fuel), the government had constituted the Kirit Parikh Committee to relook into the pricing mechanism of domestic APM gas.
- Its recommendations have been made public on 29th Nov'22, with a dynamic ceiling of USD6.5/mmBtu (and an annual escalation of USD0.5/mmBtu) and a fixed floor of USD4/mmBtu.

Recommendations

- In addition to the floor and ceiling and pricing mentioned above, the committee has recommended a 20% premium for production from a new well or well intervention in nominated fields. It has also suggested marketing freedom for this incremental gas.
- The benefit of the decrease in APM gas price is to be passed on to consumers. Hence, the margin of CGDs may not rise as a result of this reduction.
- The committee has retained priority for CNG and domestic PNG. However, it has also recommended that the government develop a staggered plan for exiting priority allocation. It has championed full deregulation of APM prices by 1st Jan'27, if global volatility moderates.
- It has recommended a floor to the ceiling price for HPHT gas, which equals the dynamic ceiling of APM gas. Complete marketing and pricing freedom has been advocated by Jan'26.
- The committee has also recommended bringing gas under the GST regime.

Valuation and view

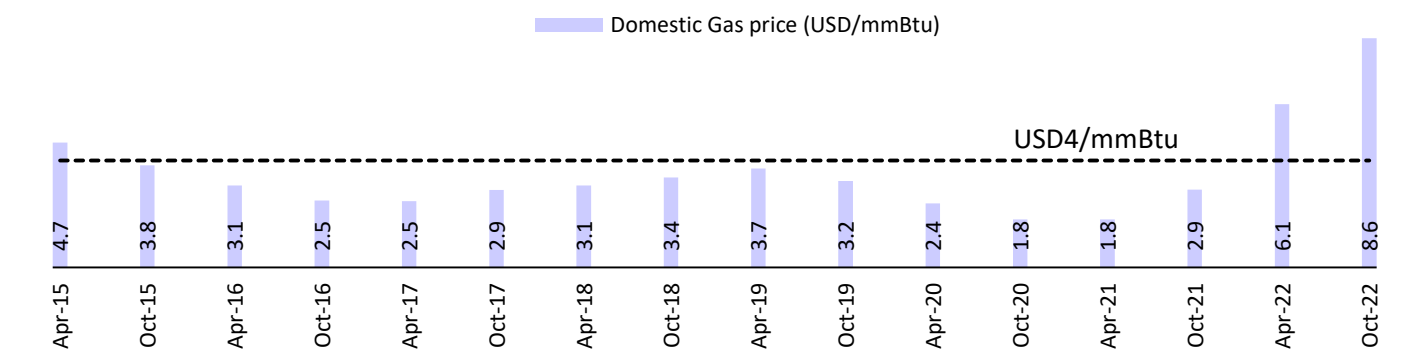
- In the current pricing mechanism, domestic APM gas prices have been largely below USD4/mmBtu, due to the higher weightage of the cheaper Henry Hub in the current formula. Domestic gas prices were higher than USD4/mmBtu in only three out of a total of 16 periods.
- If the recommendations are implemented, then the minimum APM cost will be raised to USD4/mmBtu. In the current regime, if there were no geopolitical risks, CGDs would have witnessed lower prices. With a decline in oil prices, auto fuel prices will also come off. Domestic APM blended with other higher cost gases for the shortfall may not provide significant savings against auto fuels.
- As a result, we reiterate our Neutral stand on IGL with a TP of INR406. The threat posed by EVs to the long-term growth potential of the company poses a huge risk to its valuation. We reiterate our Buy call on MAHGL, given its attractive valuations. GUJGA remains our preferred pick due to its higher industrial exposure.
- The floor is a much needed reprieve for ONGC and OINL as they had to sell gas below cost when domestic APM gas prices were low. A USD1/mmBtu change in gas price changes ONGC's consolidated EBITDA by ~INR45b (4% FY23E EBITDA). Similarly, a USD1/mmBtu change in gas price changes OINL's standalone EBITDA by INR4b (4% FY23E standalone EBITDA). We reiterate our Buy rating on both companies, valuing ONGC/OINL at INR192/INR244 per share.

Exhibit 1: Valuation snapshot for Gujarat Gas, Indraprastha Gas, Manhanagar Gas, ONGC and OINL

Company	Reco	TP (INR)	EPS (INR)			P/E (x)			P/BV (x)			EV/EBITDA (x)			ROE (%)			Div. Yield FY23E
			FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	
ONGC	Buy	192	39.9	51.2	63.8	3.5	2.8	2.2	0.7	0.6	0.5	3.3	2.2	1.4	21.3	23.6	25.4	2.3
Oil India	Buy	244	34.4	61.2	63.8	5.9	3.3	3.2	0.8	0.7	0.6	6.3	3.2	3.1	13.9	21.7	20.0	7.0
Gujarat Gas	Buy	583	18.8	19.8	20.8	26.5	25.2	24.0	6.1	5.0	4.2	16.7	15.4	14.3	25.8	22.0	19.2	0.4
Indraprastha Gas	Neutral	406	18.8	19.8	20.2	23.5	22.3	21.8	4.5	3.9	3.5	15.4	13.3	13.3	26.2	18.7	16.8	1.2
Mahanagar Gas	Buy	1,025	60.4	67.6	73.2	14.9	13.3	12.3	2.5	2.2	2.0	9.1	7.3	6.7	17.5	17.6	17.2	2.6

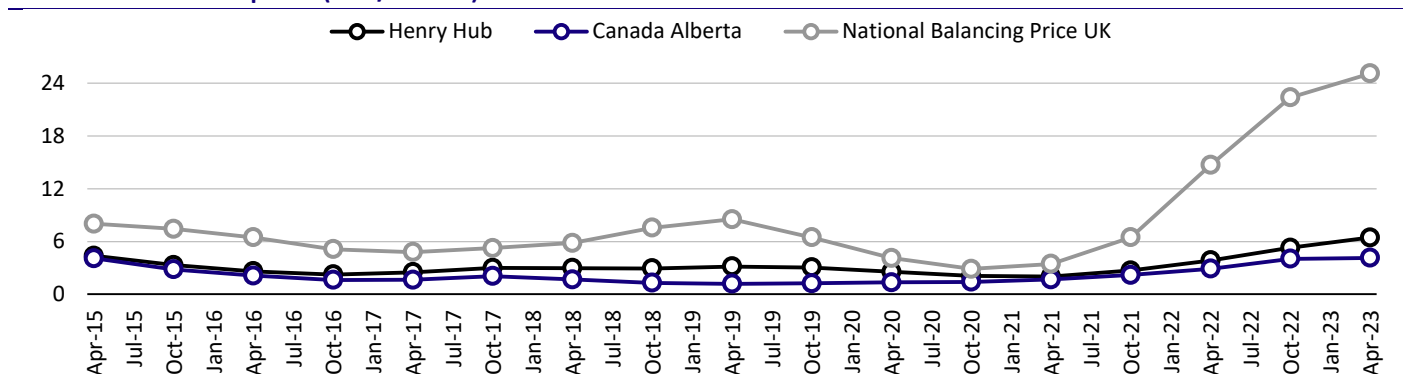
Source: MOFSL

Exhibit 2: Domestic APM price history



Source: MOFSL

Exhibit 3: Benchmark prices (USD/mmBtu)



Source: MOFSL

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
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