Press Release
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Margins outlook mixed for FY2022 across the oil and gas sector value chain; however, strong recovery in volumes likely: ICRA

The domestic demand for petroleum products was hit hard by the lockdowns, which led to demand crashing to 40-50% of pre-Covid levels. However, demand for most fuels has been increasing with the easing of the lockdowns, the onset of the festive season and the revival of economic activity. In FY2022 the demand for petroleum products is expected to increase at a heathy rate of 8-10% vis-à-vis FY2021 with the growth in economy and pick-up in industrial activity. While growth is expected in MS consumption due to preference for personal mobility, HSD and industrial fuel growth is expected to be driven by a pick-up in the industrial activity and growth in the economy. ATF demand is expected to lag due to the discretionary nature and the perceived risk of air travel.

According to **Mr. Prashant Vasisht, Vice President and Co-Head, Corporate Ratings, ICRA Ltd:** *"Though refinery capacity utilisation levels are recovering and were 89% in October 2020, refining margins remained weak due to the global supply overhang. Going forward in FY2022 the refinery margins are expected to remain low owing to significantly lower ATF demand vis-à-vis pre-Covid levels. Even though there have been announcements of the closure of a number of refineries in CY2020 in the US, Europe and Asia, weak refinery economics are expected to be protracted. The gross under-recoveries are expected to be moderate at Rs 15 billion in FY2022 (at average Indian crude basket price of $60/bbl and exchange rate of INR/$ of 76). Low gross under-recovery levels and moderate crude oil prices should lead to lower working capital borrowings and interest costs. Additionally, the GoI's divestment of BPCL would be a key monitorable to determine the future competitive dynamics in the refining and marketing sector."*

Gas utilities sector entities' volumes were impacted up to 30-50% during the lockdown, however, these have recovered to almost pre-Covid levels now. The domestic demand for natural gas is expected to grow by ~10% YoY in FY2022. Gas consumption would increase as more and more CGD GAs ramp up as the initial infrastructure building phase nears completion, new fertiliser plants are commissioned, and new customers are connected to the gas grid owing to expansion in the pipeline network. ICRA expects the City Gas Distribution (CGD) entities to report healthy growth in volumes on the back of the GoI's push for increasing penetration of CGD networks and provision of domestic gas for the CNG and PNG(d) segments. However, some of the new pipelines are also expected to be sub-optimally utilised in the initial years owing to lack of adequate volumes. The margins of gas utilities entities are expected to remain healthy in FY2022 owing to the regulatory protection or dominant competitive position of most entities in this sector. The Unified Tariff regime implemented by the PNGRB will be revenue neutral for the natural gas pipeline operators but reduces tariff paid by far off consumers.

The domestic gas prices, as governed by the modified Rangarajan formula, are currently at $1.79/mmbtu for H2 FY2021 and have remained below the cost of production of the upstream companies for many years. At such low prices, gas production remains a loss-making proposition for even benign geologies. Accordingly, a fervent demand of the upstream industry is the provision of a floor for the gas prices. However, the average crude oil realisations for upstream producers should be significantly higher than FY2021, owing to higher demand and active management of supplies and production by OPEC+. The production of crude oil is expected to remain stagnant or decline marginally in FY2022 but gas production is expected to increase significantly owing to the commercialisation and ramp up of new fields such as ONGC and RIL-BP's KG Basin fields.

Capex and investments are expected to be healthy in FY2022 as companies make up for the time lost due to restrictions and lockdowns in FY2021. Additionally, a clearer outlook on demand and prices and a greater impetus for local manufacturing under Atmanirbhar Bharat are expected to spur demand over the long term. The debt levels are expected to decline owing to lower capex undertaken in FY2021 and higher cash accruals in FY2022, even though several companies have raised bonds/NCDs to capture low interest rates. The debt levels would moderate to around Rs. 4.9 lakh crore by FY2022 end from Rs 5.8 lakh crore at FY2021 end. The credit metrics (interest coverage – 7.3x and debt/OPBDITA – 2.0x) are likely to improve in FY2022 due to a decline in debt levels and improvement in profitability.

The credit profile of the entities in the oil and gas sector should remain stable, given the increase in crude oil realisations, stable returns from pipelines, healthy demand growth, dominant market position, strong financial flexibility and headroom in key credit metrics.

For further information, please contact:

Media Contacts:		
Naznin Prodhani Head Media & Communications ICRA Ltd Tel: + (91 124) 4545300, Dir - 4545860 Email:naznin.prodhani@icraindia.com	Venkat Raman Manager - Media & Communications ICRA Ltd Tel: +91 90297 92600 Email:venkat.raman@icraindia.com	Poornima Tyagi Deputy Manager- Media & Communications ICRA Ltd Tel: +(91-124)4545300, Ext: 840 Email:poornima.tyagi@icraindia.com
Girish Dikey/ Khushal Devera Ketchum Sampark Mob: 7738020260/ 9819666376 Email:girish.dikey@ketchumsampark.com/ khushal.devera@ketchumsampark.com		

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