THE LOCKDOWN IMPACT – Recovering from the Lows

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The COVID19 pandemic has hit an already declining global gas demand. As a result the global natural gas market has witnessed the biggest-ever drop in demand. This has clearly been an event which has impacted the gas industry growth not only for the immediate future but for a long time to come.

The International Energy Agency's Gas 2020 Report has projected consumption to slump by 4% this year under the successive impacts of lower heating demand from a mild winter and the implementation of lockdown measures in almost all countries. Faced with this unprecedented shock, natural gas markets too have been going through a strong supply and demand adjustments. This in turn has resulted in high volatility and historically low spot prices. It is expected that the pandemic will have a longer lasting impact on the gas markets. According to IEA, even though the global gas consumption was already starting to slowdown, the pandemic is expected to further impact the global demand growth to just 1.5% annually upto 2025, compared with a previous forecast of 1.8%. As of early June, all major gas markets have been experiencing a fall in demand or a sluggish growth at best as has been the case of China. Europe has been the hardest hit market, with a 7% year-on-year decline so far in 2020 mostly due to drop in use of gas in power generation and industrial use.

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Indian Scenario: Similar but not totally so

In India, the impact on the oil and gas sector has been very similar but in a way a bit different also. And though everything went southward and in great measure, the recovery, specially in the CGD sector has perhaps been comparatively more rapid.

In the last financial year, India witnessed an increase in imports of all petroleum products except naphtha and aviation turbine fuel. More importantly due to the low commodity prices the government was able to maintain trade deficit. However, with declaration of COVID 19 as a pandemic by the World Health Organization and the consequent lockdown of almost two months to contain the spread of the Coronavirus dented the domestic oil and gas demand, thereby also impacting the government's revenue from taxes. The lockdown severely hurt the petroleum sector of the economy, including oil and gas production, and refining and consumption suffering a sharp decline.

Due to the lockdown, the overall oil demand is expected to fall to 4.60 million barrels per day in 2020 compared with 5.01 million barrels per day in 2019, according to sources. The natural gas output in April fell 18.64% to 2.161 BCM against 2.656 BCM a year ago. LNG imports dropped in April by a whopping 29.4% from a level of 2757 MMSCM a year ago to 1947 MMSCM, even though, in the financial year 2019-20, the country's import of LNG spiked 17% to 33,680 MMSCM. In value terms, however, imports declined 7.76% to $9.5 billion. The decline in global commodity prices helped the country increase imports of petroleum products and LNG in 2019-2020 without inflating the import bill.

According to PPAC data India's oil imports, including petroleum products, decreased 8.15% to $129 billion in 2019-2020, as compared to the previous year. However, in volume terms, oil imports increased 4% to 270 MMT.

New Lows in LNG

The pandemic, as we all know, was immediately followed by a sharp fall in crude oil prices and consequently a drop in gas prices across the globe, spot prices of LNG fell to historic lows of $1.3 per MMBtu. Long term contracted gas prices were also hit where gas prices with suppliers in Qatar, Russia or Australia are linked to moving average of crude oil prices for the past three or more months. GAIL's US LNG contracts are linked to gas hub rates but high liquefaction and transport costs make it uncompetitive. This has had serious implications for India as it becomes so much more difficult to be able to sell gas to long term contracted customers as supplies under long-term contracts have been at a much higher price of $5-7 per unit. Though LNG rates had been under pressure for more than a year due to a supply glut but the extraordinary demand destruction by the coronavirus pandemic and the difficulty in storing the super-cooled liquid hammered global gas prices like never before.

A sharp fall in domestic prices followed the drop in international gas price; the new domestic prices fell by 26% in the last six-monthly revision on April 1 to $2.39 based on the government-set formula. Today the maximum price producers can charge for gas from fields located in difficult terrains have also dropped a third to $5.61 per MMBtu. Gas prices at various international gas hubs have declined, which would again lead to lower domestic gas prices in FY2021 based upon the current formula.

The average of spot-LNG prices in April dropped significantly as compared to $5.2 in last April and $6.4 in December, and is projected to be around $2.30-2.40 per MMBtu for August 2020 delivery. This has the producer community worried over the medium term with no greenshoots on the horizon. Gas marketers like GAIL, Indian Oil, GSPC and Bharat Petroleum have been procuring LNG via one or more long-term contracts (having take-or-pay provisions) with suppliers in Qatar, Russia, Australia and the US. They make this supply available to city gas distributors or industrial customers also with the "Take or Pay" provision in long term contracts.

The disparity in price between long-term and spot is very stark in the current times. Therefore, amid lockdown, consumers were forced to declare force majeure but suppliers were not agreeing, until the eventual suppliers

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like Qatar agreed to FM, thereby creating a strong possibility for litigation along the entire value chain. In the Indian context, bigger consumers like fertilizer have a cost pass-through facility but other industries don't. Smaller players would want to get out of such expensive contracts, but that could result in suppliers encashing their bank guarantees, resulting in legal disputes. Mercifully, there does not appear to have been much of consequence in this regard. However, the low price of LNG has the potential to revive some of the stranded power generating capacities. The current situation also has the potential to hurt margins of gas marketers. Pursuant to the drop in consumption, pipeline utilization has been falling which would diminish returns for operators like GAIL, IOC and Reliance (now Brookefields).

India's gas demand gradually picking up as virus restrictions ease:

After a precipitous drop of 26.7% in April, when gas consumption dropped to 3910 MMSCM as compared to 5336 MMSCM a year ago, India's natural gas consumption has been recovering slowly as the world's biggest lockdown starts to ease with the gradual resumption of economic and industrial activity. Gas demand has been rising as some industries start to come back, like chemicals and pharmaceuticals. Some textile, ceramic, and steel have also started operations and demand from refineries is picking up fast. Daily gas consumption in Morbi in western Gujarat state, the country's largest ceramic industry cluster, has for instance risen to 0.9 MMSCMD from zero in April according to reports. Natural gas demand has risen by a third from its recent lows as factory activity continue to be expanded and more gas-driven vehicles come on the roads following the easing of lockdown curbs. The fertilizer sector had shown robust demand even in April, registering an increase of 11.9% over the same month last year, an increase of 137 MMSCM. Fertilizer plants are now operating at full capacity or more to meet with the immediate of farmers for the current sowing

FUEL SCENARIO

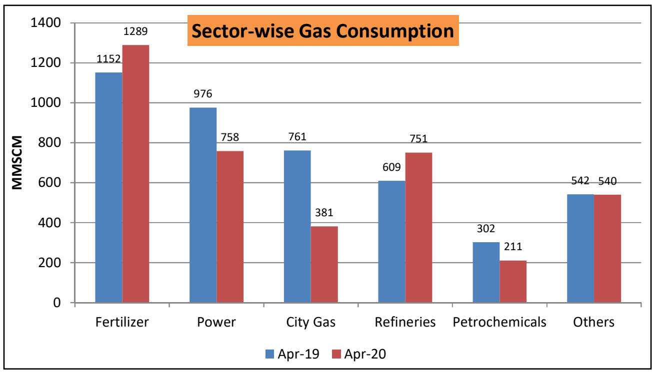
India's fuel demand has recovered fast in May after falling at a record pace in April following the easing of lockdown that has permitted more vehicles on the roads and increased factory activity. Diesel and petrol sales by state oil companies had fallen by 28% and 47.5%, respectively, in the first fortnight of May from a year earlier. This was however a sharp improvement from April, when the sale of diesel and petrol had declined by 56.5% and 61%, respectively. A staggered easing of nationwide lockdown has got many factories humming back to life and more goods trucks and passenger cars on the roads, driving up demand for fuel. The first fortnight of April had witnessed the sharpest fall in fuel demand with diesel and petrol sales falling 61% and 64%, respectively, from a year earlier. An expected further easing of the lockdown curbs may boost fuel demand in the second fortnight of May. Jet fuel sales, however, have been barely recovering as passenger planes are still barred from flying. Jet fuel sales fell 87% in the first fortnight of May from a year earlier. In April, it had declined by 91.5%. The sales of liquefied petroleum gas (LPG), used mainly for cooking in the country, has jumped 24% in the first fortnight of May from a year earlier, further improving its blistering growth pace of the past many months. The LPG sales in the first half of April was 21% higher though for the full month reduced to just 12% mainly because dealers slowed taking delivery towards the end of the month. Increased fuel demand has come as a big relief to refineries, which are now increasing their run rates. Indian Oil Corp said its refineries have raised capacity utilization to 60% from 45% last month and plan to raise it further to 80% by end-May. A demand collapse and overflowing storage had forced all refiners to cut capacity utilization. None of the refineries was shut down though some came very close to it.

Fuel sales growth on the recovery path

Fuel	May 1-15	April
Diesel	-28 per cent	-56.5 per cent
Petrol	-47.5 per cent	-61 per cent
Jet Fuel	-87 per cent	-91.5 per cent
LPG	24 per cent	12 per cent

Source: Economic Times/Indiatimes

season. Refinery and petrochemical consumption which had dropped in April by 20% and 30% respectively as compared to April 2019 have started contributing to increased gas demand. We have attempted to cover the city gas distribution sector in more detail here because of its growing importance in the sectoral demand curve. Over the years, the contribution of the CGD sector in the gas pie has been increasing and currently it stands just below the fertilizer sector.



City Gas Distribution:

The city gas distribution business, which mainly caters to smaller production units, hotels, hospitals, homes, shops and natural gas vehicles, besides households, was the worst hit and the biggest contributor to gas demand slump during the lockdown. CNG sales in Delhi, Mumbai, Gujarat and other cities were down by about 70-80 per cent as except for a few buses and essential service vehicles other vehicles remained mostly off-road. CNG sales had reportedly dropped by a whopping 90 per cent to 3.5 lakh kilograms in April in Delhi NCR. IGL was forced to shut down half of their CNG retail stations in the Delhi-NCR region. Source said that IGL had closed 95 of its 150 COCO outlets to rationalize volumes. Commercial piped natural gas (PNG) volumes were also significantly down as restaurants and hotels were closed, and the scenario was similar for industrial PNG demand.

Comparative Consumption Table
April 2020 vs April 2019 in MMSCM

Sectors	April 2019	April 2020
Fertilizer	1152	1289
Power	976	758
City Gas	761	381
Refineries	609	751
Petrochemicals	302	211
Others	542	540
Total	5336	3910

The sector was hit by a massive drop in gas consumption to the extent of about 50%. From a level of 25.36 MMSCMD (761 MMSCM) in April 2019, the consumption came down to 12.7 MMSCMD (381 MMSCM).

Recovery of the sector:

With the government deciding to relax coronavirus lockdown restrictions in a phased manner, CNG sales have rebounded to around 30 per cent of the level prevalent before the lockdown was imposed. The sector has gradually started picking up. With more NGVs coming on the roads, the demand for CNG is expected to go up. Further strengthening of gas demand would depend largely on how fast factories return to production levels seen before the lockdown. Factory activity could be challenged by the paucity of labour and demand in the economy. Lakhs of migrant workers have gone to their villages from cities and getting them back to factories could take months. The CNG demand growth would be largely determined by how quickly people start attending offices and the return to normalcy.

Similarly refiners and other gas players are also witnessing a consumption recovery. Indian refineries such as Indian Oil Corp, Hindustan Corporation and Bharat Petroleum Corp. had come back into the spot market to seek LNG cargoes for May to June delivery. India's Gujarat State Petroleum Corp is seeking five LNG cargoes for delivery over July to December, its first requirement since March, when it issued force majeure notices to its suppliers. An executive from India's top gas importer Petronet LNG, which declared force majeure on purchases from Qatar under long-term deals in late March, reportedly said there had been some recovery in demand compared to last month. However, with Indian gas major GAIL (India) halting LNG imports at its 5 MMTPA Ratnagiri terminal until end-September, any rise in imports of super cooled gas into the country will be limited. Full revival of demand will take a few weeks or months, depending on the sector and locatio. By the middle of April, in a scenario where gas demand had been going down and business falling due to the lockdown, city gas operators sought tax relief and loan restructuring to tide over difficult times. Barring supply of piped natural gas to households' kitchens, all segments under CGD showed a sharp fall in gas offtake. The falling demand resulted in majority of the CGD entities facing steep fall in revenue and margins and cash flow problems which impacted their ability to maintain the required investment/capex for the sector to grow. As a result of the slowdown in the overall economic activity, capex plans especially under the newly awarded city gas licenses is likely to be affected and will, therefore, act as a dampener for infrastructure growth. Some suggestions have been made by the CGD companies to provide the necessary impetus to the sector and bring back the growth story, like,

1.Seeking exemption of the CGD sector from excise duty on CNG
2.Deferment of statutory tax compliances at least till September-December, 2020.
3.Restructuring of loans by banks
4.Providing a moratorium on interest payments for at least another six months
5.Allocation of Government-priced controlled gas to CGD operators
6.To do away with additional charges like excess gas, take-or-pay, imbalance etc. by suppliers and transporters, 7.Waiver of penalty for not making committed investment in a city gas area. It has been proposed that a deferment of at least 24 months in minimum work programme (MWP) be allowed post lockdown period and till the restoration of normalcy period in the industrial activities.
8.Assist in generation of finances for investment and to ease the financial stress being faced by the CGD entities, the Ministry of Petroleum should consider financial assistance to the sector, adding, this could be through creation of a special fund of the Oil Industry Development Board (OIDB) and the oil regulator PNGRB reserves.

Indian City Gas Distribution (CGD) companies were also found to be scrambling to deal with impending force majeure notices, demand destruction, labour shortage and liquidity squeeze as a result of Covid-19. The industry was of the view and rightly so that the time-line of pipeline and city gas distribution projects being implemented will be hit due to ongoing challenges faced by the industry. Some of the leading CGD companies are of the opinion that few of the challenges they see are invocation of force majeure, renegotiations to bring down the prices of old contracts and project execution during the lockdown. It is expected that even after the lockdown is lifted there could be delay in restarting operations owing to lack of adequate workers and equipment. It is also expected that there would be a shortfall in achieving the minimum work programme. This could have a cascading effect on all the CGD company's working capital requirement as there would be delays in realisation of receivables.

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We are very confident that the CGD sector would bounce back to its accelerated demand growth path with the gradual return to normalcy. IGL, MGL, Adani and Gujarat Gas are few of the existing players expected to lead the growth, while GAIL Gas and other new entities who have entered the business recently are likely to add to the growing increase in demand from the sector.