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Sector Analysis

Gas utilities run out of steam

Destruction of demand due to COVID-led crisis could offset gains from lower gas cost

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Like many other sectors, natural gas utilities, too, have been badly hit by the coronavirus spread. The 21-day nationwide lockdown up to April 14, has had a major impact on the sales volumes of gas utilities. With most vehicles off the roads, and operations of many industries and commercial establishments shut or curtailed, the demand from key segments — compressed natural gas (CNG) for vehicles and piped natural gas (PNG) for businesses — has crashed.

Reports say that in major city gas distribution (CGD) markets such as Delhi, Mumbai and Gujarat, CNG demand has fallen 70-80 per cent, and many outlets have been shut down.

PNG demand from consuming sectors such as tile makers, small and medium industries, and hotels and restaurants has also been battered. Demand for gas from power and refinery companies is also likely to be reduced, given the lower demand for electricity, transport fuels and petrochemicals.

A silver lining is the likely continued demand for PNG from households, with many people remaining in their houses. But this is a relatively smaller segment. Another positive for many gas utilities is the sharp fall in gas prices — both locally and internationally — due to the global supply glut; this reduces raw material costs, and can potentially aid margins for the sector.

International prices of spot LNG (liquefied natural gas), including Asian imports, have fallen to record lows, and are in low single digits per mmbtu (one million British thermal units). Also, domestic gas price in India has been reduced, in the recent price revision, to $2.39 per mmbtu for the April-September 2020 period, down 26 per cent from $3.23 per mmbtu for the October 2019-March 2020 period.

Major impact

But the massive demand destruction and lower capacity utilisation due to the coronavirus crisis could more than offset these positives, and gas utility companies could see a significant hit on their financials until the lockdown situation eases. Even after that, it may be a while before things stabilise.

The performance of gas companies in FY20 is expected to be weighed down by the weak show in the March quarter; some companies though could benefit from a low base effect.

Also, FY21 could be impacted by poor performance in the June quarter and beyond.

The pain will likely be felt across the gas utility value chain — from importers such as Petronet LNG, and transmitters such as GAIL (India) and GSPL, to city gas distributors such as Indraprastha Gas, Mahanagar Gas, Gujarat Gas and Adani Gas. Some companies such as Petronet LNG and GAIL (India) are said to have issued *force majeure* notices to their gas suppliers.

No surprise then that many of these stocks have lost heavily — some such as the earlier steeply valued Adani Gas have slipped as much as 45 per cent since the beginning of this calendar. The fall since mid-February, when the market crash intensified, has been high for many names.

Over the past couple of weeks though, most gas stocks — especially Petronet LNG, GSPL, Indraprastha Gas and Mahanagar Gas — have staged a recovery and cut their losses, possibly on hopes of gains from low gas cost and revival of demand when the storm blows over.

It remains to be seen though whether low gas-sourcing cost translates into better margins — the prices of competing liquid fuels have also fallen due to the crude oil price crash, and this could impact the pricing power of the gas utilities.

Also, the extent and timeline for revival in gas demand and its growth will depend, to a good extent, on the prospects of consuming sectors such as auto, MSMEs, hotels and restaurants, many of which also have been hammered.

Long-term prospects

Over the long run though, once the coronavirus dust settles, many of these gas utilities hold potential as sound franchises.

Demand for natural gas in the country is expected to grow at a good pace in the long run, with cost advantages and the Centre's thrust on promoting use of the fuel and increasing its share in the country's energy mix from about 6 per cent now to 15 per cent.

This, along with capacity expansions and roll-out of a countrywide city gas distribution network, should translate into good growth prospects for the sector

The financial position of many of these gas companies seems robust enough to be able to weather the ongoing turbulence. The strong parentage of most gas utility companies — with major government holdings (directly or indirectly) — also helps.

After their price fall over the past few months, the valuations (price-to-earnings ratio) of all the gas stocks are trading well below their three-year averages (see table).


REUTERS

Demand crash
CNG demand has reportedly fallen 70-80% in major markets such as Delhi, Mumbai and Gujarat

Stock trouble

	Petronet LNG	GAIL (India)	GSPL	Indraprastha Gas	Mahanagar Gas	Gujarat Gas	Adani Gas
Stock price (₹) as on							
December 31, 2019	267.9	121.1	219.4	428.2	1,063.7	237.6	162.7
April 1, 2020	200.4	75.75	182.4	391.2	814.8	227.0	89.1
Change (%)	**-25**	**-37**	**-17**	**-9**	**-23**	**-4**	**-45**
PE ratio (times)*							
Current	10.5	5.5	6.6	23.08	10.58	14.67	24.9
3-year average	18.15	17.02	14.77	29.42	19.04	37.12	57.9^

*Trailing 12-month, consolidated basis; ^1-year average