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THE COMPASS

Near-term margin pressure for city gas distribution majors

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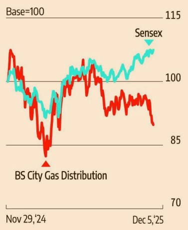
Global energy markets are trending down. Sanctions on Russia have not disrupted supply, given weak global gross domestic product (GDP) growth and production increases from Opec and non-Opec countries.

Global supply is expected to increase by 2.2 million barrels per day (mbpd) in 2026 (averaging 107.2 mbpd) which will probably mean a net supply surplus of 2-3 mbpd. The benchmark Brent crude may trade below $60/barrel (bbl) mark in 2026. Since administered pricing mechanism (APM) and new well gas (NWG) prices are tied to global prices, which are tied to crude, this may be a positive.



City gas distribution (CGD) companies may clock operating profit of ₹7.2–7.5 per standard cubic metre (scm) in FY26, up 8–12 per cent compared with H2FY25. This is when margins dropped as APM gas allocation was cut, forcing spot imports.

CGD gas has several cost-tiers. Lowest prices are under the APM.

Beyond APM, there is NWG and high pressure, high temperature (HPHT) gas, and imported regasified liquified natural gas (R-LNG) under contract and spot.

In H2FY25, APM gas allocated to CNG was reduced to less than 40 per cent of total CNG requirement, compared with 70 per cent in H1FY25. Spot gas is usually 80-100 per cent more expensive than APM. CGD companies have since moved to contracting for long-term supplies to reduce supply risks.

They have 15-20 per cent long-term allocations from domestic NWG, and signed medium- and long-term contracts for HPHT gas and R-LNG. This reduces spot exposure, where the prices are the highest. Procurement costs for CGD companies will be about 5 per cent lower in FY26, compared to H2FY25.

Realisations are steady following hikes. But CGD companies may incur other costs as they roll out capex to expand infrastructure to support volume growth. Even so, CNG has an arbitrage advantage, since it is 20–40 per cent cheaper than petrol and diesel.

There may be a potential demand boost as GST 2.0 sparks demand for vehicles. CNG vehicle registrations for IGL, MGL and Gujarat Gas were strong following GST reforms. October was inflated by festival demand, but year-on-year (Y-o-Y) growth is strong in November.

The CGD sector should see healthy volume growth of 8-10 per cent in FY26, following 15 per cent Y-o-Y growth in FY25. Better margins and higher volume will support cash generation which will enable capex while sustaining debt-to-operating-profit ratios of around 1.

Risks to projections include sudden significant APM allocation cuts, policy shifts, and any geopolitical impact on prices.

However, while crude prices may trend benign in CY26, Saudi Aramco has raised LPG prices by 3-5 per cent for December due to tighter global supply.

Higher propane and butane prices will increase LPG under-recoveries for oil marketing companies (OMCs) from ₹17/cylinder currently to ₹45/cylinder starting January 2026.

Gujarat Gas may be a beneficiary from higher propane prices as propane competes against LNG (which is supplied by Gujarat Gas) as an industrial fuel, in the Morbi region. The rupee depreciation in the last two months will impact OMCs with a 4-5 per cent operating profit drop for every 1 per cent depreciation in the rupee versus the dollar. CGDs may see 3-5 per cent impact on unit operating profit for every 1 per cent rupee depreciation.

Upstream, ONGC and Oil India will be positively impacted by rupee depreciation though this may be offset by mark-to-market losses on dollar-denominated liabilities.

Henry Hub (HH) gas prices are up 47 per cent since end-September and this may impact MGL and IGL.

This is seasonal due to heating demand. MGL sources more than 30 per cent of gas from HH-linked contracts while IGL sources 18 per cent sourcing from HH-linked contracts. GAIL has a HH-linked US gas contract of 5.8 mtpa with 80 per cent contracted on back-to-back basis, while remaining 20 per cent volume is sold via Brent-linked contracts.

Near-term margins will slip below guidance of companies due to higher HH and rupee weakness. Structurally, the APM phase-out by FY29 implies steady shift in mix to higher-cost LNG and NWG. This may cap operating profit per standard cubic metre for the long term.