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Indian Upstream Oil and Gas Industry

Cess revised with movement in crude oil prices

AUGUST 2022

Highlights

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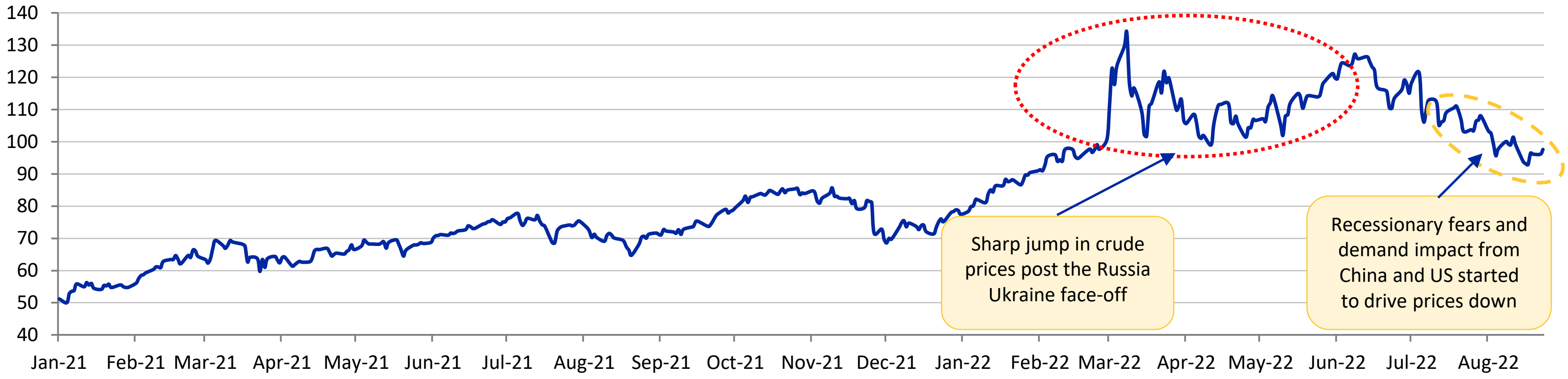
Crude oil prices have started to cool off as recessionary and inflationary pressures in some parts of the world have dampened demand. With the correction in crude oil prices, the Government has also revised the cess on the upstream sector to Rs. 13,000 per tonne (around $22/bbl) from initial cess of Rs. 23,250 per tonne (around $40/bbl) of crude produced.

This will result in a decline in Government collections to around Rs. 31,000 crore in the current fiscal as per the current rates from around Rs. 51,800 crore under the previous rates.

- The armed conflict between Russia and Ukraine led to a spike in crude oil prices. A few countries, including the US, banned Russian oil and gas imports, while some European nations decided to phase out Russian oil and oil products by the end of the year.
- Given the elevated crude oil prices, the upstream companies have been generating healthy profits. Looking at this, the Government had earlier imposed a cess of Rs. 23,250 per tonne on the crude produced w.e.f. July 01, 2022 (~$40/barrel).
- Crude oil prices have been falling as inflationary and recessionary pressures in some parts of the world dampened demand, prompting the Indian Government to revise the cess downwards.
- The cess was first revised downwards to Rs. 17,000 per tonne w.e.f. July 20, 2022 (~$30/barrel) and was then increased to Rs. 17,750 per tonne w.e.f. August 02, 2022, which has now been reduced to Rs. 13,000 per tonne (~$22/barrel) w.e.f. August 18, 2022.
- This cess was initially likely to result in the Government of India mopping up Rs. 51,800 crore in the current fiscal, which has now reduced to Rs. 31,000 crore. This will also be the total impact on the EBITDA of the upstream companies owing to reduction in realisation of crude.
- ICRA expects that the capex plans of the incumbents to remain largely intact owing to the still remunerative realisations of $70-90/barrel for crude, post the imposition of cess. Additionally, ICRA expects the cess to be dynamically revisited in case crude prices decline further.

Crude prices have started to cool off from their highs

Exhibit : Brent crude price trend ($/bbl)

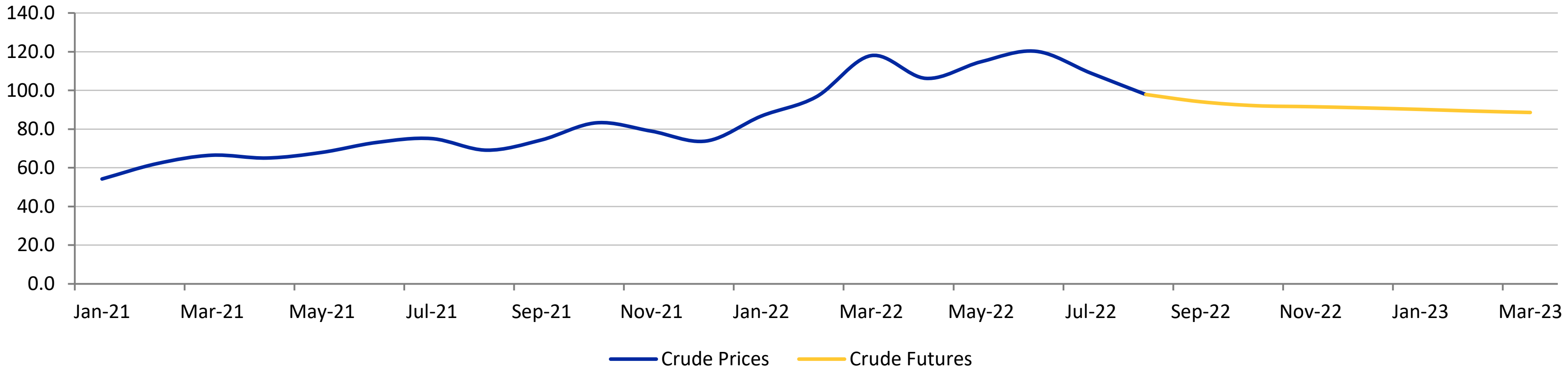


Source: Bloomberg, ICRA Research

- Oil prices soared after the start of the Russia-Ukraine face-off and peaked at $135/bbl; the prices have moderated to ~$97/bbl as of now.
- Inflation and pressures on economic expansion have dampened demand. Lower demand from China owing to the extended lockdown because of rising Covid-19 cases and fears of a US recession have pulled down crude oil prices from the highs.
- The possibility of an Iranian nuclear deal could lower oil prices further even though Saudi Arabia has indicated that OPEC+ might cut production.

Crude price outlook

Exhibit: Monthly Brent crude price trend ($/bbl)

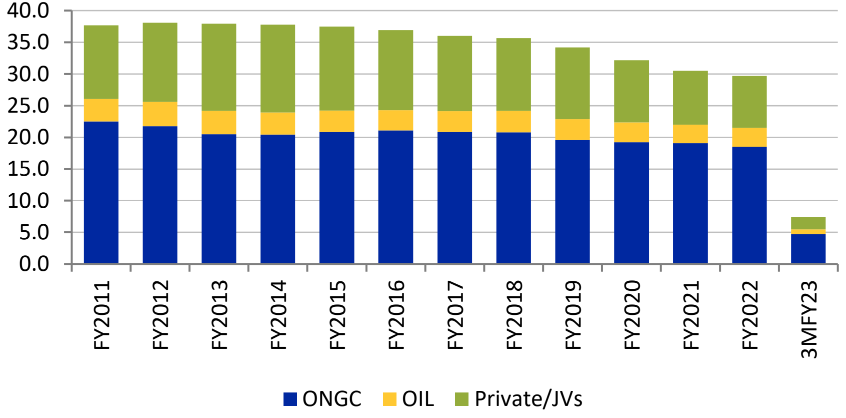


Source: EIA, CME, ICRA Research

- Oil futures indicate that the prices are expected to decline, largely following the current trend.
- The decline predicted by futures is on account of the inflationary and recessionary pressures across the major world economies which can impact the demand, going forward.

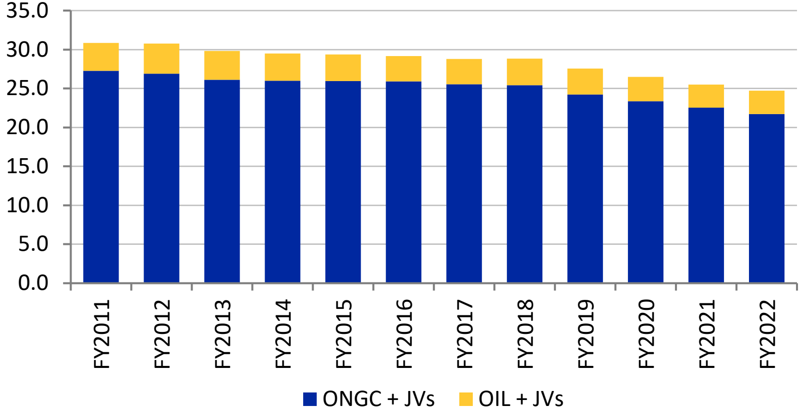
Domestic crude oil production on a declining trend

EXHIBIT: Domestic crude oil production (MMT)



Source: PPAC

EXHIBIT: Crude oil production – OIL and ONGC (incl. JVs) (MMT)



Source: ONGC and OIL Annual Reports

- Domestic crude oil production has been declining steadily, primarily on account of a natural decline in the mature oil fields.
- While the production for both ONGC and OIL (along with its JVs) has been following a declining trajectory, their combined share in the total production remains high at around 83%.

Government revises the cess, in line with falling crude prices

Elevated crude oil prices leading to upstream companies earning healthy profits

Government imposes additional cess equivalent to $40/bbl w.e.f. July 01, 2022

Crude prices started to cool off owing to fall in demand post inflationary and recessionary pressures

Government reduced the cess to $30/bbl w.e.f. July 20, 2022, only to increase it to $31/bbl w.e.f. Aug 02, 2022

The cess has now been recently reduced to $22 per barrel w.e.f. Aug 18, 2022

On July 1, 2022, the GoI imposed a cess of Rs. 23,250 per tonne of crude, translating to ~$40 per barrel. This largely stems from elevated crude prices and the windfall gains made by the crude producers

Since then, there have been three revisions in the cess and the latest round of revision leaves the cess at Rs. 13,000 per tonne of crude (~$22/barrel).

Details of the cess and its impact

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Details of the Cess

Imposition of Cess

A cess of Rs. 23,250 per tonne (equivalent to around $40/bbl) was imposed on domestic crude producers w.e.f. July 01, 2022, which has been cut down to ~$22/bbl from Aug 18, 2022

Sunset Clause

There is no sunset clause as such. However, this is likely to be a temporary cess and should phase out when crude prices ease to normal levels

Exemptions

Small producers, whose annual production of crude is less than 2 million barrels, will be exempted from this cess. Additionally, no cess will be imposed on the quantity of crude that is produced in excess of last year's production by a crude producer.

Impact Assessment

Realisations

The realisations of crude oil producers to fall to around $70-$90 per barrel now from more than $100 per barrel, as ICRA expects crude oil price to average at $100-$120 per barrel for FY2023

Impact on Margins

With the reduction in realisations, the margins and cash accruals will be impacted, although the same are likely to remain healthy

Capex Impact

Even at these levels of crude, the capex plans are not likely to materially slow down for the domestic upstream industry

Impact assessment

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	Assessment	Impact Meter
Impact on Government collections	The Rs. 23,250/tonne of cess could have resulted in the Government collecting around Rs. 51,800 crore this fiscal (cess effective from July 1, 2022) and could have partially offset the excise duty cuts on petroleum products done earlier. However, this cess has been reduced now to Rs. 13,000/tonne and Government collections now will be around Rs. 31,000 crore for FY23	High
Impact on realisations of upstream players	The upstream industry was having a dream run as the realisation of crude has been consistently above $90/bbl mark since March 2022 and this cess will lower the net realisations of the companies (by $22/bbl now from $40/bbl earlier)	High
Impact on margins of upstream players	With the fall in realisations, the margins and cash accruals of the industry will also be impacted. Considering the current production levels, ONGC's EBITDA will be lower by around Rs. 20,000 crore, while for OIL it would be lower by around Rs. 3,200 crore in FY2023 vis-à-vis the scenario of no windfall tax.	High
Impact on capex plans	The capex plans of the incumbents would remain largely intact owing to the still remunerative realisations of $70-90/barrel for crude post the imposition of the cess. Additionally, ICRA expects the cess to be rolled back in case crude prices decline	Low

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Analytical Contact Details

Sabyasachi Majumdar	**Prashant Vasisht**	**Ankit Jain**
Senior Vice-President	*Vice-President*	*Vice-President*
sabyasachi@icraindia.com	prashant.vasisht@icraindia.com	ankit.jain@icraindia.com
0124- 4545 304	0124 – 4545 322	0124 – 4545 865

ICRA Business Development/Media Contact Details

	L. Shivakumar	**Jayanta Chatterjee**	**Naznin Prodhani**
	Executive Vice-President	*Executive Vice-President*	*Head Media & Communications*
	shivakumar@icraindia.com	jayantac@icraindia.com	communications@icraindia.com
	022- 6114 3406	080 – 4332 6401	0124 – 4545 860

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Thank You!