
Impact Note for Provisional Tariff Structure for Natural Gas Pipelines

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Approval of provisional gas tariff structure positive for gas transmission companies

Petroleum and Natural Gas Regulatory Board (PNGRB) has provisionally approved tariff rates for three natural gas pipelines, namely, the East-West Pipeline Project (EWPL) operated by Reliance Gas Transportation Infrastructure Ltd (RGTIL), the existing HVJ-GREP-DVPL network operated by GAIL and the DVPL/GREP Upgradation project operated by GAIL.

The regulator has approved gas transmission tariff of Rs. 52.23 per million Btu (mmbtu) for the EWPL, as against the RGTIL proposal of Rs. 53.64/mmbtu. The tariff rates for the HVJ-GREP-DVPL and DVPL/GREP Upgradation projects have provisionally been approved at Rs. 25.46/mmbtu and Rs. 53.65/mmbtu, respectively. GAIL's proposal to increase tariff rate for existing HVJ-GREP-DVPL from the existing Rs. 28.48/mmbtu to a single levelized postal based tariff of Rs. 35.39/mmbtu (including DVPL/GREP Upgradation) has not been accepted by the board, as it would result in higher tariff charges for the existing customers.

The provisional tariffs will be applicable from the date of commission for the EWPL (i.e. 1-April-2009); and retrospectively from 20-Nov-2008 for existing HVJ-GREP-DVPL; and from the date of commissioning for the DVPL/GREP Upgradation. It may be noted that the tariff rates are provisional only and may be finalized on later date by the PNGRB on receipt of actual data by the operator.

"The board's decision is a step forward and likely to provide more regulatory clarity to the gas transmission business" commented Ms. Revati Kasture, Head of Research, CARE Ltd. The provisional tariff structure is very positive for GAIL, as the 10.6% decline in its existing HVJ-GREP-DVPL pipelines would be outwitted by an increase of 88.4% in the DVPL/GREP Upgradation, implying significant upside in future tariff revenues. CARE Research estimates that the proposed tariffs charges would imply **tariff revenue of about Rs 19 billion from existing network and Rs 36 billion from upgradation, totaling to Rs 55 billion for GAIL in 2010-11**, as against Rs 49 billion proposed by GAIL under levelized postal based tariff of Rs. 35.39/mmbtu. However, the tariff charges are applicable retrospectively from 20-Nov-2008 for existing HVJ-

GREP-DVPL network. This would result in **one-time pre-tax charges of Rs 3.1 billion for GAIL** due to higher tariff charged to existing customers. Whereas, **RGTIL is likely to show tariff revenues of about Rs 54 billion in 2010-11** as a result of the tariff structure. **The one-time pre-tax charges due to retrospective implementation would be Rs 0.8 billion in case of RGTIL.** The government has shown inclination towards approving an overall capital expenditure in range of Rs 1.5 million-per-km-per-mmscmd, and we expect this to remain as benchmark for future pipeline projects. On the other hand, the board has adhered to its volume provisions specified under the “Determination of Natural Gas Pipeline Tariff” by not accepting RGTIL’s higher volume assumptions and GAIL’s unaccounted gas volume assumptions.

Annexure-1: Approved Capital Expenditure for Natural Gas Pipelines

Pipeline	Operator	Capex (Rs million- per-km-per- mmscmd)
Dadri-Bawana-Nangal Pipeline	GAIL	1.216
Chainsa-Gurgaon-Jhajjar-Hissar Pipeline	GAIL	0.775
Jagdishpur-Haldia Pipeline	GAIL	1.158
Dabhol-Bangalore Pipeline	GAIL	2.044
Kochi Mangalore Bangalore Pipeline	GAIL	1.701
Dahej-Vijaipur/GREP upgradation	GAIL	1.554
Vijaywada-Nagpur-Bijapur	GAIL	1.602
Surat Paradip*	GSPL	1.160
East-West Pipeline	RGTIL	1.484

* - EOI submitted. Under review by PNGRB

Source: CARE Research

Annexure-2: Tariff Proposals by GAIL, PNGRB Acceptance and CARE Comments

GAIL's Proposal	PNGRB Approval	CARE Research Comments
Merging the capital expenditure of DVPL/GREP Upgradation (Rs. 9,165 cr) to the depreciated capex of the HVJ-GREP-DVPL (Rs. 3,603 cr)	Merging of capital expenditure not allowed by the board.	Agreed. As the existing capacity of 57.3 mmscmd has already been contracted out and the Upgradation project serves to new customers.
Merging of capital expenditure resulting in a tariff of Rs 35.39/mmbtu for existing system and Rs 62.12 / mmbtu for the combined system	Tariff for the existing network and upgrade network should be counted differently. Approved tariff for existing system at Rs. 25.46/mmbtu and for upgradation at Rs. 53.65/mmbtu	Agreed. As the existing customers should not be burdened by the capacity augmentation targets by the company.
Capital expenditures of DVPL/GREP Upgradation the HVJ-GREP-DVPL are pegged at Rs. 9,165 cr and Rs. 3,603 cr, respectively.	Accepted	The capital expenditure for the upgradation project is estimated at Rs 0.14 crore-per-km-per-mmscmd. This is in line with the GAIL's earlier approved pipeline capital expenditure in the range of Rs 0.07-0.17 crore-per-km-per-mmscmd. <i>(Annexure-1)</i>
Operating expenditure: HVJ-GREP-DVPL – historic data; Upgradation – 7.5% of revenue.	Accepted	Logical. Normally the operating expenditure ranges between 7-8% of revenue
Maintenance capital expenditure	The board has restricted the maintenance capex to 70% of the claimed amount. i.e. reduction of 30%	The maintenance capex for the existing pipeline will be higher compared to the upgradation segment. There might be a scope of upward revision in the maintenance capex as the company is likely to transmit more gas through its network as KG-D6 achieves its plateau production.
Volume Assumptions: HVJ-GREP-DVPL – Flat 52 mmscmd; Combined network – 49.83 mmscmd in year 1 to 72.91 mmscmd in year 5	Split the existing network and upgradation capacities. Existing network assumed at 100% capacity and upgradation assumed at 60-100% of capacity	Agreed. The board has assumed 25% of common carrier capacity of upgradation network, yielding normative capacity utilization of about 45%, 52%, 60%, 67%, and 75% through year 1-5.
Inflation assumed at 5%	The board has considered inflation of 4.5%	The board assumption appears to be a on the lower side, given the fact that India's 52-week average inflation during last five FYs has ranged between 4.4-8.4%, and RBI targeting inflation higher than 5%.
Economic Life: Existing network, 2022-23, considering 10 year extension; Upgradation network – 25 years from 2011-12	Accepted	Agreed and in-line with PNGRB regulations
Unaccounted volume of gas assumed at 0.6%	No unaccounted volume considered	Although PNGRB regulations are silent on treatment of the transmission losses, some losses need to be accounted for. However, GAIL's estimate for the transmission loss is about 0.5 mmscmd, which appears to be on higher side. Keeping numbers in perspective, the 0.5 mmscmd gas would be able to cater to 1) 92.5 MW of power capacity or, 2) 1.7-2.3 lakh tonne of fertilizer capacity or, 3) entire CGD networks of two tier-II cities. <i>(Annexure-4)</i>

Source: CARE Research and PNGRB

Annexure-3: Tariff Proposals by RGTIL, PNGRB Acceptance and CARE Comments

RGTIL's Proposal	PNGRB Approval	CARE Research Comments
Capital expenditure of Rs. 17,310 cr	The board reduced capital expenditure by Rs. 862 cr or 5% of the original proposal.	The RGTIL proposal yields capital expenditure of Rs 0.156-crore-per-km-per-mmscmd. The board has reduced it to normative assumption of Rs 0.15-crore-per-km-per-mmscmd. It may be noted that the EWPL pipeline is 48", and requires special rolling equipments and installation cranes leading to higher capex requirement.
Operating expenditure: 7-8%	Accepted	Agreed.
Volume Assumptions: 60 mmscmd for 2009-10 and 80 mmscmd thereafter	The board has assumed normative capacities of 40, 42, 48, 54 and 60 mmscmd through year 1-5.	The RGTIL assumptions are realistic but aggressive. As per the PNGRB regulations, capacity under consideration to be increased from 60% to 100% through year 1-5.
Maintenance capital expenditure	The board has restricted the maintenance capex to 70% of the claimed amount. i.e. reduction of 30%	Agreed. EWPL pipeline is relatively new and would require lower maintenance capex.
Inflation assumed at 4.5%	Accepted	The inflation assumption appears to be on lower side, given the fact that India's 52-week average inflation during last five FYs has ranged between 4.4-8.4%, and RBI targeting inflation higher than 5%.

Source: CARE Research and PNGRB

Annexure-4: Utilization of Gas

0.5 mmscmd can cater either of

Power Sector 92.5 MW capacity¹

Fertilizer Sector 1.7-2.3 lakh tonne capacity

CGD Two Tier-II cities; and One Tier-I city²

Notes:

1) At 90% PLF

2) As per EOI submitted by various companies to PNGRB.

Source: CARE Research