ICICI direct Research

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Progressive regulations for pipeline industry

The Petroleum and Natural Gas Regulatory Board has revised natural gas pipeline tariff regulations. While the expected return ratio remains the same (IRR: ~12-14% range), Tariff determination for pipelines by the regulator have been amended, to reflect more ground realities and support economics of newer pipelines.

Few highlights include:

a) Capacity utilisation ramp up to occur over a 10-year period instead of 5 years,

b) Volume adjustment would now be possible in case actual volumes are higher than normative volumes

c) Capacity expansion of pipelines from new gas sources would be exempted for tariff calculations for 5 years

d) Lower tax rate of 25.2% would be applied prospectively (and no retrospective taxation)

e) There would now be provision for transmission losses

f) Unified tariffs will now be applicable over 3 zones vs 2 earlier

g) The PNGRB may allow a gradual annual increase in the tariffs

h) Integrated tariffs for inter connected pipelines of a single entity will now be introduced.

These changes are positive for GSPL and GAIL as it would encourage capacity expansion and completion of pending projects.

GSPL and GAIL to be benefitted from these amendments

- As per the amendments a more relaxed capacity utilisation has been introduced for the pipelines. This capacity utilisation would be ramped up over a 10-year period vs 5 years earlier. The ramp up would start from 30% to 100% of the nominal pipeline capacity instead of 60% to 100% earlier. This development is positive for GAIL as blended capacity utilisation is around ~50% (will also positively impact GSPL on upcoming capex) and hence a longer period would help reflect the actual volumes flowing through the pipeline.
- Flexibility to adjust volumes in case the actual volumes are higher than the normative volumes would help create a more balanced tariff regime.
- Increase in capacity of pipelines due to gas coming from new sources will be exempted from tariffs for 5 years. In case the capacity expansion is more than 10% of the nominal capacity, additional capex, opex and volumes will now be considered while calculating the tariffs. This would help GSPL in completing its connecting pipelines to the GSPC Mundra LNG terminal and HPCL's Chhara terminal.
- For companies opting for a tax rate of 25.2% vs 33.3% earlier, amendments have been made to factor in this impact only prospectively, FY24 onwards. This would help midstream companies as the hit on its tariff would be lower than expected as the impact of lower tax rate for FY21-23 would be excluded from tariff calculations
- Transmission loss of 0.1% of actual volume multiplied by the gas price will now be allowed as a deduction for tariff calculation.
- Unified tariffs will come into effect from April 2023 and these tariffs will be applicable to 3 zones vs 2 earlier. First zone would be upto a distance of 300km, second zone start from 300 km upto 1200 km and the third zone would be beyond 1200 Km. The unified tariffs would be in the ratio 40:75:100 of the determined tariff vs 40:100 earlier.

Recent highlights & Key Risks

Key Risk: (i) Lower than expected volume growth (ii) Lower than expected gas trading margins

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Sector Update

ICICI Securities – Retail Equity Research

- The tariffs are now allowed to be changed on an annually based on pipeline utilisation.
- For multiple pipelines which have common interconnected tap offs, integrated tariffs may help boost tariffs for GAIL.

Valuation and Outlook

We retain our **BUY** rating on GSPL with a target price of ₹350/share. We value GSPL's transmission business at ₹210/share. We value its investments in Gujarat Gas and unlisted Sabarmati Gas at ₹ 140/share. For GAIL, we maintain our **HOLD** rating with a target price of ₹100/share based on SoTP method.

Exhibit 1: Rating matrix

Company	Rationale	New FY24E EPS	CMP	New Target Price	Rating
GSPL	The amendments made to the pipeline tariff regulations will benefit GSPL as it will help with the company's expansion plans and improve transmission volumes	22.0	272.0	350	BUY
GAIL	GAIL would be benefitted to a lower extent when compare to GSPL due to the uncertainty surrounding its other business segments	8.9	93.0	100	HOLD

Source: Company, ICICI Direct Research

Exhibit 2: Gas Pipeline Network as on 01/04/2019

Gas pipeline network as on 01.04.2019						
Network/Region	Entity	Length (Kms)	Design capacity (mmscmd)	Pipeline size	Average flow 2018-19 (P) (mmscmd)	Percentage capacity utilisation in 2018-19 (P)
Hazira-Vijaipur-Jagdishpur Pipeline/Gas rehabilitation and expansion project pipeline/Dahej-Vijaipur Pipeline & spur/ Vijaipur-Dadri Pipeline	GAIL	4554	53	36"	29.5	56%
DVPL-GREP upgradation (DVPL-II & VDPL)	GAIL	1385	54	48"	35.9	67%
Chhainsa-Jhajjar-Hissar Pipeline (CJPL) including spur lines *	GAIL	310	5	36" /16"	1.0	20%
Dahej-Uran-Panvel Pipeline (DUPL/ DPPL) including spur lines	GAIL	928	20	30"/18"	13.9	70%
Dadri- Bawana-Nangal Pipeline (DBPL)	GAIL	852	31	36"/30"/24"/18"	5.5	18%
Dabhol-Bengaluru Pipeline (Including spur)	GAIL	1116	16	36"/4"	1.3	8%
Kochi-Koottanad-Bengaluru-Mangalore (Phase-1)	GAIL	48	6	16"/4"	2.3	38%
Tripura (Agartala)	GAIL	60	2	12"	1.3	55%
Gujarat	GAIL	685	9	24"/16"/12"	4.4	49%
Rajasthan	GAIL	151	2	12"	1.4	57%
Mumbai (Uran-Thal-Usar & Trombay-RCF)	GAIL	131	7	26"	6.4	91%
KG Basin	GAIL	884	16	18"	5.4	34%
Cauvery Basin	GAIL	306	9	18"	3.3	38%
GSPL network	GSPL	2692	43	Assorted	34.6	80%
Total		14103	237			

Source: PPAC

Exhibit 3: GAIL and GSPL's share in the total pipeline network as on 01/04/2019

S. no.	Transporter	Length in KM	Percentage share
1	GAIL	11411	69.9%
2	RGTIL / RGPL	1784	10.9%
3	GSPL	2692	16.5%
4	AGCL/DNPL	297	1.8%
5	IOCL	140	0.9%
	Total	**16324**	**100.0%**

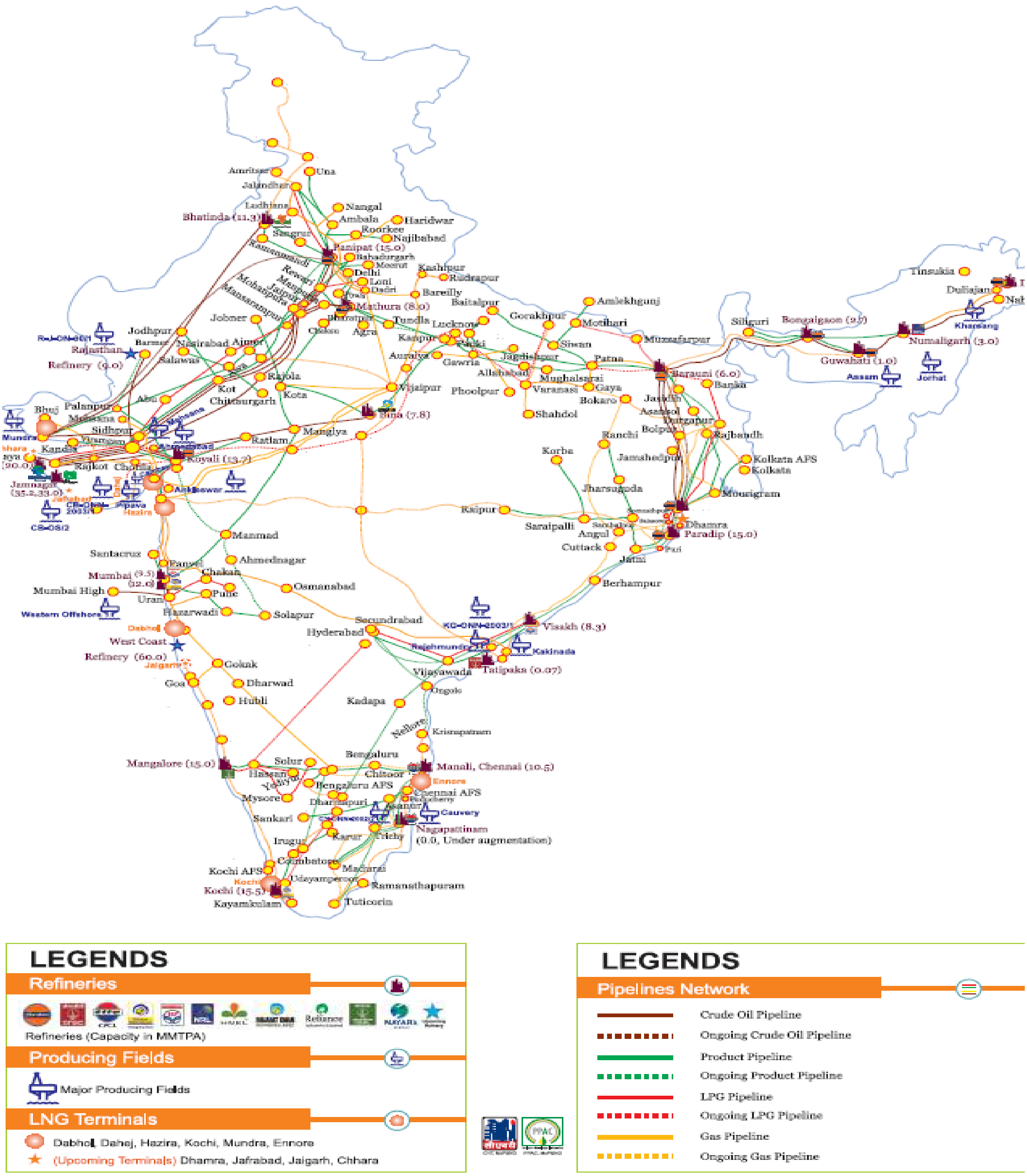
Source: PPAC

Exhibit 4: Total length of GAIL and GSPL's pipeline as on 30/06/2022

Nature of pipeline		GAIL	GSPL	PIL	IOCL	AGCL	RGPL	GGL	DFPCL	ONGC	GIGL	GITL	Others*	Total
Operational	Length	9,602	2,695	1,459	143	107	304	73	42	24				14,449
	Capacity	167.2	43.0	85.0	20.0	2.4	3.5	5.1	0.7	6.0				333
Partially commissioned#	Length	4,519			166						1,131	365		6,180
	Capacity				-						-	-		-
Total operational length		14,121	2,695	1,459	309	107	304	73	42	24	1,131	365	0	20,629
Under construction	Length	5,404	100		1,265						1,201	1,666	3,550	13,186
	Capacity	-	3.0		-						-	-	149.0	-
Total length		19,524	2,795	1,459	1,574	107	304	73	42	24	2,332	2,031	3,550	33,815

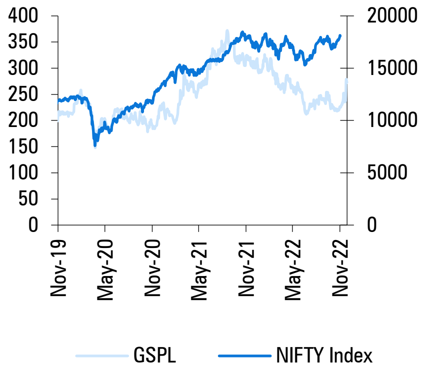
Source: PPAC

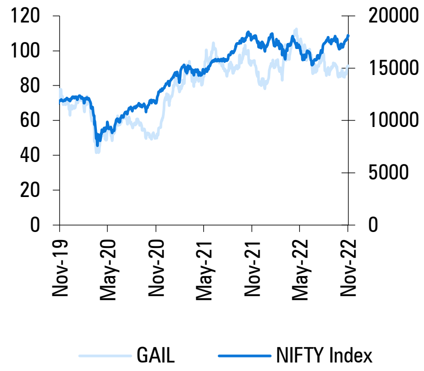
Exhibit 5: Oil and Gas Map of India



Source: PPAC

Price Chart (GSPL)	Price Chart (GAIL)





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Buy: >15%

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