

CRISIL's criteria for rating LPG parallel marketeers

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Executive summary

The Ministry of Petroleum and Natural Gas has mandated that liquefied petroleum gas (LPG) and auto LPG parallel marketeers will not be able to operate unless they obtain a rating. Further, they may use only imported LPG for carrying out their business. Towards this, the ministry has announced a four-point ratings scale - 'good', 'satisfactory', 'low risk' and 'high risk'.

The ministry said all parallel marketeers must obtain a rating and that auto LPG parallel marketeers must have at least a 'low risk' rating to carry out business.

CRISIL was one of the rating agencies that had been selected to provide ratings to these LPG marketeers based on their capability, infrastructure and business readiness. CRISIL's evaluation methodology is based on four parameters – market position, sourcing and storage infrastructure, operations, and financial flexibility. The final rating is based on the combined score of the four parameters.

Regulations regarding LPG/auto LPG ratings

According to the Liquefied Petroleum Gas (Regulation of Supply and Distribution) Order, 2000, issued by the Ministry of Petroleum and Natural Gas on April 26, 2000, no marketeer will commence business, such as importing, storing, transporting, bottling, marketing, distribution and sale – or any activity relating to the LPG business – without obtaining a rating, which certifies the marketeer's capability, infrastructure, business readiness including provision for adequate safety back-up for transportation, accident relief during transportation, and attending to emergency complaints of customers. These regulations were extended to auto LPG parallel marketeers, and as per the Gazette of India, No. 393, dated August 1, 2001, no parallel auto LPG marketeer will commence business, such as import (including auto LPG import substitution), transport, marketing, distribution and sale of automotive fuel, without obtaining a minimum of 'low risk' rating certificate on the basis of evaluation of the infrastructure network, readiness, and ability to deliver the goods and services.

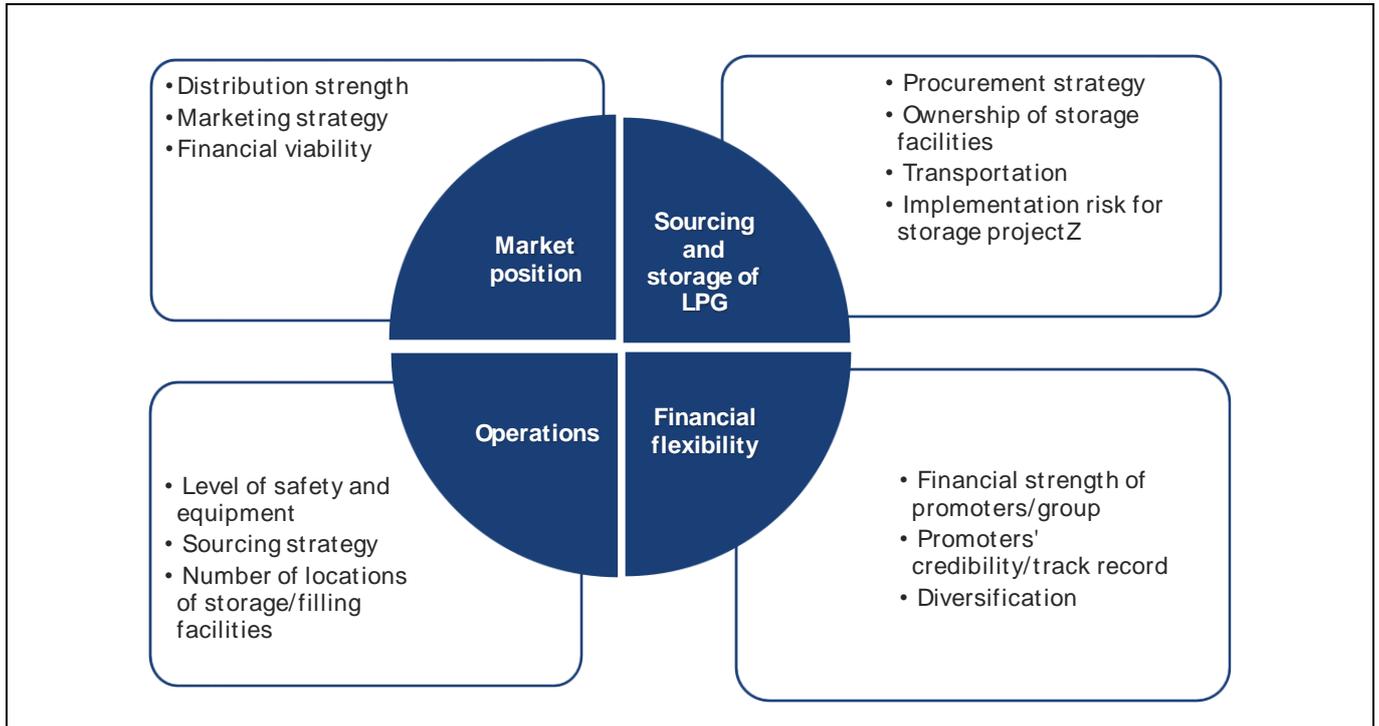
Scope and rating validity

This criteria will apply only to parallel marketeers, as defined in the Liquefied Petroleum Gas (Regulation of Supply and Distribution) Order, 2000, issued by the Ministry of Petroleum and Natural Gas, dated April 26, 2000, and for parallel marketeers of auto LPG, as defined in the Gazette of India No. 393, dated August 1, 2001.

The validity of the assigned 'good' or 'satisfactory' grade by CRISIL will be for two years, and for 'low risk' or 'high risk', for one year.

Grade	Signifier	Validity
1	Good	2 years
2	Satisfactory	2 years
3	Low risk	1 year
4	High risk	1 year

Methodology



Market position

- **Market radius:** Under this parameter, the marketeer's market penetration, in terms of strength of its existing and planned distribution network, is evaluated. A wide geographical coverage with an entrenched distribution network helps to not only address location-related risks, but also ensure low-cost delivery.
- **Marketing strategy:** The selling strategy and value-added services provided to customers are assessed. For example, for LPG parallel marketeers, the franchise ownership model is ascertained and the risk-reward of the strategy evaluated. Also taken into account is value-added services in LPG parallel marketing, which include provision of cylinder stands and stoves for customers, and set up of advance billing systems. How diversified is the customer base is also looked at – that is, in terms of sectors catered to – industrial, commercial and domestic. Typically, a diversified business catering to multiple customer segments is considered favourably. For auto LPG parallel marketeers, the strategy towards establishing and owning auto LPG dispensing stations is assessed as well. Value-added services for auto LPG parallel marketeers could include the fitting of auto LPG kits in automobiles.
- **Financial viability:** CRISIL analyses marketeers on several financial parameters, such as return on capital employed, profitability, sales and net worth.

Sourcing and storage of LPG

- **Procurement strategy:** Only imported LPG can be sold through the parallel marketing system. However, there are marketeers who directly import the LPG, and others who purchase the product from importers. The procurement strategy has a significant bearing on cost, with long-term direct sourcing reducing cost, expanding profit margin and ensuring steady availability of the product, thus, providing sustainability to the business.

- **Ownership of storage facilities:** CRISIL evaluates whether the storage facilities used by the marketeer are owned, and whether these owned facilities are sufficient for the entire operations of the business. Owned storage facilities not only lower the cost of distributing LPG, but also ensures timely availability, thus supporting business continuity.
- **Transportation:** Proximity to a port where LPG can be sourced from improves access, in terms of increased availability and lower cost of transportation. In case the port is at a distance, CRISIL evaluates whether there exists an established network to transport the LPG from the nearest LPG port to the facility. This factor assumes prominence given the high transportation cost involved.
- **Implementation risk for storage project:** CRISIL also takes into account risks associated with the setting up and expansion of facilities. These involve capital expenditure and demand risks. CRISIL evaluates the degree of planning and whether there is a market available. In case the project is under execution, it also assesses the degree of completion. Thus, this parameter evaluates project implementation as well as stabilisation risks.

Operations

- **Level of safety and equipment:** Licences from the Petroleum and Explosives Safety Organisation (PESO), with respect to the safety levels of the plant, are looked at by CRISIL. PESO's objectives include administration of responsibilities delegated under Explosives Act 1884 and Petroleum Act 1934, and rules related to the manufacture, import, export, transport, possession, sale and use of explosives, petroleum products and compressed gases. A set of licences from PESO are essential for a parallel marketeer to carry out business. Further, the extent and type of insurance availed by the entity is evaluated.
- **Sourcing strategy:** CRISIL evaluates whether the material procured is from a single or multiple vendors. The extent of integration is also analysed.
- **Number of locations/storage network:** The number of locations where the parallel marketeer has storage and filling facilities is gauged. Having multiple locations typically entails lower risk.

Financial flexibility

- **Financial strength of promoters/group:** The ability of the promoter(s) to infuse funds to sustain the business and grow it sustainably, and provide support in times of stress is assessed by CRISIL.
- **Promoter's credibility:** CRISIL assesses the background of the promoter(s), their relevant experience and reputation in the market. The track record of the promoter(s) in the business is also evaluated.
- **Diversification:** The dependence of the entity on the LPG business is evaluated. Diversified entities with limited dependence on any one segment are considered less risky.

Conclusion

CRISIL's framework takes into account the guidelines issued by the Ministry of Petroleum and Natural Gas to evaluate the LPG and auto LPG parallel marketeers' capability, infrastructure network and readiness to carry out the business, and to deliver the goods and services. To assess these, a wide range of parameters are evaluated, including market position, sourcing and storage of LPG, operations, and financial flexibility.

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