September 30, 2021

Mahanagar Gas Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term debt programme	100.00	100.00	[ICRA]AAA (Stable); reaffirmed
Long-term Non-Fund-based Limits	200.00	200.00	[ICRA]AAA (Stable); reaffirmed
Short-term Non-Fund based Limits	400.00	400.00	[ICRA]A1+; reaffirmed
Total	700.00	700.00	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation factors in the strong parentage of Mahanagar Gas Limited (MGL); its dominant position in the Greater Mumbai (Geographical Area 1, or GA1), surrounding expansion areas (GA2) and Raigad (GA3), as well as its diversified customer profile. Despite the expiry of MGL's marketing exclusivity in both GA1 and GA2 a few years ago and infrastructure exclusivity in May 2020 for GA1, ICRA expects it to continue to enjoy a dominant market share because of its first-mover advantage, as evident from its established infrastructure network. Apart from GA1, MGL continues to enjoy network/infrastructure exclusivity in all its GAs. In addition, there are significant entry barriers for third-party marketers or new entrants, arising mainly from concerns regarding gas availability at competitive prices. MGL benefits from its strong parentage (GAIL India Limited) in terms of technical/management support and operational synergy through its tie-up for sourcing natural gas for meeting a sizeable part of its requirements. The ratings consider the favourable outlook for demand growth in both compressed natural gas (CNG) and piped natural gas (PNG) categories, given the push by the Government of India (GoI) to promote the use of cleaner fuels and the cost advantage of CNG and PNG over alternative fuels. The ratings also consider the company's strong financial profile characterised by healthy profitability levels, zero debt and strong liquidity profile, with sizeable unencumbered cash balances and liquid investments.

Despite significant dip in sales in Q1 FY2021 due to the adverse impact of the pandemic/nationwide lockdowns, MGL reported strong recovery in sales with an operating income (OI) of Rs. 2,152.5 crore in FY2021 against Rs. 2,972.1 crore in FY2020. It recorded some moderation in revenue in Q1 FY2022 owing to the second wave of the pandemic, though the impact was significantly lower than during first wave. Regasified Liquified Natural Gas (RLNG) prices have firmed up in recent quarters and domestic gas prices are also likely to witness a sharp increase in the near term. While this is likely to lead to some moderation in margins, the impact is expected to be mitigated, to a large extent, as the company has long-term tie-ups for sourcing of gas and would be able to absorb the same through price revisions in the various business segments, as witnessed in the past when it undertook regular price revisions to maintain its margins. MGL's EBITDA[1] per standard cubic metre (scm) of gas sold also increased to Rs. 11.57 in FY2021 from Rs. 9.75 in FY2020, among one of the highest in the domestic CGD sector. Nonetheless, the company's ability to avail price hikes and the long-term demand prospects remain exposed to the changes in spread between CNG/PNG and alternative fuel prices.

ICRA notes that MGL is undertaking capex for expanding its network in Raigad (GA3) as well as its existing GAs. MGL has achieved slower than expected progress on its infrastructure plans in Raigad compared to the minimum work programme (MWP) submitted to the GoI, due to delays in receiving necessary approvals and impact of Covid-19 pandemic. The company

[1] *Earnings before interest, taxes, depreciation, and amortisation*

has achieved its target for setting up domestic connections, however, it is behind in laying inch km of steel pipeline, and the company has requested Petroleum and Natural Gas Regulatory Board (PNGRB) for an extension till March 2022. Nonetheless, potential encashment of the bank guarantee submitted by MGL to PNGRB for Raigad remains a key rating sensitivity.

ICRA also notes the company's interest in bidding for additional cities in further rounds of competitive bidding for CGD networks. MGL has aggressive expansion plans entailing an outlay of ~Rs. 600-800 crore p.a. over the next few years. While the large scale of the capex and the gestation period associated with build-up of sales volumes are expected to have some moderating impact on the company's return and credit metrics, the same is expected to remain robust on an absolute basis.

The Stable outlook reflects ICRA's expectation that MGL will continue to benefit from its well-established market position, strong parentage and favourable demand outlook.

Key rating drivers and their description

Credit strengths

Dominant position in gas distribution business in Greater Mumbai and expansion areas - At present, MGL enjoys a dominant position and first-mover advantage in retail gas distribution in Greater Mumbai (GA1), its expansion areas (GA2) and Raigad (GA3). By the provisions of the PNGRB Act, the company enjoys infrastructure exclusivity in GA3 for a 25-year period, i.e., till 2040. The company has, thus, been able to take the regular price hikes to factor in any increase in input costs, thereby protecting its operating profits.

Strong parentage, with deep understanding and interest in the domestic gas business - MGL is promoted by GAIL (India) Limited (GAIL, [ICRA]AAA (Stable)/[ICRA]A1+), who has a deep understanding and interest in the domestic gas distribution business. The chairman of GAIL is currently serving as the chairman of MGL. GAIL has a 32.5% shareholding in MGL. Further, a favourable allocation policy assures gas availability from GAIL for CNG and PNG (domestic) segments. In February 2014, the GoI announced allocation of 100% domestic gas towards CNG and PNG (domestic) segments of CGD entities, up from the initial 80% proportional allocation. However, for its PNG (industrial and commercial) segments, where there is growth potential in the expansion areas, MGL's ability to meet additional gas requirements at competitive prices would remain critical.

Favourable outlook on demand growth in both CNG and PNG segments, given the price differential between gas and liquid fuels, apart from other advantages – Despite some moderation in demand due to the adverse impact of the pandemic, the medium to long-term outlook for the CGD sector remains favourable for existing cities, where incumbents are already operational with domestic gas allocation in place for CNG and PNG (domestic) segments, which should witness healthy growth in volumes. While growth of CNG would be supported further by conversion of auto-rickshaws and taxis to CNG and its cost advantage over alternative fuels, the PNG (domestic) segment will continue to benefit from the cessation of LPG subsidy by the government. The PNG (industrial and commercial) segment would, however, continue to face intense competition from alternative liquid fuels.

Strong financial profile with healthy profitability and return indicators; comfortable capital structure and healthy liquidity position – MGL's financial risk profile remains robust, as marked by sizeable scale of operations, strong cash accruals, comfortable liquidity profile and capital structure with healthy debt protection metrics and high profitability and return indicators. Despite significant dip in sales in Q1 FY2021 due to the adverse impact of the pandemic/nationwide lockdowns, MGL reported strong recovery in sales with an operating income (OI) of Rs. 2,152.5 crore in FY2021 against Rs. 2,972.1 crore in FY2020. However, it recorded some moderation in revenue in Q1 FY2022 owing to the second wave of the pandemic, though the impact was significantly lower as compared to the first wave.

Credit challenges

Operations exposed to changes in spread between CNG/PNG and alternative fuel prices - MGL relies primarily on spot buying for the PNG (industrial and commercial) categories. Therefore, MGL's operations in these price-sensitive segments are exposed to the spread between the PNG rates and the prices of alternative fuels (such as furnace oil, low sulphur heavy stock, bulk LPG, etc). While MGL receives 100% allocation of gas at Administrative Price Mechanism (APM) prices for CNG and PNG (domestic) categories, volume growth in these categories could be impacted by any sharp changes in the spread between APM gas prices and alternative fuel prices.

Expiry of marketing exclusivity along with physical exclusivity in Key GAs, exposes MGL to threat from new entrants - Expiry of marketing exclusivity for GA1 and GA2 during 2012-2014, together with physical exclusivity for GA1 in May 2020, exposes the company to threat from new entrants. However, it continues to benefit from the first-mover advantage and steady development of CGD infrastructure undertaken by it in these areas. Moreover, any third-party marketer looking to utilise MGL's infrastructure for CNG/PNG sales, will face issues associated with its ability to secure gas supplies at competitive rates, operational issues related to retail management set-up/expertise (billing, collection and metering along with after-sales/repair related services) and unattractiveness of returns in case of low sales volume.

Slower than expected progress on ongoing expansion in Raigad - MGL continues to make progress in Raigad, albeit at a gradual pace, due to delays in getting approvals and impact of Covid-19. While the company has achieved its target for setting up domestic connections, it is behind the minimum work programme (MWP) target for laying inch km of steel pipeline. Accordingly, the company has requested PNGRB for extension till March 2022. However, any potential encashment of the bank guarantee submitted by MGL to the PNGRB for Raigad remains a key rating sensitivity.

Liquidity position: Superior

MGL has a healthy liquidity profile with sizeable unencumbered cash and cash equivalents of ~Rs. 1,486 crore as of March 31, 2021. Further, MGL has been generating healthy cash accruals, which increased to ~ Rs. 438 crore in FY2021 and has no long-term debt repayment obligations at present. The company's liquidity profile should remain healthy despite its expansion plans given the healthy profitability of its operations and high liquid investments.

Rating sensitivities

Positive factors – NA

Negative factors – Negative pressure on ratings may arise because of any large debt funded acquisition or slippage from MWP commitments leading to large penalties or any adverse regulatory developments impacting the revenues and profitability on a sustained basis or any significant decline in profitability emanating from increased competition from new entrants on open access basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the City Gas Distribution companies
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company.

About the company

Mahanagar Gas Limited (MGL) was incorporated in 1995 as a joint venture between GAIL (India) Limited (GAIL) and BG Asia Pacific Holdings Pte Limited (BGAPH) - a Royal Dutch Shell Plc subsidiary. Subsequently, the company was listed in June 2016, after which both GAIL and BGAPH's stake reduced to 32.5% each, with the remaining 35% stake held by the public (of which 10% is with the State Government of Maharashtra). Further, in August 2019, BGAPH sold its entire stake in the company. Now GAIL is the only promoter in the company.

Over the past two decades, MGL has established a firm presence in the Greater Mumbai gas distribution business, where it is the dominant player, with its growth primarily driven by the CNG business, which contributes 70-75% of its revenues at present. The company also supplies piped natural gas (PNG) to industrial, commercial, and residential segments. The company sources most of its gas requirements from GAIL, while a small part is bought from the spot market. MGL has put in place large plans to augment its gas distribution network in the existing Mumbai region as well as expand its network in the surrounding regions of Mumbai. The company currently operates in three Geographical Areas (GAs)—GA1, which includes the Greater Mumbai region; GA2, which includes expansion areas, such as Mira-Bhayander, Thane-Vashi-Belapur (TVB), Kharghar-Panvel-Taloja (KPT), Kalyan-Dombivli-Ambernath and Ulhasnagar (KD& AB); and GA3, which is the Raigad district (won by the company in 2015).

Key financial indicators (audited)

LTHL Consolidated	FY2020	FY2021
Operating Income (Rs. crore)	2,972.1	2,152.5
PAT (Rs. crore)	793.5	619.6
OPBDIT/OI (%)	35.4%	43.4%
PAT/OI (%)	26.7%	28.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.4
Total Debt/OPBDIT (times)	-	-
Interest Coverage (times)	161.3	129.8

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Aug 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY20119
					Sep 30, 2021	Sep 21, 2020	June 06, 2019	June 06, 2018
1	Debt Programme	Long-term	100.00	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2	Non-fund based bank facilities	Long-term	200.00	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)/	[ICRA]AAA (Stable)	[ICRA]AAA (Stable
3	Non-fund based bank facilities	Short-term	400.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Debt Programme	Simple
Long-term/ Short -term – Non-fund Based Working Capital	Very Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: Click Here

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
Yet to be placed	Long-Term Debt Programme	NA	NA	NA	100.0	[ICRA]AAA (Stable)
Axis Bank	Long-Term Non-Fund Based – Working Capital Facilities	NA	NA	NA	115.0	[ICRA]AAA (Stable)
IndusInd Bank	Long-Term Non-Fund Based – Working Capital Facilities	NA	NA	NA	30.0	[ICRA]AAA (Stable)
Kotak Bank	Long-Term Non-Fund Based – Working Capital Facilities	NA	NA	NA	20.0	[ICRA]AAA (Stable)
Union	Long-Term Non-Fund Based – Working Capital Facilities	NA	NA	NA	4.0	[ICRA]AAA (Stable)
NA	Long-Term Non-Fund Based – Working Capital Facilities	NA	NA	NA	31.0	[ICRA]AAA (Stable)
Standard Chartered Bank	Short-Term Non-Fund Based – Working Capital Facilities	NA	NA	NA	80.0	[ICRA]A1+
Axis Bank	Short-Term Non-Fund Based – Working Capital Facilities	NA	NA	NA	135.0	[ICRA]A1+
IndusInd Bank	Short-Term Non-Fund Based – Working Capital Facilities	NA	NA	NA	20.0	[ICRA]A1+
Kotak Bank	Short-Term Non-Fund Based – Working Capital Facilities	NA	NA	NA	160.0	[ICRA]A1+
NA	Short-Term Non-Fund Based – Working Capital Facilities	NA	NA	NA	5.0	[ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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