June 06, 2019

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 current monopoly in the Greater Mumbai (Geographical Area 1 - GA1) and surrounding expansion areas (GA2), as well as its diversified customer profile. Despite the expiry of MGL's marketing exclusivity in both GA1 and GA2 a few years back, ICRA expects it to continue to enjoy a dominant market share because of its first-mover advantage, as evident from its established infrastructure network. MGL continues to enjoy network/infrastructure exclusivity in all its GAs. While its network exclusivity is set to expire in May 2020 for GA1 (and April 2030 for GA2), the same can be further extended for a block of 10 years through application to the Petroleum and Natural Gas Regulatory Board (PNGRB). In addition, there are significant entry barriers for third-party marketers or new entrants, arising mainly from concerns regarding gas availability at competitive prices. 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 take into account the company's strong financial profile characterised by healthy profitability levels, zero debt and strong liquidity profile, with sizeable free cash balances and liquid investments (Rs. 941 crore as on March 31, 2019).

The ratings also take into account the competitive advantage of gas over alternative fuels (especially in CNG and domestic segments) and the consequent positive impact on demand. While the city gas distribution (CGD) sector enjoyed lower gas costs due to a decline in global gas indices, the GoI-announced price for gas allocation increased in H2 FY2018 and FY2019, leading to higher gas costs for CGD players. However, the company has undertaken regular price revisions (two upward revisions in FY2019 and one in FY2020 so far), leading to improvement in its contribution levels. The company's EBITDA[1] per standard cubic meter (scm) of gas sold also increased to Rs. 8.22 in FY2019 from Rs. 7.91 in FY2018, among 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 setting up its network in Raigad, Maharashtra (its third GA). MGL has achieved limited 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. As a result, MGL submitted a revised catch-up plan to the PNGRB in August 2018 and is primarily on track as per the requirements pertaining to pipeline length and

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

domestic connections laid out. Nonetheless, potential encashment of the bank guarantee submitted by MGL to the PNGRB for Raigad remains a key rating sensitivity.

Outlook: Stable

ICRA expects MGL to continue to benefit from its well-established market position and strong parentage. The outlook may be revised to Negative in case of any material increase in gas costs that the company is unable to adequately pass on to its customers. Any adverse regulatory development would also be a rating sensitivity.

Key rating drivers

Credit strengths

Monopoly in gas distribution business in Greater Mumbai and expansion areas - At present, MGL enjoys a near-monopoly status and has a first-mover advantage in retail gas distribution in Greater Mumbai (GA1) and its expansion areas (GA2). The company has, thus, been able to take the regular price hikes to factor in the increase in input costs, thereby protecting its operating profits.

Strong parentage - MGL is jointly promoted by GAIL (India) Limited (GAIL, [ICRA]AAA (Stable)/[ICRA]A1+) and BG Asia Pacific Holdings Pte Limited (BGAPH, a Royal Dutch Shell subsidiary), who have 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, while BGAPH's current stake is 10.0% (reduced gradually from 32.5% by stake sale in April 2018). ICRA has noted the reduction in BGAPH's equity stake in MGL but does not foresee any material impact on MGL, even if BGAPH exits, owing to GAIL's continued presence as a promoter and MGL's established business position.

Favourable outlook on demand growth in CNG and PNG segments - The 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 8-10% 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 for high-income consumers. The PNG (industrial and commercial) segment would, however, continue to face intense competition from alternative liquid fuels.

Secure gas tie-up with GAIL - 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.

Healthy financial profile - The company has a healthy financial profile characterised by high profitability and return indicators. Also, MGL has a comfortable capital structure with negligible gearing levels, strong coverage metrics, and a sound liquidity position.

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 the APM gas prices and the alternative fuel prices.

Limited progress on ongoing expansion in Raigad - The company is currently setting up its network in its new GA (Raigad). The same has witnessed significant delays on account of delays in getting land acquisition approvals, as the concerned area lies in an eco-reserve. MGL submitted a revised catch-up plan to the PNGRB in August 2018. At present, the company has achieved limited physical progress at Raigad, though it plans to ramp up activity over the near to medium term. The potential encashment of the bank guarantee submitted by MGL to the PNGRB for Raigad remains a key rating sensitivity.

Liquidity position

MGL has a healthy liquidity profile, with sizeable free cash and cash equivalents of Rs. 941 crore as on March 31, 2019. Further, MGL generates healthy cash accruals and has no long-term debt repayment obligations at present. It has adequate cushion available in the form of unutilised non-fund based limits. The company's liquidity profile should remain healthy despite its expansion plans, given the healthy profitability of its operations and the high liquid investments.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Rating Methodology for 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 is a joint venture between GAIL and BGAPH. The company was listed in July 2016, after which both GAIL and BGAPH's stake reduced to 32.5% each, with the remaining 35% stake being held by the public (of which 10% remains with the Government of Maharashtra). In 2018, BGAPH gradually sold its 22.5% stake in MGL, thereby reducing its total stake in the company to 10%, while the pubic shareholding increased to 47.5%.

MGL has, over the last 23 years, established a firm presence in the Greater Mumbai gas distribution business (where it enjoys a monopoly), with its growth being driven primarily by the CNG category, which currently contributes 70-75% to its revenues. The company also supplies PNG to industrial, commercial, and residential/domestic segments. MGL has put in place large plans to augment its gas distribution network in the existing Mumbai region as well as the surrounding regions. The company currently operates in three 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), and GA3 (the Raigad district, won by the company in April 2015).

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	2,233.0	2,791.1
PAT (Rs. crore)	477.9	546.4
OPBDIT/OI (%)	35.0%	31.7%
RoCE (%)	41.7%	40.4%
Total Debt/TNW (times)	0.0	0.0
Total Debt/OPBDIT (times)	0.0	0.0
Interest Coverage (times)	8,657.1	2,767.0

Status of non-cooperation with previous CRA: Not applicable

Any other information: A member of the board of directors of ICRA Limited is also an Independent Director on the board of directors of Mahanagar Gas Limited. This director was not involved in any of the discussions and processes related to the rating of the instrument(s) mentioned herein.

Rating history for last three years

		Current Rating (FY2020)				Chronology of Rating History for the past 3 years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating June 2019	Date & Rating in FY2019 June 2018	Date & Rating in FY2018 May 2017	Date & Rating in FY2017 April 2016
1	Debt Programme	Long Term	100.00	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2	Non-fund Based Limits	Long Term	200.00	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
3	Non-fund Based Limits	Short Term	400.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance/ Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-term Debt Programme	Yet to be placed	-	-	100.00	[ICRA]AAA (Stable)
NA	Long-term Non-fund Based Limits	-	-	-	200.00	[ICRA]AAA (Stable)
NA	Short-term Non-fund Based Limits	-	-	-	400.00	[ICRA]A1+

Source: Mahanagar Gas Limited

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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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