March 10, 2022

Sabarmati Gas Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	15.46	0.00	-
Long-Term Fund-based - CC	13.50	13.50	[ICRA]AA-(Stable); reaffirmed
Long-Term Non-fund Based	251.50	251.50	[ICRA]AA-(Stable); reaffirmed
Long-Term/Short Term Unallocated	94.98	110.44	[ICRA]AA-(Stable)/[ICRA]A1+; Reaffirmed
Total	**375.44**	**375.44**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation takes into account the strong parentage of Sabarmati Gas Limited (SGL) with Bharat Petroleum Corporation Limited (BPCL) and Gujarat State Petroleum Corporation (GSPC) as the main promoters. The ratings continue to draw comfort from SGL's strong financial risk profile characterised by healthy profitability, return indicators, capital structure and coverage metrics in FY2021 and H1 FY2022. The ratings also factor in the increasing contribution of compressed natural gas (CNG) in the total sales volumes, improving the gross contribution margin. The long-term favourable demand prospects for city gas distribution (CGD) business in India and SGL's strong market position in its areas of operation also work in favour of the rating action.

Though the company's marketing exclusivity expired in October 2014, ICRA expects the company to continue to have a dominant market share in the near term because of its first-mover advantage evident from its established network. In addition, there are significant entry barriers for third-party marketers due to (i) issues of gas availability at competitive prices and (ii) regulated returns (at 21% pre-tax RoCE) to be paid by third parties to SGL through network tariff and compression charge because of the physical exclusivity in place (25 years starting from 2009).

The ratings also factor in SGL's long-term take-or-pay contracts for re-gasified liquefied natural gas (R-LNG) sourcing, covering its entire piped natural gas (PNG) requirement for industrial and commercial segments, assuring an uninterrupted supply.

The ratings, however, remain constrained by the expected pressure on SGL's profitability as gas prices have been on the uptrend and the company would not be able to pass on fully the hike in input costs reflected in its operating profit of 26.5% in 9M FY2022 from 32% in FY2021. However, SGL has contracts in place for R-LNG (on account of the long-term sourcing contracts with BPCL and GSPC) which would provide cushion. Moreover, SGL has moderate growth prospects with authorisation in only four GAs and no new GAs have been awarded in the recently concluded bid rounds.

The Stable outlook reflects ICRA's expectations that given the favourable demand outlook, SGL's sales volume is expected to show moderate growth, driven by increased CNG offtake. In addition, the availability of low-cost domestic gas for the CNG and PNG (domestic) segments and a comfortable contribution margin should result in healthy profitability and cash generation.

Key rating drivers

Credit strengths

Strong parentage - BPCL holds a 49.94% stake in SGL, while GSPC (22.47%) and Gujarat State Petronet Limited or GSPL (27.47%) have formed a consortium to hold ~49.94% stake together. The parent companies are dominant players in the oil and gas sector and have extensive understanding and interest in the domestic gas business.

Diversified business portfolio with increasing CNG contribution - Over the last few years, the company's sales mix has become more balanced. The contribution of PNG (industrial) in the overall sales mix has reduced to 46% in FY2021 and further to 44% in H1 FY2022 (against 57% in FY2017). On the other hand, the CNG contribution has grown at a steady pace over the years and accounted for 46% of the total sales volume in FY2021 and 49% in H1 FY2022 (against 39% in FY2017). SGL's sales volumes reported a modest decline of 4% YoY in FY2021 to reach 0.99 million standard cubic meters of gas per day (mmscmd) due to the pandemic; however, the sales volumes have improved by 22% in H1 FY2022 at 1.21 mmscmd with the improvement in demand.

Long-term tie-up for gas sourcing ensures uninterrupted supply - SGL has secured itself to a large extent on the purchase side by entering into long-term contracts with BPCL and GSPC for its R-LNG requirement. These long-term take-or-pay contracts cover its entire PNG requirement for the industrial and commercial segments, assuring uninterrupted supply. On the other hand, following the GoI directive on the allocation of 100% domestic gas to CNG and PNG (domestic) segments in February 2014, SGL has been receiving the same from GAIL Ltd.

Healthy financial risk profile - SGL registered a significant improvement in margins in FY2021 owing to improved proportion of the higher-margin CNG and PNG (domestic) in its overall sales mix. While the operating income declined marginally in FY2021 owing to lower volumes due to the adverse impact of the pandemic, the same has improved significantly in 9M FY2022 with the overall improvement in demand and realisations. The operating margin, which stood at 18.3% in FY2020, improved significantly to 32.2% in FY2021 as the company retained higher contribution. Further, healthy cash accruals and the ongoing repayment of the term loan helped achieve a sustained improvement in the capital structure as SGL does not have any outstanding external debt obligations as on September 30, 2021. SGL's debt protection metrics remained strong with interest coverage metrics (OPBDIT/Interest and Finance) at 702.5 times and total debt/OPBDIT at 0.01 times in FY2021.

Credit challenges

Operations exposed to changes in spread between CNG/PNG and alternative fuel prices – The operating margins are expected to moderate in FY2022 as the gas cost has been on an uptrend which is reflected in the moderation in the operating margin in 9M FY2022 at 26.5% against 32.2% in FY2021. However, the long-term gas contracts limit the contraction in margin to a certain extent. Also, for the PNG (industrial) segment, consumer preference for the fuel depends on the available spread between natural gas and alternative fuel. Hence, a narrowing price differential with alternative fuel could impact the overall demand growth. While CNG remains highly competitive with respect to petrol and diesel, the competitiveness of PNG (industrial) remains modest compared to alternative industrial fuels.

Competitive risks from third-party marketers following expiry of marketing exclusivity - After the expiry of marketing exclusivity in SGL's key geographical areas in October 2014, the company remains exposed to competition from third-party marketers. However, for any such marketer, ICRA notes that there are significant entry barriers with the payment of network tariff and compression charge on regulated assets to SGL during the physical exclusivity period (25 years starting from 2009) being the most significant as it accounts for a sizeable portion of the overall margin. Also, there are issues associated with the ability to get 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 unattractive returns in case of low sales volumes.

Moderate growth prospects with no new GAs awarded – SGL has been awarded four GAs which has been operational for more than five years now. The company has not been awarded any new GAs in the 10th and 11th CGD bid round. While this leads to no new capex commitments for SGL on that front, the volume growth is expected to remain moderate.

Liquidity position: Strong

SGL's liquidity position remains strong with healthy annual fund flow from operations of Rs. 266.3 crore in FY2021 and surplus cash and liquid investments of Rs. 409.7 crore as on December 31, 2021. The company had a sanctioned fund-based working capital facility of Rs. 13.5 crore as on December 31, 2021, the average utilisation of which remained nil over the past 12 months. Further, the company does not have any outstanding debt, resulting in a debt-free position with no repayment obligation and a moderate capex requirement.

Rating sensitivities

Positive factors – Clarity on BPCL's (promoter company) disinvestment plan and the future ownership of SGL will be key for a rating upgrade. ICRA could also upgrade the ratings if there is a significant increase in gas sales volume coupled with the maintenance of healthy gross contribution on a sustained basis.

Negative factors – Negative pressure on the ratings can arise if the gross contribution drops and remains below Rs. 6.5/scm on a sustained basis or if there is a significant drop in gas sale volumes. Any unfavourable change in the domestic gas allocation policy will also exert pressure on the ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for City Gas Distribution Companies
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on the standalone financial profile of the company.

About the company

Sabarmati Gas Limited was incorporated on June 6, 2006, by BPCL along with GSPC/GSPL to carry on the CGD business in the four North Gujarat districts of Gandhinagar, Mehsana, Sabarkantha and Patan. Prior to the formation of the joint venture (JV), BPCL independently carried on the CGD business in these districts. Subsequent to the JV, BPCL stopped its own CGD operations in these districts and transferred the assets to the entity. BPCL and the GSPC-GSPL conglomerate hold 49.94% stake each, while the remaining 0.12% stake is held by 12 individual shareholders. SGL retails PNG and CNG to various sectors like industrial, domestic, commercial and transportation.

Key financial indicators (audited)

Standalone	FY2020	FY2021	9M FY22
Operating Income (Rs. crore)	1106.6	1049.9	1230.6
PAT (Rs. crore)	100.5	129.2	220.1
OPBDIT/OI (%)	18.3%	32.2%	26.5%
PAT/OI (%)	11.7%	21.5%	17.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.5	0.4	0.4
Total Debt/OPBDIT (times)	0.12	0.01	0.01
Interest Coverage (times)	60.2	179.2	767.2

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 on Sep 3, 2021 (Rs. crore)	Date & Rating on		Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					Mar 10, 2022	Feb 14, 2022	04-Jan-2021	10-Jan-2020	27-Dec-2018
1	Term Loan	Long Term	-	-	-	[ICRA] AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Long Term Fund Based - CC	Long Term	13.50	-	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
3	Long Term Non-fund Based	Long Term	251.50	-	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	-
4	Unallocated limits	Long Term/ Short Term	110.44	-	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/[ICRA]A1+	[ICRA]AA- (Stable)/[ICRA]A1+	[ICRA]AA- (Stable)/[ICRA]A1+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term Fund Based - CC	Simple
Long Term Non-fund Based	Very Simple
Unallocated limits	Not applicable

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: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Long Term Fund Based - CC	NA	NA	NA	13.50	[ICRA]AA-(Stable)
NA	Long Term Non-fund Based	NA	NA	NA	251.50	[ICRA]AA-(Stable)
NA	Long Term/Short Term Unallocated limits	NA	NA	NA	110.44	[ICRA]AA-(Stable)/[ICRA]A1+

Source: *Company*

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

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