May 19, 2023

Sabarmati Gas Limited: Long-term rating upgraded to [ICRA]AA(Stable); short-term rating reaffirmed and withdrawn; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Fund Based - Cash Credit	13.50	19.00	[ICRA]AA(Stable); upgraded from [ICRA]AA-(Stable)
Long Term - Non Fund Based - Others	251.50	361.00	[ICRA]AA(Stable); upgraded from [ICRA]AA-(Stable)
Long Term/Short Term - Unallocated	110.44	0.00	[ICRA]A1+; reaffirmed and withdrawn
Total	**375.44**	**380.00**	

**Instrument details are provided in Annexure-I*

Rationale

The rating upgrade of Sabarmati Gas Limited (SGL) takes into account its improving consumer mix with the rising revenue share of compressed natural gas (CNG) and domestic piped natural gas (PNG-d). The increased contribution from the higher-margin gas sales has improved SGL's cash generation significantly and the financial risk profile of the company is expected to remain healthy, going forward. In FY2023, sales of industrial PNG (PNG-I) declined owing to a sharp rise in imported natural gas prices which rendered the use of PNG(I) uneconomical vis-à-vis alternative fuels such as liquified petroleum gas (LPG)/propane. However, the decline in PNG(I) sales was offset by the sales growth in CNG and PNG(d) segments. Going forward, with the softening of imported natural gas prices, the sales volume of PNG(I) is expected to recover, which should support the company's cash generation along with expectations of a ramp up in the sales of CNG and PNG(d).

The rating continues to factor in the operational benefits derived from 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 rating continues to draw comfort from SGL's strong financial risk profile characterised by healthy profitability, return indicators, capital structure and coverage metrics in FY2022 and 9M FY2023, increasing contribution of compressed natural gas (CNG) in the total sales volumes, resulting in improved 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 is expected to keep the financial risk profile healthy.

ICRA also notes that the factors such as reduction in VAT levied by the Gujarat government to ~5% in FY2023 from ~15% on the sale of CNG and PNG(d), priority allocation of high-pressure high-temperature (HPHT) gas to CGD players for the PNG(d) and CNG segments and the linking of APM gas prices to the Indian crude basket following the Kirti Parikh committee's recommendations will collectively have a favourable impact on SGL's ability to offer competitive pricing to its consumers vis-à-vis competing fuels.

Though SGL'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 company expects to re-enter these contracts on expiry.

The ratings, however, remain constrained by SGL's limited growth prospects with authorisation in only four geographical areas (GAs) and no new GAs being awarded in the recently concluded bid rounds. The ratings are also constrained by the volatility in natural gas prices which can impact the competitive advantage SGL has over competing fuels. However, with the increase in the share of CNG and PNG(d), the impact on contribution levels on per unit basis is expected to remain moderate as the price pass-through in this segment remains relatively easy.

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.

ICRA has withdrawn the short-term rating outstanding, as the rated instrument has been extinguished, in line with its policy on withdrawal of credit ratings.

Key rating drivers and their description

Credit strengths

Operational benefits of 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. SGL initially benefited from its parentage in tying up natural gas supply contracts and receiving managerial guidance.

Diversified business portfolio with rising CNG contribution - Over the last few years, the company's sales mix has transformed with CNG contributing a major share of the revenue. The contribution of PNG (industrial) in the overall sales mix has reduced to 41% in FY2022 and further to 32% in FY2023 (against 60-70% a decade ago). On the other hand, CNG contribution has grown at a steady pace over the years and accounted for 51% of the total sales volume in FY2022 and 60% in FY2023 (against 25-30% a decade ago). SGL's sales volumes reported a modest decline of ~1.3% YoY in FY2023 to 1.07 million standard cubic metres of gas per day (mmscmd) as offtake from industrial customers decreased due to elevated R-LNG prices. The decline in PNG(I) sales was nearly offset by the growth in CNG offtake.

Long-term tie-up for gas sourcing ensures uninterrupted supply - SGL has secured its R-LNG requirement to a large extent by entering into long-term contracts with BPCL and GSPC. 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, for the CNG and PNG(d) segments, SGL has been receiving domestic APM gas and any shortfall in the gas allocation is being met from HPHT gas with the GoI's recent directive to prioritise CGD (CNG and PNG D) players bidding for HPHT gas.

Healthy financial risk profile – SGL continues to register healthy profitability and improved contribution margins owing to the increased share of the higher-margin CNG and PNG (d) in the overall sales mix. While the operating margins declined to 22.2% in 9M FY23 and 27.7% in FY2022 from 32.2% in FY2021 due higher realisations, the absolute profits have improved during the period. Further, healthy cash accruals and no outstanding external debt obligations as on December 31, 2022 support the credit profile. The financial risk profile is expected to improve further going forward on expectations of stable contribution margins, no debt repayments and limited capex plans.

Credit challenges

Operations exposed to changes in spread between CNG/PNG and alternative fuel prices – 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 contingent on the movement of R-LNG prices and appears to be reclaiming its competitiveness at presents.

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 such as the payment of network tariff and compression charge on regulated assets to SGL during the physical exclusivity period (25 years starting from 2009) 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 that have been operational for more than five years now. The company has not been awarded any new GAs in the recent CGD bid rounds. 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 is expected to remain strong, given the healthy cash generation, low working capital intensity of operations, no debt repayments and limited capex programmes which are to be funded using internal accruals. The company had liquid cash and investments of Rs. 684.4 crore as on December 31, 2022. While the company's dividend payments have risen over the last two years, the overall cash generation remains strong which will ensure a strong liquidity position despite the high dividend levels.

Rating sensitivities

Positive factors - ICRA could upgrade the ratings if SGL demonstrates a significant increase in gas sales volume while maintaining robust gross contributions along with healthy liquidity on a sustained basis.

Negative factors – Pressure on the ratings can arise if there is a significant drop in gross contribution or/and gas sales 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 Policy on Withdrawal of Credit Ratings
Parent/Group support	Not Applicable
Consolidation/Standalone	The ratings are 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 northern 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. After the JV was formed, 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)

SGL Standalone	FY2021	FY2022	9M FY2023^
Operating income	1,049.0	1,791.4	1,661.6
PAT	225.0	346.5	267.3
OPBDIT/OI	32.2%	27.7%	22.2%
PAT/OI	21.5%	19.3%	16.1%
Total outside liabilities/Tangible net worth (times)	0.4	0.3	0.3
Total debt/OPBDIT (times)	0.01	0.01	0.00
Interest coverage (times)	179.2	613.4	518.8

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore; ^Unaudited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on Mar 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021
					May 19, 2023	-	Mar 10, 2022	Feb 14, 2022	Jan 04, 2021
1	Term Loan	Long Term	-	-	-	-	-	[ICRA] AA- (Stable)	[ICRA]AA- (Stable)
2	Long Term Fund Based - CC	Long Term	19.00	-	[ICRA]AA (Stable)	-	[ICRA] AA- (Stable)	[ICRA] AA- (Stable)	[ICRA]AA- (Stable)
3	Long Term Non-fund Based	Long Term	361.00	-	[ICRA]AA (Stable)	-	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
4	Unallocated limits	Long Term/ Short Term	110.44	-	[ICRA]A1+ Reaffirmed & Withdrawn	-	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+

**The unallocated limit of Rs 110.44 crore was rated on short/long term scale, the amount is reduced to nil as it has shifted to other instruments and the short term rating has been withdrawn*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term Fund Based - CC	Simple
Long Term Non-Fund Based	Very Simple
Long Term/Short Term - Unallocated	NA

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 analysing 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 are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	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	19.00	[ICRA]AA (Stable)
NA	**Long Term Non-fund Based**	NA	NA	NA	361.00	[ICRA]AA (Stable)
NA	**Long Term/Short Term - Unallocated**	NA	NA	NA	110.44	[ICRA]A1+ withdrawn

*Source: Company; *The unallocated limit of Rs 110.44 crore was rated on short/long term scale, the amount is reduced to nil as it has shifted to other instruments and the short term rating has been withdrawn*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis – Not Applicable

ANALYST CONTACTS

Sabyasachi Majumdar
+91 124 4545 304
sabyasachi@icraindia.com

Prashant Vasisht
+91 124 4545 322
prashant.vasisht@icraindia.com

Varun Gogia
+91 124 4545 319
Varun.gogia1@icraindia.com

Adarsh Sule
+91 88 1889 4310
adarsh.sule@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

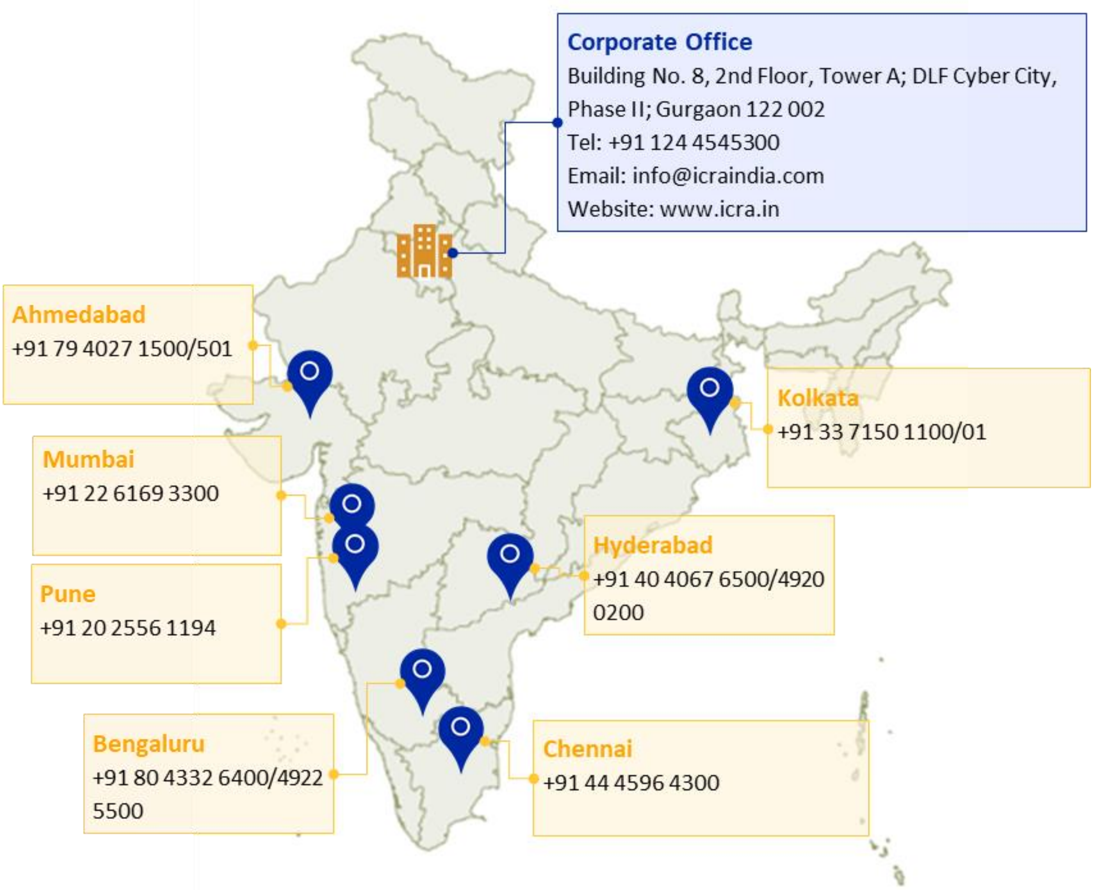
For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches



ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.