September 01, 2023

Mahanagar Gas Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term non-fund based limits	465.00	465.00	[ICRA]AAA (Stable); reaffirmed
Long-term fund-based limits	80.00	80.00	[ICRA]AAA (Stable); reaffirmed
Short-term non-fund based limits	910.00	910.00	[ICRA]A1+; reaffirmed
Short-term non-fund based limits (Sublimit)	(80.00)	(80.00)	[ICRA]A1+; reaffirmed
Short-term fund-based limits	12.50	12.50	[ICRA]A1+; reaffirmed
Short-term fund-based limits (Sublimit)	(2.00)	(2.00)	[ICRA]A1+; reaffirmed
Long-term/Short-term - Unallocated limits	32.50	32.50	[ICRA]AAA (Stable)/ [ICRA]A1+; reaffirmed
Total	**1,500.00**	**1,500.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings factor in the strong parentage of Mahanagar Gas Limited (MGL), its current exclusive position in the Greater Mumbai (geographical area 1, or GA1), surrounding expansion areas (GA2) and Raigad (GA3), as well as its diversified customer profile and robust credit 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 the company to continue to enjoy a dominant market share because of its first-mover advantage, 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 because of concerns regarding gas availability at competitive prices and the policy of open access being sub-judice.

MGL benefits from its strong parent, GAIL India Limited (GAIL, rated [ICRA]AAA (Stable)/[ICRA]A1+), 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.

The company reported a healthy growth in profitability in FY2023 compared to FY2022, supported by a robust volume growth of ~14%, healthy allocation of APM gas and priority allocation in the high pressure-high temperature (HPHT) gas bids. As a result, the share of high-priced spot LNG reduced, thereby supporting an improvement in the contribution margins during the year. At present, MGL derives a major share of its revenue from the sale of CNG (~73%) and PNG (d) segment (~14%). With the revision in the APM gas pricing methodology announced by the GoI in April 2023, APM prices have come down to $6.5/mmbtu which along with the availability of HPHT gas has stabilised the contribution margin on the sale of CNG and PNG(d) and will support healthy cash generation. Nonetheless, the company's ability to hike prices and the long-term demand prospects remain exposed to the changes in the spread between CNG/PNG and alternative fuels.

ICRA notes that MGL is undertaking capex to expand its network in Raigad (GA3) as well as the existing GAs. While the progress in Raigad was slower than expected compared to the minimum work programme (MWP) submitted to the GoI due to delays in receiving necessary approvals and the impact of the pandemic, the company had achieved its target of setting up domestic connections and laying inch km of steel pipeline in January 2022 itself. However, any potential partial encashment of the bank guarantee submitted by MGL to PNGRB for Raigad for the past delays remains a key rating sensitivity.

ICRA also notes that MGL had recently signed a share purchase agreement (SPA) with Ashoka Buildcon Limited along with its co-shareholder, an investment fund managed by Morgan Stanley India Infrastructure, to sell their 100% stake in Unison Enviro Private Limited {UEPL; rated [ICRA]AA- (CE) (Stable)} for a consideration of Rs. 531 crore. The acquisition is expected to enable MGL to expand to newer geographical areas in Maharashtra (Ratnagiri, Latur & Osmanabad) and Karnataka (Chitradurga & Davanagere). The completion of the transaction will be subject to approvals and ICRA will continue to monitor the developments and their impact on the credit profile, going forward.

MGL has expansion plans entailing an outlay of ~Rs. 600-800 crore per annum over the next few years. While the large scale of the capex and the gestation period associated with the 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 the credit profile will remain healthy, aided by healthy cash accruals due to its well-established market position, strong parentage and favourable demand outlook.

Key rating drivers and their description

Credit strengths

Exclusive position in gas distribution business in Greater Mumbai and expansion areas - At present, MGL has an exclusive 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 has infrastructure exclusivity in GA3 for a 25-year period, i.e., till 2040. The company has, thus, been able to take regular price hikes to factor in any increase in input costs, thereby protecting its operating profits.

Benefits of strong parentage - MGL is promoted by GAIL (India) Limited (GAIL, [ICRA]AAA (Stable)/[ICRA]A1+), which has a deep understanding and interest in the domestic gas distribution business. GAIL's Chairman is the Chairman of MGL too. GAIL has a 32.5% shareholding in MGL. Further, a favourable allocation policy assures gas availability from GAIL for the CNG and PNG (domestic) segments.

Favourable outlook on demand growth – The CNG and PNG segments have been facing headwinds over the last couple of years due to the Covid-19 pandemic followed by the sharp spike in CNG prices driven by the rise in natural gas prices. However, the outlook for the CNG/PNG(d) segments remains favourable amid their competitiveness against alternative fuels as well as the GoI's support by providing priority in APM gas allocation. The growth of the CNG segment would be further supported by conversion/additions of commercial vehicles and taxis to CNG and launch of new CNG variants by OEMs due to its cost advantage over alternative fuels. The PNG (domestic) segment will continue to benefit from the discontinuation of the LPG subsidy by the Government. The PNG (industrial and commercial) segment would, however, continue to face intense competition from alternative liquid fuels.

ICRA also takes note of the implementation of a number of recommendations by the Kirit Parikh Committee on gas pricing from April 2023 and changes in the gas allocation policy for the CNG and PNG domestic segments, which ensure higher domestic gas allocation for the sector. This is beneficial for players like MGL, ~85% of whose sales are driven by these sectors. However, for the PNG (industrial and commercial) segments, while there is growth potential in the expansion areas, MGL's ability to meet additional gas requirements at competitive prices would remain critical.

Strong financial profile, comfortable capital structure and healthy liquidity – MGL's financial risk profile remains robust, marked by its sizeable scale of operations, strong cash accruals, a comfortable liquidity profile and capital structure with healthy debt protection metrics and high profitability and return indicators. In FY2023, increased sales volume on the back of a better-than-expected ramp-up in the CNG segment and higher realisations helped MGL report a strong operating income (OI) of Rs. 6,299.3 crore against Rs. 3,560.2 crore in FY2022. Increased realisations and allocation of HPHT gas in Q4 FY2023 led to a sharp rise in contribution margins in FY2023. Consequently, MGL's EBITDA/scm increased to Rs. 9.5 in FY2023 from Rs. 8.5 in FY2022. In Q1 FY2024, the company's margins further improved, backed by the softening of both APM gas and spot LNG prices with EBITDA/scm at Rs. 16.8.

Credit challenges

Operations exposed to changes in spread between CNG/PNG and alternative fuel prices - MGL relies primarily on term contracts for the PNG (industrial and commercial) categories and shortfall, if any, is met through spot procurement. 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.). MGL is allocated gas at administrative price mechanism (APM) rates based on the policy for CNG and PNG-domestic categories, which mitigates the impact of price volatility for these segments. However, in recent period, the allocation of domestic gas has been lower than the requirement, resulting in increased procurement from the spot market. Further, while the policy was modified in FY2023 to ensure better availability and increased allocation for the sector, APM gas price for the nomination fields, as per the new policy, will remain at the ceiling level of $6.5/mmbtu in the near to medium term on expectation of crude oil prices remaining elevated. With the APM and HPHT gas meeting the requirement for the CNG and PNG(d) segments, the overall margins are expected to be stabile for MGL.

Expiry of marketing exclusivity along with physical exclusivity in key GAs – MGL's marketing exclusivity for GA1 and GA2 expired during 2012-2014, while its physical exclusivity for GA1 expired in May 2020, exposing the company to the threat of new entrants. However, it continues to benefit from the first-mover advantage and the steady development of its CGD infrastructure in these areas. Further, the matter related to the end of exclusivity period is legally contested and is sub-judice. Moreover, any third-party marketer looking to utilise MGL's infrastructure for CNG/PNG sales will face issues such as ability to secure gas supplies at competitive rates, operational challenges 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 volume.

Liquidity position: Superior

MGL has a healthy liquidity profile with sizeable, unencumbered cash and cash equivalents of ~Rs. 1,605 crore as on March 31, 2023. Further, MGL has been generating healthy cash accruals, which increased to ~ Rs. 733 crore in FY2023 from Rs. 559.9 crore in FY2022 and has no long-term debt repayment obligations at present. The company's liquidity profile should remain strong despite its expansion plans, given the healthy profitability of its operations and high liquid investments.

Rating sensitivities

Positive factors – NA.

Negative factors – Pressure on the ratings may arise from any large debt-funded acquisition or any adverse regulatory developments impacting the revenues and profitability on a sustained basis. Any significant decline in profitability due to increased competition from new entrants may also weigh on the ratings.

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 financials of Mahanagar Gas Limited

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 being 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. At present, 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. Its growth is 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 and 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)

MGL	FY2022	FY2023
Operating income	3560.2	6299.3
PAT	596.9	790.0
OPBDIT/OI	26.2%	18.9%
PAT/OI	16.8%	12.5%
Total outside liabilities/Tangible net worth (times)	0.5	0.5
Total debt/OPBDIT (times)	0.0	0.0
Interest coverage (times)	123.8	126.7

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023)			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
					September 01, 2023	March 14, 2023	September 23, 2022	March 04, 2022	September 30, 2021	September 21, 2020
1	**Non-fund based limits**	Long term	465.00	-	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**
2	**Long-term fund based limits**	Long term	80.00	-	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**	-	-
3	**Non-fund based limits**	Short term	910.00	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**

4	**Short-term non-Fund based limits (Sublimit)**	Short term	(80.00)	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	-	-
5	**Short-term fund based limits**	Short term	12.50	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	-	-
6	**Short-term fund-based limits (Sublimit)**	Short term	(2.00)	-	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	**[ICRA]A1+**	-	-
7	**Long-term/Short-term - Unallocated limits**	Long term/ Short term	32.50	-	**[ICRA]AAA (Stable)/ [ICRA]A1+**	**[ICRA]AAA (Stable)/ [ICRA]A1+**	**[ICRA]AAA (Stable)/ [ICRA]A1+**	**[ICRA]AAA (Stable)/ [ICRA]A1+**	-	-
8	**Debt programme**	Long term	-	-	-	-	-	**[ICRA]AAA (Stable); reaffirmed and withdrawn**	**[ICRA]AAA (Stable)**	**[ICRA]AAA (Stable)**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term non-fund based limits	Very Simple
Long-term fund-based limits	Simple
Short-term non-fund based limits	Very Simple
Short-term non-fund based limits (Sublimit)	Very Simple
Short-term fund-based limits	Simple
Short-term fund-based limits (Sublimit)	Simple
Long-term/Short-term - 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 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 non-fund based limits	NA	NA	NA	465.00	[ICRA]AAA (Stable)
NA	Long-term fund-based limits	NA	NA	NA	80.00	[ICRA]AAA (Stable)
NA	Short-term non-fund based limits	NA	NA	NA	910.00	[ICRA]A1+
NA	Short-term non-fund based limits (Sublimit)	NA	NA	NA	(80.00)	[ICRA]A1+
NA	Short-term fund-based limits	NA	NA	NA	12.50	[ICRA]A1+
NA	Short-term fund-based limits (Sublimit)	NA	NA	NA	(2.00)	[ICRA]A1+
NA	Long-term/Short-term unallocated limits	NA	NA	NA	32.50	[ICRA]AAA (Stable)/ [ICRA]A1+

Source: Company

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

Annexure II: List of entities considered for consolidated analysis- NA

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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.

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