February 07, 2020

GAIL (India) Limited: Ratings assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long Term/short Term fund Based/ non-fund based- unallocated	2000.00	[ICRA]AAA (Stable)/ [ICRA]A1+; assigned
Total	**2000.00**	

Instrument details are provided in Annexure-1

Rationale

The ratings reflect GAIL's leadership position in the and stable nature of cash accruals from the natural gas transmission business, favourable demand prospects for natural gas in India, and downstream integration into petrochemicals and liquefied petroleum gas (LPG). The ratings also take into account GAIL's strong financial position and strengths derived from the significant sovereign ownership. In addition, the ratings factor in the concerns related to regulatory uncertainty on natural gas pipeline tariffs and to the gas availability for some of the new pipeline projects along with the risks arising from its large contingent liabilities. The ratings factor in commodity price risks for petrochemical and LPG segments. Any significant loss in marketing of Henry Hub (HH) linked LNG from the US in a scenario of sustained low crude oil prices will remain a key rating sensitivity.

Key rating drivers

Credit strengths

Leadership in natural gas transmission, the sector is characterised by high entry barriers: GAIL enjoys a dominant position in the natural gas transmission business with a market share of ~70%, catered to by its large pipeline network covering ~12200 km. The setting up of pipelines requires large investments and navigating a complex regulatory framework. As a result, the entry barriers to the natural gas transmission business remain high.

Regulated returns in pipelines leading to stable cash generation: Dominant market share in transmission segment, along with regulated returns on the capital employed, resulted in healthy profitability and stable cash generation for GAIL. The Return on Capital Employed (RoCE) for the gas transmission division moderated from 26% in FY2011 to around 9% in FY2016 due to lower than anticipated tariffs approved by PNGRB. However, PNGRB has revised transmission tariffs for several pipelines in the last couple of years providing an uplift to the return indicators for the transmission segment which improved to ~11.9% and 11.7% in FY2019 and H1 FY2020 respectively. PNGRB is expected to revise the transmission tariff for the remaining pipelines which should provide further uplift to the profitability of the segment.

Favourable demand growth for natural gas in India: GoI's focus on increasing the share of natural gas in the overall energy mix of the country to 15.0% from 6.5% currently has resulted in the government taking several steps to increase natural gas consumption. As domestic gas production has been on a downtrend since FY2013 with marginal growth witnessed in FY2019, the reliance on imported LNG has been on the rise. Additionally, the increase in R-LNG consumption can be attributed to the significant decline in the R-LNG prices during last couple of years and the implementation of gas pooling mechanism in the fertiliser sectorGoing forward the demand for natural gas is expected to remain healthy driven by the City Gas Distribution (CGD) and the fertiliser sector.

Downstream integration benefits arising from presence in Petrochemicals and LPG: In order to diversify its revenue streams and utilise its ability to source natural gas efficiently, GAIL has also diversified into downstream sectors i.e. manufacturing of petrochemicals and liquified petroleum gas (LPG). The LPG segment has been aiding profitability of GAIL and maintaining healthy segmental contribution. The Petrochemical segment's profitability has fluctuated over the years owing to the volatility in polymer realisations and raw material prices.

Strong financial risk profile arising from healthy capital structure, high profitability and comfortable debt protection metrics: GAIL's financial risk profile is characterised by healthy profitability and strong cash accruals resulting in comfortable debt metrics and capital structure. While the profitability has seen moderation in H1 FY2020 driven by moderation in the performance across segments, the overall financial risk profile continues to remain robust. The net profit moderated to Rs. 2351.8 crore in H1 FY2020 as against Rs. 3222.2 crore in H1 FY2019. The debt levels vis-à-vis operating profit and networth continues to remain low. The gearing of the company (Total Debt/Tangible networth) remained low at 0.02x at the end of H1 FY2020 unchanged from 0.02x at the end of FY2019. The leverage levels (Total Debt/OPBDITA) remained low at 0.1x at the end of H1 FY2020 unchanged from the levels at the end of FY2019. Interest coverage ratio of the company remained robust at 74.3x in H1 FY2020 as against 69.0x in FY2019.

Exceptional financial flexibility arising from sovereign ownership, market leadership position and robust cash accruals: GAIL enjoys exceptional financial flexibility given the stable cash accruals, large sovereign ownership, strategic importance to GoI and long relationship with the investors and capital markets. As a result, the company can access the capital markets at short notice to raise funds and also finds favour with the lending community for raising loans at attractive rates.

Credit challenges

Risks related to HH based LNG tied up in the US in scenario of low crude oil prices: In December 2011, GAIL signed an agreement to import 3.5 MMTPA of LNG from Cheniere Energy's Sabine pass liquefaction plant in the US for a period of 20 years. Besides, GAIL has another 2.3 MMTPA contract to liquefy gas at Cove Point terminal in the US. The pricing formula for these contracts is linked to the HH index (the benchmark natural gas price in the US), which in the past had remained significantly cheaper than the oil indexing contracts for importing countries. In recent years HH prices have remained rangebound between $2.5-3.5/mmbtu. As a result of the pricing formula, HH-based LNG is costlier which puts it in a significantly uncompetitive position as compared to spot LNG and other crude oil price linked LNG contracts in a scenario of low Brent crude prices. In a sustained low crude oil price scenario, GAIL may face profitability pressure on the marketing HH linked LNG. However, the company has taken remedial measures to ensure offtake of the gas being procured from the US through destination swaps and commodity hedging which should enable the company to avoid material losses on the LNG being procured from the US. In the current scenario, the henry hub gas prices have remained subdued at around $1.9/mmbtu and the delivered gas to India remains competitive with the Brent crude indexed LNG. However, in case of unplaced cargoes, they may face pressures due to low spot LNG prices prevailing in the current market.

Lower than anticipated tariffs approved by PNGRB leading to the pressure on return indicators of the transmission segment; besides low returns from the new projects to impact overall return indicators: The tariffs approved by the PNGRB have been lower than the provisional tariffs proposed by GAIL. However, the recent significant upscaling of tariffs for several pipelines indicates a more benign regulatory regime which should lead to higher tariffs for the remaining pipelines. The new pipeline projects being undertaken have been allocated on the basis of competitive bidding due to which the returns on the new projects are expected to be lower resulting in overall lower returns from the transmission segment.

Commodity price risks associated with petrochemicals, LPG and liquid hydrocarbons (LHC) businesses, especially in view of significantly lower crude oil and petroleum product prices: Petrochemical, LPG and LHC segment are exposed to the commodity price risk as sustained low crude oil prices result in low realisations for petroleum products. As was visible in H1 FY2020, petrochemical segment witnessed significant decline in its profitability driven by low polymer margins.

Liquidity Position: Strong

The liquidity of GAIL is strong given the healthy cash accruals, unutilised fund-based limits and the ability to access capital markets at highly competitive rates. With internal cash generation expected to be more than adequate to meet the near-term debt repayments and margin funding for the capex program, the liquidity position of the company is expected to remain strong.

Rating sensitivities:

Positive Triggers- NA

Negative triggers– Downward pressure on GAIL's ratings could arise in the event of i) weakening in linkage with the GoI ii) materially large debt funded capex/acquisition resulting in the deterioration in the credit profile iii) material negative impact on profitability owing to the losses on sale of US-LNG.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Parent: Government of India (GoI) The ratings factor in the parentage from GoI and strategic importance of GAIL for GoI given the company helps meet the energy needs of the country and has the largest pipeline network in the country.
Standalone	The ratings are based on the standalone financials of the company.

About the company:

Incorporated in 1984, GAIL (India) Limited (GAIL) has over the years evolved as an integrated natural gas company, with a presence in transmission, gas processing, and downstream petrochemicals (which use natural gas as a primary input). Apart from these businesses, GAIL also has interests in the Liquefied Natural Gas (LNG) business through Petronet LNG Ltd. (PLL), Ratnagiri Power Project (RGPPL), and in city gas distribution projects both in India Mahanagar Gas Ltd. (MGL), and Indraprastha Gas Ltd. (IGL)] and overseas (Natgas and Fayum Gas in Egypt). Among these projects, GAIL's most significant interest lies in the PLL and RGPPL. In PLL, GAIL apart from being an equity investor and the major transmitter of gas, has also undertaken to market 60% of the R-LNG through a 25-year take or- pay contract from Dahej terminal and 30% of the volumes from the Kochi terminal of PLL. GAIL now controls the Dabhol LNG terminal through Konkan LNG Private Limited (KLPL), post demerger of Ratnagiri Gas & Power Private Limited's (RGPPL) assets and liabilities related to the LNG terminal to KLPL which was approved in February 2018. GAIL also has stakes in exploration and production of hydrocarbons. GAIL has wholly owned subsidiaries in Singapore and the US for expanding its presence outside India in the segments of LNG, petrochemical trading and shale gas assets.

Key financial indicators (audited):

	FY2018	FY2019	H1 FY2020
Operating Income (Rs. crore)	53,661.6	75,126.3	36,350.5
PAT (Rs. crore)	4,618.4	6,025.7	2,351.8
OPBDIT/OI (%)	14.3%	12.7%	10.5%
RoCE (%)	17.1%	22.2%	17.1%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.5	0.5
Total Debt/OPBDIT (times)	0.3	0.1	0.1
Interest Coverage (times)	27.8	69.0	74.3
DSCR	3.0	6.7	27.7

Source: ICRA estimates; OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg. (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital; H1 FY2020 results are un-audited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2020)						Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Month and Year			Month and year in rating			
								FY2019	FY2018		FY2017
			Rs crore		February 07, 2020	January 23, 2020	April 30, 2019	17 Dec 2018	1 Feb 2018	4 Jul 2017	8 Jun 2016
1	Bank lines-Unallocated	Long Term/Short Term	2000.0	0.0	[ICRA]AAA (Stable)/ [ICRA]A1+; assigned	-	-	-	-	-	
2	Bank lines-Unallocated	Long Term/Short Term	0.0	0.0	-	[ICRA]AAA (Stable)/ [ICRA]A1+; Withdrawn	[ICRA]AAA (Stable)/ [ICRA]A1+	ICRA]AAA (Stable)/ [ICRA]A1+	ICRA]AAA (Stable)/ [ICRA]A1+	ICRA]AAA (Stable)/ [ICRA]A1+	ICRA]AAA (Stable)/ [ICRA]A1+
3	Non-convertible debentures	Long term	0.0	0.0	-	-	-	-	[ICRA]AAA (Stable); Withdrawn	[ICRA]AAA(Stable)	[ICRA]AAA(Stable)

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/Short Term fund Based/Non fund based (unallocated)	NA	NA	-	2000.00	**[ICRA]AAA (Stable)/ [ICRA]A1+**

Source: GAIL (India) Ltd

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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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