September 23, 2022

Mahanagar Gas Limited: Ratings reaffirmed and assigned for enhanced amount

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Non-Fund based limits	254.00	465.00	[ICRA]AAA (Stable); reaffirmed/assigned
Long-term Fund-based limits	80.00	80.00	[ICRA]AAA (Stable); reaffirmed
Short-term Non-Fund based limits	410.00	910.00	[ICRA]A1+; reaffirmed/assigned
Short-term Non-Fund based limits (Sublimit)	(160.00)	(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	43.50	32.50	[ICRA]AAA (Stable)/ [ICRA]A1+; reaffirmed
Total	**800.00**	**1500.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings consider 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. 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 it to continue to enjoy a dominant market share because of its first-mover advantage, as 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, arising mainly from concerns regarding gas availability at competitive prices and also the policy of open access is not finalized as the matter is subjudice. MGL benefits from its strong parentage (GAIL India Limited) 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.

In FY2022, higher sales volume on the back of a better-than-expected ramp up in the CNG segment, coupled with increase in prices, helped MGL report an operating income (OI) of Rs. 3,560.2 crore against Rs. 2,152.5 crore in FY2021. Natural gas prices have witnessed sharp increase in last few quarters and domestic gas prices has also witnessed a sharp increase accordingly, leading to some moderation in the margins. Further, due to sharp increase in volumes, the domestic gas allocation for CNG and PNG (domestic) sector was not adequate leading to increased reliance on spot gas procurement, However, the impact was partly mitigated by the long-term tie-ups for sourcing gas (for part of the requirements), and the regular price revisions undertaken in various business segments. ICRA also takes note of the changes in gas allocation policy for CNG and PNG domestic segment in current fiscal, which ensures higher domestic gas allocation for the sector, which is beneficial for players like MGL, where ~85% of sales is driven by these sectors. 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 fuel prices.

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 minimum work programme (MWP) submitted to the GoI due to delays in receiving necessary approvals and the impact of the pandemic; as of January 2022, the company has achieved its target for setting up domestic connections and laying inch km of steel pipeline. 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. MGL has expansion plans entailing an outlay of ~Rs. 600-750 crore per annum over the next few years. While the large scale of the capex and the gestation period associated with 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

Current exclusive position in gas distribution business in Greater Mumbai and expansion areas - At present, MGL enjoys a exclusive position currently 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 enjoys infrastructure exclusivity in GA3 for a 25-year period, i.e., till 2040. The company has, thus, been able to take the 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 at present 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 in CNG and PNG segments – Despite some moderation in demand due to the adverse impact of the pandemic, the medium to long-term outlook for the CGD sector remains favourable for existing cities, where the incumbents are already operational and for which a domestic gas allocation is in place for the CNG and PNG (domestic) segments. The growth of the CNG segment would be supported further 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 cessation of 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 changes in gas allocation policy for CNG and PNG domestic segment in current fiscal, which ensures higher domestic gas allocation for the sector, which is beneficial for players like MGL, where ~85% of sales is driven by these sectors. However, for the 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.

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 FY2022, higher sales volume on the back of a better-than-expected ramp-up in the CNG segment helped MGL report a strong operating income (OI) of Rs. 3,560.2 crore against Rs. 2,152.5 crore in FY2021. However, it recorded moderation in the operating margin in FY2022 to 26.2% compared to 43.5% in FY2021 on account of the steep increase in gas costs (input cost) in recent quarter and lower allocation of APM gas towards the CNG and domestic segments compared to the demand growth, due to which there was higher spot purchase of gas. However, the impact was partly mitigated through multiple price revisions.

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 the 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.). While MGL receives allocation of gas at administrative price mechanism (APM) prices based on the policy for CNG and PNG-domestic categories, which mitigates the impact of price volatility for these segments; in recent period the allocation of domestic gas has been lower than requirement resulting in increased procurement of gas from spot market in FY2022. Further, while the policy was modified in current fiscal to ensure better availability and increased allocation for the sector, the APM prices are also expected to witness increase due to sustained high natural gas prices. Hence, the volume growth in these segments could also be impacted by sharp change in the spread between APM gas prices and alternative fuel prices (Petrol, Diesel and LPG prices).

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 from 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 currently remains subjudice. 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. 1,549 crore as on March 31, 2022. Further, MGL has been generating healthy cash accruals, which increased to ~ Rs. 560 crore in FY2022, and has no long-term debt repayment obligations at present, although it has capex plans of Rs. 600-750 crore per annum for FY2023 and FY2024. The company's liquidity profile should remain healthy despite its expansion plans, given the healthy profitability of its operations and high liquid investments.

Rating Sensitivities

Positive factors – NA

Negative factors – Negative pressure on the ratings may arise because of any large debt-funded acquisition or any adverse regulatory developments impacting the revenues and profitability on a sustained basis or any significant decline in profitability emanating from increased competition from new entrants on open access basis.

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 financial profile of the company.

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 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, with its growth 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)

	FY2021	FY2022
Operating income (Rs. crore)	2152.5	3560.2
PAT (Rs. crore)	619.6	596.9
OPBDIT/OI	43.5%	26.2%
PAT/OI	28.8%	16.8%
Total outside liabilities/Tangible net worth (times)	0.4	0.5
Total debt/OPBDIT (times)	0.0	0.0
Interest coverage (times)	130.3	123.8

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 (FY2023)				Chronology of Rating History for the past 3 years			
		Type	Amount rated (Rs. crore)	Amount outstanding as of Mar 31, 2022 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022		Date & rating in FY2021	Date & rating in FY2020
					September 23, 2022	March 04, 2022	Sep 30, 2021	Sep 21, 2020	June 06, 2019
1	Non-Fund based limits	Long term	465.00	-	[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)		-	-
3	Non-Fund based limits	Short term	910.00	-	[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+			
5	Short-term Fund-based limits	Short-term	12.50	-	[ICRA]A1+	[ICRA]A1+			
6	Short-term fund-based limits (Sublimit)	Short-term	(2.00)	-	[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+**			
8	Debt Programme	Long term	-	-		**[ICRA]AAA (Stable); reaffirmed and withdrawn**	**[ICRA]AAA (Stable)**	**[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: www.icra.in

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.

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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