April 01, 2020

GAIL (India) Limited: Ratings assigned to enhanced bank lines

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loan	2000.0	2000.00	[ICRA]AAA (Stable); outstanding
Long Term/Short Term-Unallocated	0.0	5000.0	[ICRA]AAA(Stable)/[ICRA]A1+; assigned
Total	**2000.00**	**7000.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings reflect GAIL's leadership position in the natural gas transmission segment resulting stable cash accruals from the same, 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.

ICRA takes note of the recent decline in the crude oil prices which will have a significant impact on the profitability from the US LNG portfolio. Most of GAIL's downstream supply contracts are linked to the three-month average Brent crude price. While the Brent crude prices have witnessed a steep decline, henry hub natural gas prices have not witnessed a similar decline because of which, the profitability on the HH indexed natural gas is expected to be adversely impacted. Further, the weakness in the volumes and/or profitability of the transmission, marketing and petrochemicals segments owing to the Covid-19 lockdown are also expected to impact the revenues, profitability and cash accruals of GAIL in the near term. As a result, GAIL's credit metrics are expected to moderate in FY2020 and FY2021 with leverage (Total Debt/OPBDITA)[1] expected to be around 0.7x at the end of FY2020 and to rise further in FY2021.

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

[1] *OPBDITA: Operating Profit before Depreciation Interest Amortisation and Taxes*

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 12.1% in FY2019 and 9M 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 sector. Going 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 9M FY2020 driven by moderation in the performance across segments, the overall financial risk profile continues to remain robust. The net profit moderated to Rs. 3602.4 crore in 9M FY2020 as against Rs. 4903.44 crore in 9M 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 78.0x in 9M FY2020 as against 70.3x and 69.0x in 9M FY2019 and FY2019 respectively.

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 Brent crude prices have witnessed a steep decline and the competitiveness of the HH indexed LNG has come under pressure vis-à-vis Brent indexed LNG. Going forward, the relative competitiveness of the Brent indexed and HH indexed LNG will remain a key monitorable.

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 9M 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 a) fall in the transmission volumes owing to the Covid-19 lockdown and/or b) material loss 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		April 01, 2020	February 20, 2020	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	5000.0	0.0	[ICRA]AAA (Stable)/ [ICRA]A1+ assigned	[ICRA]A1+ rating withdrawn	[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)
4	Term loans	Long term	2000.0	2000.0	[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	-	5000.00	**[ICRA]AAA (Stable)/ [ICRA]A1+; assigned**
NA	Term Loan	24 February 2020	-	31 March 2033	2000.0	**[ICRA]AAA (Stable)**

Source: GAIL (India) Ltd.

ANALYST CONTACTS

K Ravichandran
+91 44 4596 4301
ravichandran@icraindia.com

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

Varun Gogia
+91 124 4545 373
varun.gogia@icraindia.com

RELATIONSHIP CONTACT

L. Shivkumar
+91 22 6169 3300
shivkumar@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:

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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

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
Ahmedabad	+ (91 79) 2658 4924/5049/2008
Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999

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