September 21, 2020 (Revised)

Mahanagar Gas Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term debt programme	100.00	100.00	[ICRA]AAA (Stable); Reaffirmed
Long-term non-fund based limits	200.00	200.00	[ICRA]AAA (Stable); Reaffirmed
Short-term non-fund based limits	400.00	400.00	[ICRA]A1+; Reaffirmed
Total	**700.00**	**700.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation factors in the strong parentage of Mahanagar Gas Limited (MGL), its current monopoly in the Greater Mumbai (Geographical Area 1, or GA1) and surrounding expansion areas (GA2), as well as its diversified customer profile. Despite the expiry of MGL's marketing exclusivity in both GA1 and GA2 a few years back 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. 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 take into account the company's strong financial profile characterised by healthy profitability levels, zero debt and strong liquidity profile, with sizeable free cash balances and liquid investments (~Rs. 1,351 crore as on March 31, 2020).

The ratings also take into account the competitive advantage of gas over alternative fuels (especially in the CNG and domestic segments) and the consequent positive impact on demand. The city gas distribution (CGD) sector enjoyed lower gas costs due to a decline in global gas indices pursuant to which the GoI announced price for gas allocation declined in H2 FY2020 and H1 FY2021. The company has undertaken regular price revisions to maintain its margins, leading to improvement in its contribution levels over the years. The company's EBITDA[1] per standard cubic meter (scm) of gas sold also increased to ~Rs. 9.75 in FY2020 from ~Rs. 8.22 in FY2019, among the highest in the domestic CGD sector. Nonetheless, the company's ability to avail price hikes and the long-term demand prospects remain exposed to the changes in spread between CNG/PNG and alternative fuel prices.

ICRA notes that MGL is undertaking capex for setting up its network in Raigad, Maharashtra (its third GA). MGL has achieved limited progress on its infrastructure plans in Raigad compared to the minimum work programme (MWP) submitted to the GoI, due to delays in receiving necessary approvals. As a result, MGL submitted a revised catch-up plan to the PNGRB in August 2018 and is primarily on track as per the requirements pertaining to pipeline length and domestic connections. Nonetheless, potential encashment of the bank guarantee submitted by MGL to the PNGRB for Raigad remains a key rating sensitivity.

[1] *Earnings before interest, taxes, depreciation, and amortisation*

ICRA notes that MGL has aggressive expansion plans entailing an outlay of approximately Rs. 2,400 crore over FY2021-FY2023. 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, nevertheless on an absolute basis, these metrics are expected to continue being robust.

ICRA notes that the sales volumes of the company across all segments, barring PNG (domestic), have been adversely impacted by the Covid-19 pandemic. However, with the easing of lockdowns, volumes across most segments (barring commercial) are recovering.

The Stable outlook reflects ICRA's opinion that MGL will continue to benefit from its well-established market position and strong parentage.

Key rating drivers and their description

Credit strengths

Monopoly in gas distribution business in Greater Mumbai and expansion areas - At present, MGL enjoys a near-monopoly status and first-mover advantage in retail gas distribution in Greater Mumbai (GA1) and its expansion areas (GA2). The company has, thus, been able to take the regular price hikes to factor in the any increase in input costs, thereby protecting its operating profits.

Strong parentage, with deep understanding and interest in the domestic gas business - MGL is promoted by GAIL (India) Limited (GAIL, [ICRA]AAA (Stable)/[ICRA]A1+), who has a deep understanding and interest in the domestic gas distribution business. The chairman of GAIL is currently serving as the chairman of MGL. GAIL has a 32.5% shareholding in MGL. Further, a favourable allocation policy assures gas availability from GAIL for CNG and PNG (domestic) segments. In February 2014, the GoI announced allocation of 100% domestic gas towards CNG and PNG (domestic) segments of CGD entities, up from the initial 80% proportional allocation. However, for its 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.

Favourable outlook on demand growth in both CNG and PNG segments, given the price differential between gas and liquid fuels, apart from other advantages – Despite the current weakness due to the Covid-19 pandemic, the long-term outlook for the CGD sector remains favourable for existing cities, where incumbents are already operational with domestic gas allocation in place for CNG and PNG (domestic) segments, which should witness healthy growth in volumes. While growth of CNG would be supported further by conversion of auto-rickshaws and taxis to CNG and its cost advantage over alternative fuels, the PNG (domestic) segment will continue to benefit from the cessation of LPG subsidy for high-income consumers. The PNG (industrial and commercial) segment would, however, continue to face intense competition from alternative liquid fuels.

Strong financial profile with healthy profitability and return indicators; comfortable capital structure and healthy liquidity position - The company has a healthy financial profile characterised by high profitability and return indicators. Also, MGL has a comfortable capital structure with negligible gearing levels, strong coverage metrics, and a sound liquidity position.

Credit challenges

Operations exposed to changes in spread between CNG/PNG and alternative fuel prices - MGL relies primarily on spot buying for the PNG (industrial and commercial) categories. 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 100% allocation of gas at Administrative Price Mechanism (APM) prices for CNG and PNG (domestic) categories, volume growth in these categories could be impacted by any sharp changes in the spread between APM gas prices and alternative fuel prices.

Expiry of marketing exclusivity in GA1 and expansion areas over 2012–2014, along with expiry of physical exclusivity for GA1 in May 2020, exposes MGL to threat from new entrants, though enough entry barriers still exist - Expiry of marketing exclusivity for GA1 and GA2, together with physical exclusivity for GA1, exposes the company to threat from new entrants. However, any third-party marketer looking to utilise MGL's infrastructure for CNG/PNG sales, will face issues associated with its ability to secure 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 unattractiveness of returns in case of low sales volume.

Limited progress on ongoing expansion in Raigad - The company is currently setting up its network in its new GA (Raigad). The same has witnessed significant delays on account of delays in getting land acquisition approvals, as the concerned area lies in an eco-reserve. MGL submitted a revised catch-up plan to the PNGRB in August 2018. At present, the company has achieved limited physical progress at Raigad, though it plans to ramp up activity over the near to medium term. The potential encashment of the bank guarantee submitted by MGL to the PNGRB for Raigad remains a key rating sensitivity.

Liquidity position: Superior

MGL's liquidity profile is expected to remain superior, owing to healthy cash accruals, no long-term debt obligations and sizeable free cash and cash equivalents of Rs. 1,351 crore as on March 31, 2020. It has adequate cushion available in the form of unutilised non-fund based limits. The company's liquidity profile should remain superior despite its expansion plans, given the healthy profitability of its operations and the high liquid investments.

Rating sensitivities

Positive triggers – NA

Negative triggers – Any large, debt-funded acquisition or slippage from MWP commitments leading to large penalties ii) any adverse regulatory developments impacting the revenues and profitability iii) any significant decline in profitability emanating from competition from 3rd parties on open access basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for 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 was a joint venture between GAIL and BGAPH. The company was listed in July 2016, after which both GAIL and BGAPH's stakes in the company reduced to 32.5% each, with the remaining 35% stake being held by the public (of which 10% remains with the State Government of Maharashtra). In 2018, BGAPH gradually sold its 22.5% stake in MGL, thereby reducing its total stake in the company to 10%, followed by BGAPH selling its remaining stake in the company in 2019.

Over the last 24 years, MGL has established a firm presence in the Greater Mumbai gas distribution business (where it enjoys a monopoly), with its growth being driven primarily by the CNG category, which currently drives 70-75% of its revenues. The company also supplies PNG to industrial, commercial, and residential/domestic segments. MGL has put in place large plans to augment its gas distribution network in the existing Mumbai region as well as the surrounding regions. The company currently operates in three GAs—GA1 (the Greater Mumbai region), GA2 (expansion areas such as Mira-Bhayander, Thane-Vashi-Belapur (TVB), Kharghar-Panvel-Taloja (KPT), Kalyan-Dombivli-Ambernath and Ulhasnagar), and GA3 (the Raigad district, won by the company in April 2015).

As per the Q1 FY2021 financials, MGL achieved operating income of Rs. 261.8 crore and net profit of Rs. 45.3 crore as against operating income of Rs 686.5 crore and net profit of Rs 166.6 crore in Q1 FY2020.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income (Rs. crore)	2791.1	2972.1
PAT (Rs. crore)	546.4	793.5
OPBDIT/OI (%)	31.9%	35.4%
PAT/OI (%)	19.6%	26.7%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.4
Total Debt/OPBDIT (times)	0.0	0.1
Interest Coverage (times)	2756.1	161.4

Status of non-cooperation with previous CRA: Not applicable

Any other information: A member of the board of directors of ICRA Limited is also an Independent Director on the board of directors of Mahanagar Gas Limited. This director was not involved in any of the discussions and processes related to the rating of the instrument(s) mentioned herein.

Rating history for past three years

		Current Rating (FY2021)				Chronology of Rating History for the past 3 years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & rating 21-Sept-2020	Date & Rating 06-June-2019	Date & Rating in FY2019 06-June-2018	Date & Rating in FY2018 26-May-2017
1	Debt Programme	Long Term	100.00	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
2	Non-fund Based Limits	Long Term	200.00	-	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)	[ICRA]AAA (Stable)
3	Non-fund Based Limits	Short Term	400.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

Amount in Rs. Crore

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 Debt Programme	Yet to be placed	-	-	100.00	[ICRA]AAA (Stable)
NA	Long-term Non-fund Based Limits	-	-	-	200.00	[ICRA]AAA (Stable)
NA	Short-term Non-fund Based Limits	-	-	-	400.00	[ICRA]A1+

Source: Mahanagar Gas Limited

Annexure-2: List of entities considered for consolidated analysis – Not applicable

Corrigendum

Document dated September 21, 2020 has been corrected with revisions as detailed below:

• Any other information section on page no. 4: Disclosure pertaining to common Independent director incorporated in the section.

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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.

For more information, visit www.icra.in

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