Gujarat Gas Limited

September 14, 2021

Ratings

Facilities	Amount (Rs. Crore)	Ratings[1]	Rating Action
Long-term / Short-term Bank Facilities	2,000.00	**CARE AA+; Positive / CARE A1+ (Double A Plus; Outlook: Positive / A One Plus)**	**Reaffirmed; Outlook revised from Stable**
Total Bank Facilities	**2,000.00 (Rs. Two thousand crore only)**		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Gujarat Gas Limited (GGL) continue to derive strength from GGL's leading position in the city gas distribution (CGD) business in India, its well-established and significantly large scale of operations, established gas-sourcing arrangements and moderately diversified customer segment mix. The ratings also continue to factor in sustained growth in its scale of operations along with improvement in its leverage and debt coverage indicators, healthy cash accruals along with its strong liquidity and efficient working capital management. The ratings further continue to derive strength from its professional and experienced management along with favourable outlook for the CGD business, being an environmentally cleaner fuel.

GGL's long-term rating, however, continues to remain constrained on account of its medium-term capex plans for developing the CGD network in various geographical areas (GAs), including in the seven new GAs awarded to it in the 9th and 10th CGD bidding rounds conducted by the Petroleum and Natural Gas Regulatory Board (PNGRB) coupled with regulatory risk associated with the CGD business. The rating is also constrained by susceptibility of demand for natural gas basis the price dynamics of competing fuels and its concomitant impact on GGL's profitability.

Outlook: Positive

The positive outlook on the long-term rating of GGL reflects CARE's expectation of further growth in GGL's scale of operations along with improvement in its leverage and debt coverage indicators. The outlook may be revised to 'Stable' if GGL contracts any additional large debt or if it encounters significant delays in implementation of its project in the new GAs leading to deterioration in its overall gearing.

Rating Sensitivities

Positive Factors

- Significant growth in its scale of operations through greater revenue diversification with increase in share of piped natural Gas (PNG)-Domestic / Compressed Natural Gas (CNG) segments driven by early commercialization of the newly-won GAs while earning PBILDT margin above 20% over a sustained period of time; along with favourable regulatory policy which strengthens its long-term business profile
- Improvement in leverage marked by overall gearing of less than 0.20 times on a sustained basis

Negative Factors

- Substantial and sustained decline in profitability margins marked by PBILDT margin of less than 12%
- Any large debt-funded capex or acquisitions leading to increase in the overall gearing to more than 0.90 times on a sustained basis
- Any regulatory development which may have material adverse impact on the business and financial profile of the company

Detailed description of the key rating drivers

Key Rating Strengths

Leading player in the CGD business with its established business presence in its area of operations

GGL is the leading player in the CGD business in India and has a dominant market position particularly in Gujarat, the largest natural gas-consuming state in the country, on account of its first-mover advantage in major areas, continuous infrastructure development and high level of entry barriers, primarily in the form of capex requirement as well as regulated near-monopoly marketing and infrastructure exclusivity for a given period of time. The PNGRB has granted marketing exclusivity and infrastructure exclusivity to GGL for various GAs it operates in, whereby other players are not allowed to operate within the said GAs till the end of the exclusivity period.

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

Established gas sourcing arrangements
GGL procures Administered Pricing Mechanism (APM) gas for PNG-Domestic and CNG segments from GAIL India Limited (GAIL; rated 'CARE AAA; Stable / CARE A1+') and through market for its PNG-Industrial and PNG-Commercial segments requirements which is majorly sourced as regassified liquefied natural gas (RLNG). The Ministry of Petroleum and Natural Gas (MoPNG), Government of India (GoI), under its guidelines has accorded highest priority for domestic natural gas allocation to PNG-Domestic and CNG customers from FY15 (refers to the period April 01 to March 31) onwards. Accordingly, GGL receives natural gas under the APM for meeting its requirements for these segments. However, continuation of the same allocation shall be critical going forward.

Moderately diversified customer mix
During FY21, out of the total sales volumes of GGL, proportion of PNG-Industrial, Commercial, Domestic and CNG segments remained at around 78%, 1%, 7%, and 14%, respectively. The share of CNG segment declined to around 14% in FY21 as compared with around 16% in FY20, mainly due to outbreak of COVID-19 pandemic and subsequent nationwide lockdown in Q1FY21.
During FY20, the proportion of PNG-Industrial increased to around 77% as compared with around 68% in FY19 primarily on account of rise in the demand from the industrial customers on the back of stricter enforcement of pollution control norms by various authorities including the National Green Tribunal's (NGT's) order for banning the usage of coal gasifiers in the Morbi region (Gujarat) which led to increase in the industrial demand in that region.
Going forward, the envisaged ramp-up of number of CNG stations by GGL along with commercializing of the new GAs outside the state of Gujarat is expected to aid further diversification in its sales mix along with some improvement in its operating profitability.

Sustained improvement in the scale of operations coupled with higher profitability during FY21
GGL achieved total sales volumes of 3,427 Million Metric Standard Cubic Meters (MMSCM) during FY21 (FY20: 3,454 MMSCM). The total operating income (TOI) of GGL marginally declined by around 4% to Rs.9,907 crore in FY21 (FY20: Rs.10,363 crore) mainly due to nationwide lockdown in Q1FY21 due to outbreak of COVID-19 pandemic. However, its PBILDT margin and PAT margin improved to 21.89% (FY20: 16.52%) and 12.87% (FY20: 11.51%), respectively, in FY21 mainly due to decline in the prices of natural gas, both domestic as well as imported as well as significant reduction in the finance cost pursuant to debt prepayments in FY21. Higher PBILDT margin coupled with decline in the finance cost led to significant improvement in gross cash accruals (GCA) of GGL to around Rs.1,621 crore (FY20: Rs.1,232 crore) in FY21.

Improvement in capital structure along with comfortable debt coverage indicators
During FY21, GGL prepaid its existing term loans of around Rs.988 crore in addition to its scheduled repayments. This coupled with non-availment of fresh debt for its capex and significant build-up of its net-worth base led to improvement in its overall gearing to 0.22 times as at FY21 end (FY20: 0.63 times). Also, GGL has made additional prepayments of around Rs.170 crore during Q1FY22 which has led to further improvement in its overall gearing. Along with improvement in the overall gearing, its debt coverage indicators have also improved. During FY21, the total debt / PBILDT and total debt / GCA of GGL stood at 0.45 times (FY20: 1.20 times) and 0.60 times (FY20: 1.67 times), respectively. Also, its PBILDT interest coverage stood comfortable at 16.26 times (FY20: 8.36 times) during FY21.

Favorable demand outlook for the CGD business with government's focus on environmentally cleaner fuels
In order to address the environmental concerns, the government has been actively promoting a shift towards cleaner energy sources, including natural gas. CGD projects have become an important segment in the natural gas business in India given the increasing impetus coming in the form of environmental concerns over certain polluting fuels and various court directives. Over the past many years, CGD volumes have been continuously rising on the back of improved pipeline infrastructure, better availability of natural gas, better price economics over alternative fuels, continuous rise in the number of CNG vehicles and its environment friendliness over other alternative fuels. GGL is expected to benefit from the continued increase in the natural gas demand (CNG and PNG) in Gujarat, which is amongst the highest natural gas-consuming state in India. Furthermore, there is increase in the number of CNG-operated vehicles on account of the favorable pricing economics of natural gas compared with other conventional fuels. Going forward, the number of CNG vehicles is expected to increase which could support higher CNG demand; albeit this demand might be susceptible to technological disruptions such as faster rollout of electric vehicles (EVs). Also, domestic natural gas consumption is at a very nascent stage and offers healthy opportunities for further growth. The GoI aims to increase the share of natural gas in India's energy mix from 6% at present to around 15% by 2030. Furthermore, there is an ongoing expansion of imported RLNG handling capacity in India which is expected to augment the availability of natural gas in the future. Upon availability of natural gas and associated network, majority of the industrial and commercial users are envisaged to shift to natural gas from alternative fuels due to ease in usage and favourable regulatory push. In the long run, CGD players are expected to thrive given GoI's impetus on gas-based economy, favourable regulatory regime, competitiveness of CNG over alternative fuels as well as emphasis on environmentally cleaner fuels.

Key Rating *Weaknesses*

Demand from industrial and commercial customers which have close linkages with prevailing price of competing fuels

GGL's PNG-Industrial and PNG-Commercial customers account for around 79% of its total natural gas sales volumes in FY21. The demand from these segments is inherently prone to price and volume risks depending on the price of alternative fuels, as the industrial furnaces in some of the user segments are designed for easy switch between fuels within a short time period and without any major production disruption, to take advantage of lower price of competing fuel. However, the NGT order in March 2019 for banning the use of coal gasifiers in Morbi region of Gujarat led to migration of number of industrial customers from coal gasifiers to PNG. This resulted in substantial growth in the natural gas sales volume of GGL to the industrial segment during FY20. Continued favourable regulatory environment towards stringent compliance with laid-down pollution control norms would be crucial for the CGD sector; more so for players with larger share of PNG-Industrial sales in their overall revenue mix. Furthermore, industrial natural gas sales volume is also susceptible to sharp economic / industrial downturns.

Project risk associated with its medium-term capex plans

In the 9th and 10th CGD bidding rounds conducted by the PNGRB, GGL had received authorizations from the PNGRB for development of CGD network in seven GAs in the states of Gujarat, Punjab, Haryana, Madhya Pradesh and Rajasthan. Further, the PNGRB has given its approval to transfer the authorization for laying, building, operating or expanding CGD in the GAs of Amritsar district and Bhatinda district in Punjab from its parent, viz., Gujarat State Petronet Limited (GSPL; rated 'CARE AA+; Stable / CARE A1+') to GGL. The development of CGD networks in these nine new GAs (seven won by GGL in the 9th and 10th CGD bidding rounds and two GAs from GSPL) may expose the company to project implementation risks. These inherent risks are due to unforeseen delay in regulatory approvals, etc., which could result in both time and cost overrun. The PNGRB has also specified penalties for any shortfall in the execution of the Minimum Work Programme (MWP) in the GAs allotted from 9th bidding round onwards which elevates the project risk.

GGL has envisaged capex of around Rs.2,800 crore over next three years for development of CGD network in the newly awarded GAs and expansion of CGD network in its already authorized / operational areas. As articulated by the management, the said capex plans of GGL are envisaged to be funded through internal accruals of the company without availing any additional debt and thus, its leverage is expected to improve going forward.

Regulatory risks in the CGD business

The PNGRB had granted exclusive marketing rights to the CGD players for a stipulated time period in the respective GAs. In November 2020, the PNGRB has formulated new guidelines for determining CGD network tariff and allowing third-party access to existing CGD players' infrastructure network for supply of natural gas after expiry of the marketing exclusivity period. As and when such regulatory changes are implemented and the form in which they are implemented would be a key monitorable for the CGD sector going forward as this could result in possible entry of competitors in the existing GAs through implementation of common contract carrier regulation after the expiry of the marketing exclusivity period and could lead to concomitant impact on the CGD sector's profitability. However, at the same time, it also would offer opportunities to GGL to enter into other lucrative markets. Also, any unexpected change in the regulations regarding priority in allocation of natural gas for PNG-Domestic and CNG segments and/or pricing of end-product can adversely impact the CGD sector.

Liquidity: Strong

Liquidity of GGL is marked by strong cash accruals against its debt repayment obligations and availability of cash & cash equivalents of around Rs.630 crore as on June 30, 2021. With an overall gearing of 0.22 times as of March 31, 2021, GGL has sufficient gearing headroom, to raise additional debt for its capex, if required. GGL has a very short operating cycle which results into low fund-based working capital limit requirement. Furthermore, its envisaged capex aggregating to around Rs.2,800 crore over the next three years ending FY24 is proposed to be entirely funded from its internal accruals and available liquidity.

Analytical Approach: Standalone

Applicable Criteria

Criteria on Assigning 'Outlook' and 'Credit Watch' to Credit Ratings
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Liquidity Analysis of Non-Financial Sector Entities
Rating Methodology: Notching by Factoring Linkages in Ratings
Rating Methodology: City Gas Distribution Companies
Financial Ratios: Non-Financial Sector

About the Company

GGL is India's largest CGD company, with 27 CGD licenses spread across 43 districts in six states and one union territory across the states of Gujarat, Maharashtra, Rajasthan, Haryana, Punjab, Madhya Pradesh and Union Territory of Dadra and Nagar Haveli. GGL is engaged in distribution of natural gas (piped and compressed) and currently supplies PNG to industrial, commercial and domestic customers along with CNG to the transportation sector. GGL benefits from the economies of scale, diversified customer and sourcing bases, and extensive pipeline infrastructure. GGL has a customer base of over 1.57 million domestic households, 13,107 commercial customers, 4,082 industrial units and 564 CNG stations as on June 30, 2021, providing strong revenue diversity. The natural gas sales volume of GGL stood at 3,427 MMSCM and 911 MMSCM in FY21 and Q1FY22 respectively.

Brief Financials - GGL (Standalone) (Rs. Crore)	FY20 (A)	FY21 (A)
Total Operating Income	10,363	9,907
PBILDT	1,712	2,169
PAT	1,193	1,276
Overall Gearing (times)	0.63	0.22
Interest Coverage (times)	8.36	16.26

A: Audited

During Q1FY22, as per the standalone unaudited financial results, GGL has reported PAT of Rs.476 crore on TOI of Rs.3,032 crore.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years: Please refer Annexure-2

Complexity level of various instruments rated for this company: Annexure-3

Annexure-1: Details of Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Crore)	Rating assigned along with Rating Outlook
Fund-based/Non-fund-based-LT/ST	-	-	-	2,000.00	CARE AA+; Positive / CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument	Current Ratings			Rating History			
		Type	Amount Outstanding (Rs. Crore)	Rating	Date(s) & Rating(s) assigned in 2021-2022	Date(s) & Rating(s) assigned in 2020-2021	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019
1.	Fund-based/Non-fund-based-LT/ST	LT/ST*	2,000.00	CARE AA+; Positive / CARE A1+	-	1)CARE AA+; Stable / CARE A1+ (14-Sep-20)	1)CARE AA; Positive / CARE A1+ (07-Oct-19)	1)CARE AA; Positive / CARE A1+ (08-Oct-18)

**Long-term / Short-term*

Annexure-3: Complexity level of various instruments rated for this company

Sr. No.	Name of the Instrument	Complexity Level
1.	Fund-based/Non-fund-based-LT/ST	Simple

Annexure-4: Bank/Lender details for this company

Click here to view Bank/Lender details

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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