Adani Gas Limited

October 09, 2019

Rating

Instruments	Amount (Rs. crore)	Rating[1]	Rating Action
Commercial Paper (CP) Issue	100.00	CARE A1+ [A One Plus]	**Reaffirmed**
Total Instruments	**100.00 (Rupees One Hundred Crore only)**		

Details of instruments in Annexure – 1

Detailed Rationale & Key Rating Drivers

The rating continues to draw strength from the well-established operations of Adani Gas Ltd. (AGL) in city gas distribution (CGD) business along with its established gas sourcing arrangement, well diversified customer segment mix, healthy operating profitability (PBILDT) margins, capital structure and its efficient working capital cycle. The rating of AGL further derives strength from its parentage (being part of the Adani Group – a diversified business conglomerate) along with its professional and experienced management; high financial flexibility and favourable demand outlook for City Gas Distribution (CGD) business in its key markets.

The rating is, however, constrained on account of AGL's major debt funded capex plans for new Geographical Areas (GAs) along with large investment requirement in its Joint Venture (JV) company [Indian Oil-Adani Gas Pvt Ltd. (IOAGPL; rated CARE A-; Stable / CARE A2+)] for developing CGD network in various cities, pending arrangements for equity and tie-up of the requisite debt for project financing, susceptibility of demand for natural gas from its industrial and commercial segment customers based on price dynamics of competing fuels and regulatory risk associated with CGD business.

Execution of AGL's on-going projects as well as those under its JV within envisaged time parameters, crystallization of its project cost w.r.t its recently won bids for setting-up CGD network across 15 Geographical Areas (GAs) in AGL & 10 GAs in IOAGPL, timely arrangement of equity and tie-up of requisite debt for the project, availability of adequate gas under Administered Price Mechanism (APM) for meeting its segment specific requirements, efficient procurement of re-gasified liquefied natural gas (R-LNG), growth in demand from industrial and commercial segments while maintaining its comfortable operating profitability margins shall be the key rating sensitivities. Also, timely repatriation of loans & advances extended to Adani Enterprise Limited (AEL; rated CARE A; Stable / CARE A1) on need basis shall be another key rating sensitivity.

Detailed description of the key rating drivers

Key Rating Strengths

Strong Parentage of Adani Group which has presence in diversified sectors along with professional and experienced management

AGL is Adani Group's CGD arm. AGL is the largest private player in CGD business in India. Adani Group is a diversified conglomerate engaged in various businesses across a range of sectors primarily energy (including coal mining), power generation and transmission, port operations, logistics, oil and gas, city gas distribution, agro-processing, its storage and commodity trading. The promoters of Adani Group directly hold 74.80 % stake in AGL as on June 30, 2019. AGL is being managed by a professional and experienced management team, having knowledgeable personnel with respect to various aspects of the natural gas industry in India.

Established business presence in its areas of operations

AGL has a dominant market position in Ahmedabad, Vadodara, Faridabad & Khurja for CGD business on account of its.first mover advantage, continuous infrastructure development and high level of entry barriers. Ahmedabad & Faridabad together contributes more than 90% of the total operating income of AGL. Authorizations for Ahmedabad & Khurja have been received from PNGRB, wherein PNGRB has granted marketing exclusivity and infrastructure exclusivity to AGL from the date of respective authorizations. Even after expiry of marketing exclusivity period, AGL is not expecting to face any major problem in the long-term since 'open access' has not yet developed in CGD business in India.

Established gas sourcing arrangement

The Ministry of Petroleum & Natural Gas (MoPNG), Government of India (GoI) under its guidelines in 2014 , has given first priority for gas allocation to Piped Natural Gas (PNG)-domestic & Comressed Natural Gas (CNG) customers. Accordingly, AGL is receiving natural gas under APM for its requirement for PNG- domestic & CNG from March 2014. AGL relies on imported R-LNG for its balance requirement for PNG-industrial and PNG-commercial segments. AGL's reliance on imported R-LNG has significantly declined upon availability of APM gas. AGL has been successful in passing on any

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

increase in prices of APM provided by GoI as indicated by increase in FY19 sales realization of PNG –domestic and CNG by 18% and 12% respectively. Further, sales realization improved by 21% in PNG-industrial and PNG – commercial by 18% in FY19 largely on the back on increase in prices of R-LNG which is procured on spot basis and governed by market forces.

Diversified customer mix

Customer mix of AGL is well-diversified amongst CNG (51%) and industrial (38%), domestic (8%) and commercial (3%) segments of PNG during FY19. AGL has high concentration of its operations with Ahmedabad contributing around 61% of volumes while Faridabad contributing around 30% of total volumes; albeit both are prominent markets for gas distribution business whereby exclusivity of operations significantly reduces the risk. With operationalization of GAs in a phase wise manner the customer mix and geographies are expected to diversify further.

Healthy financial risk profile

During FY19, TOI grew by 24% on the back of improved gas sales volumes by around 13% coupled with improvement in sales realization by 13%. PBILDT margin remained comfortable at 29.53% during FY19 despite increase in prices of APM and imported R-LNG. Further, AGL's has comfortable capital structure with marked by overall gearing of 0.36x as on March 31, 2019 on the back of steady accretion to reserves.

Favourable demand outlook for CGD business

AGL is expected to benefit from the continued increase in natural gas demand (CNG and PNG) in Gujarat, as per CARE, which is amongst the highest natural gas consuming states in India. Also, there is increase in the number of CNG operated vehicles on account of the favourable 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 might be susceptible to technological disruptions such as faster rollout of electric vehicles (EVs). Also, domestic gas consumption being currently at a very nascent stage presents huge opportunity for CGD companies; and AGL is working towards increasing customer connections to improve domestic supply. Further, there is an ongoing expansion of imported R-LNG handling capacity in India which shall result in availability of cheaper/environment-friendly fuel in future. Upon availability of cheaper gas, majority of the industrial & commercial users are envisaged to shift to natural gas from alternate fuels due to ease in usage and favourable regulatory push since natural gas is a lower carbon-emission fuel.

<u>Key Rating Weaknesses</u>

Project execution and funding risk associated with GAs awarded in ninth and tenth round

AGL has received authorization from PNGRB for creation of CGD network for 13 GAs in ninth round and 2 GAs in tenth round of CGD bidding conducted by PNGRB. As indicated by management, the total capex requirement for these GAs would be around Rs.8,850 crore over a period of eight years. However, the company is in the process of crystallization of detailed capex plans and its funding pattern along eight Minimum Work Programme (MWP) years. These 15 GAs present a growth opportunity for AGL along with significant execution risk. Any significant delay in execution or under-achievement of MWP may lead to penalty as per PNGRB regulation which may impact the cash flows of AGL. However, execution risk is partially mitigated with demonstrated execution capabilities of AGL. Accordingly, its yearly capex plans/investment requirements, funding plans, debt tie-up and timely achievement of minimum work programme along with realization of envisaged benefits from these projects in a timely manner would be very critical going forward.

Large investment requirement in JV Company for expanding/developing CGD network

AGL's JV company with Indian Oil Corporation Limited, Indian Oil-Adani Gas Private Limited (IOAGPL) has received authorizations from PNGRB for creation/expanding CGD network for 9 GAs in 9th round and 1 GA in 10th round of CGD bidding. As per discussion with management, around Rs.8,000 crore capex is expected to be incurred over a period MWP years. This along with capex in existing 9 GAs has significant equity investment commitments over in medium term. The above-said investments in JV would entail high amount of internal accruals to be deployed. As on March 31, 2019, AGL had already invested Rs.185.50 crore towards its equity contribution in the JV.
IOAGPL has a non-fund based facility of Rs.7,067 crore, which has been submitted to the PNGRB as a performance bank guarantee to meet the MWP for the GAs awarded to IOAGPL. AGL has extended a corporate guarantee to IOAGPL for the 50% of the facility, which is equivalent to its stake in the JV. Further, IOAGPL has submitted performance bank guarantee of Rs.432 crore for awarded GAs in 9th and 10th round. Any significant delay in execution or under-achievement of MWP may lead to penalty as per PNGRB regulation. However, execution risk is partially mitigated with demonstrated execution capabilities of promoters. Finalization of yearly capex plans and funding plans along with timely support from promoters would be crucial for AGL

Significant financial support extended to AEL

In the past, AGL has extended significant amount of loans to its erstwhile promoter AEL. However, during FY18, these loans were repatriated partly with outstanding balance of such loans at Rs.359 crore as on March 31, 2019 (Rs.359 crore as on March 31, 2018). Outstanding loans to AEL as percentage of tangible net-worth decreased from 42% as on March 31, 2018 to 33% as on March 31, 2019 on account of steady accretion to profits. In the backdrop of AGL's own large funding requirements for capex, timely repatriation of the remaining loans & advances by AEL would be a key monitorable.

Demand from industrial and commercial customers has close linkages with prevailing price of competing fuels
AGL faces higher susceptibility of changes in demand for natural gas from industrial & commercial segments (which accounted for nearly 41% of its total volumes in FY19) due to change in price of competing fuels. In industrial segment, furnaces are designed for easy switch of fuel and during times of relatively higher gas prices, they easily shift to alternate fuels which poses a risk in case of higher gas prices compared with alternate fuels. However, share of industrial segment in total sales has been increasing for the past three years ended FY19.

Inherent regulatory risk in CGD business
As per existing regulations, CGD companies are allotted APM gas to meet their requirement to cater to the PNG-Domestic & CNG segments. However, looking at the subdued domestic gas production, continuation of the same allocation of APM gas shall be critical going forward. Both these segments contribute heavily to the profitability of CGD companies, accordingly any adverse regulatory changes on this front can affect the profitability of CGD companies directly. However both CNG & PNG-Domestic are the focus areas of GoI which may result in continuation of APM pricing of gas to be supplied to both these segments.

Liquidity Analysis: Strong
AGL's strong liquidity position is marked by robust cash accruals against low repayment obligations in next one year. Further, AGL had free cash and bank balance of Rs.205 crore as on June 30, 2019 (Rs.159.25 crore as on March 31, 2019). Large amount of internal accruals are expected to be deployed for meeting own and equity investments in JV over the next three years. However, with a gearing of 0.36x as on March 31, 2019, AGL has sufficient gearing headroom, to raise additional debt for capex. Further, AGL has unutilized bank lines of Rs.135 crore which are more than adequate to meet its working capital needs over the next one year.

Analytical approach: Standalone while factoring in investments in Indian Oil Adani Gas Private Limited (IOAGPL; rated CARE A-; Stable / CARE A2+), its 50% joint-venture with Indian Oil Corporation Limited

Applicable criteria:
CARE's Policy on Default Recognition
Criteria for Short Term Instruments
Rating Methodology - Infrastructure Sector Ratings
Rating Methodology - Factoring Linkages in Ratings
Financial Ratios – Non-Financial Sector

About the company
Incorporated in 2005, Adani Gas Ltd. (AGL) is engaged in CGD business, which involves marketing and distribution of natural gas (piped and compressed). AGL currently supplies piped natural gas (PNG) to industrial, commercial and domestic customers and compressed natural gas (CNG) to transport sector in Ahmedabad & Vadodara (in Gujarat), Faridabad (in Haryana) and Khurja (in Uttar Pradesh). Previously AGL was a 100% directly owned by Adani Enterprises Limited (AEL, rated CARE A; Stable / CARE A1). However w.e.f. March 29, 2017, AEL has transferred its 100% equity shares in AGL to Adani Gas Holdings Ltd. (AGHL). Hence AGL has become a wholly-owned subsidiary of AGHL and continues to remain 100% step-down subsidiary of AEL. Further, pursuant to scheme of arrangement, AGHL was amalgamated with AGL with appointed date as August 10, 2018 and AGL was subsequently listed on stock exchange under automatic route on November 05, 2018.
AGL has received authorizations from PNGRB for 13 GAs in 9th round and 2 GAs in 10th round of CGD bidding. Further, its JV with IOCL; IOAGPL has received authorizations from PNGRB for 9 GAs in 9th round and 1 GAs in 10th round of CGD bidding. AGL along with its JV, IOAGPL has authorizations for creation/expansion of CGD network 38 GAs across India.

Brief Financials:

(Rs. Crore)

Particulars – AGL (Standalone)	FY18 (A)	FY19 (A)
Total Operating Income	1,447	1,794
PBILDT	439	530
PAT	165	229
Overall gearing (times)	1.58	0.36
Interest coverage (times)	3.51	5.95

A: Audited

As per the un-audited results for Q1FY20, AGL reported a total operating income of Rs.461 crore with a PAT of Rs.79 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

Annexure-1: Details of Instruments

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Commercial Paper-Commercial Paper (Standalone)	-	-	7-364 days	100.00	CARE A1+

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Commercial Paper-Commercial Paper (Standalone)	ST	100.00	CARE A1+	-	1)CARE A1+ (08-Oct-18) 2)CARE A1+ (12-Jun-18)	1)CARE A1+ (22-Sep-17) 2)CARE A1+ (05-Jul-17)	1)CARE A1+ (30-Sep-16)

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

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