Vadodara Gas Limited

March 28, 2019

Ratings

Facilities	Amount (Rs. crore)	Rating[1]	Rating Action
Long-term Bank Facilities	87.20 (enhanced from Rs.75.00)	CARE A-; Stable [Single A Minus; Outlook: Stable]	Reaffirmed
Short-term Bank Facilities	25.00	CARE A2+ [A Two Plus]	Reaffirmed
Total Facilities	**112.20 (Rupees One Hundred Twelve crore and Twenty lakh only)**		

Details of instruments/facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The ratings assigned to the bank facilities of Vadodara Gas Ltd (VGL) continue to derive strength from its strong parentage, its well established operations in city gas distribution (CGD) business along with established gas sourcing arrangement with GAIL (India) Ltd. (GAIL), favorable customer segment mix, comfortable capital structure & debt coverage indicators, efficient working capital cycle which further improved during FY18 and favorable demand outlook for CGD business.

The ratings, however, continue to remain constrained on account of VGL's moderate scale of operations albeit healthy y-o-y growth reported in the same during FY18 as well as H1FY19, high level of system losses due to old network and unmetered connections and moderate operating profitability which further declined during H1FY19. The ratings also continue to remain constrained due to disputed authorization of CGD network for Vadodara district, VGL's majorly debt funded capex plans over the medium term, susceptibility of demand for natural gas from industrial & commercial segment customers based on price dynamics of competing alternate fuels and regulatory risk associated with CGD business.

VGL's ability to improve its operating profitability supported by substantial reduction in system losses, availability of adequate gas under Administered Price Mechanism (APM) for meeting its demand from the Compressed Natural Gas (CNG) and Piped Natural Gas (PNG) domestic customer segments, procurement of re-gassified liquefied natural gas (R-LNG) at competitive prices compared to alternate fuels and consequent growth in demand from industrial and commercial segments, execution of planned capex within envisaged time and cost parameters along with realizing envisaged benefits thereof and maintaining its comfortable capital structure shall be the key rating sensitivities. Further, resolution of the dispute w.r.t. authorization for Vadodara district in favor of VGL shall be crucial for growth in its scale of operations.

Detailed description of the key rating drivers

Key Rating Strengths

Strong parentage: VGL is promoted by GAIL (rated CARE AAA; Stable/ CARE A1+) along with GAIL Gas Ltd. (GGL – rated CARE AA; Stable, being a wholly owned subsidiary of GAIL) and Vadodara Mahanagar Seva Sadan [VMSS; erstwhile Vadodara Municipal Corporation (VMC)]. GAIL has the largest gas transmission pipeline infrastructure in India and its activities range from gas transmission and distribution to production and marketing of petrochemicals and leasing bandwidth in telecommunications. GGL has been authorized by Petroleum and Natural Gas Regulatory Board (PNGRB) for implementing CGD projects in various cities. VMSS is the municipal corporation of Vadodara and works for all major government departments.

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

Established market position in the CGD business in Vadodara: VMSS was operating PNG network in the city of Vadodara since 1972 which is one of the oldest networks in India whereas GAIL was operating CNG network in some parts of the city of Vadodara. Looking at the growth prospects of the CGD business, both the entities contributed their PNG & CNG assets to VGL for business synergies. Post formation of VGL, PNGRB in October 2016 granted it an authorization for expansion of CGD network in the entire district of Vadodara. PNGRB has granted marketing exclusivity and infrastructure exclusivity to VGL, which would expire on October 26, 2019 and March 31, 2023 respectively.

Established gas sourcing arrangement: The Ministry of Petroleum & Natural Gas (MoPNG), Government of India under its guidelines has accorded priority in gas allocation for PNG-domestic & CNG segments. Accordingly, VGL receives natural gas for its requirement for these segments under APM (operated by GAIL). For its balance requirement, VGL relies on imported R-LNG for its PNG-industrial and PNG-commercial segments. Entire gas sourcing is done from GAIL and VGL has full freedom for pricing of gas sold by it.

Favorable customer segment mix: VGL's sales mix is well diversified between PNG & CNG segments at 41% and 59% respectively during FY18. VGL's sales mix is spread across PNG Industrial (6%), PNG commercial (12%), PNG domestic (23%) and CNG (59%). As on September 30, 2018, VGL operated three mother stations, four daughter stations and one online station for supply of CNG as on September 30, 2018. Further, it had a network of around 1,507 KMs of pipelines under its PNG network.

Comfortable capital structure and debt coverage indicators: VGL had a comfortable capital structure marked by an overall gearing of 0.08x (P.Y.: 0.09x) as on March 31, 2018. There was nominal outstanding debt as on FY18 end with major part of capex requirement being met from internal accruals. Overall gearing remained stable at 0.06x as on September 30, 2018. Debt coverage indicators also improved and continued to be comfortable during FY18 with increase in operating profit due to growth in scale of operations along with lower interest cost incurred during the period.

Favorable demand outlook for CGD business: VGL is expected to benefit from the continued increase in natural gas (CNG & PNG) demand in its geographical area on the back of rising number of CNG operated vehicles on account of the pricing economics of natural gas compared with other conventional fuels. Also, domestic PNG consumption being currently at a very nascent stage presents a huge opportunity for CGD companies and VGL is working towards increasing customer connections to improve domestic supply. Also, there is an on-going expansion of imported R-LNG handling capacity in India which shall result in greater availability of cheaper gas in future. Upon availability of cheaper gas, probability of shifting of majority of the industrial & commercial users to PNG from alternate fuels shall increase due to ease in its usage and gas being a non-emission fuel; and hence environment friendly.

Key Rating Weaknesses

Moderate scale of operations along with moderate operating profitability: VGL's scale of operations remained moderate marked by a total operating income (TOI) of Rs.129 crore (P.Y.: Rs.117 crore) during FY18. During FY18, VGL registered a 10% y-o-y growth in its TOI driven by growth in sales volume as well as sales realization in CNG segment and growth in sales volume of PNG domestic customers with increase in domestic connections during the period. VGL reported a further growth of 21% in its TOI driven by increased sales volume as well as sales realization of PNG Domestic and CNG customers. Furthermore, VGL had a moderate operating profitability predominantly due to high system losses. During FY18, VGL's operating profitability remained stable compared with that in FY17 with benefit of lower gas cost offset by high maintenance charges incurred during the year. However, its operating profitability moderated by 721 bps y-o-y during the period due to higher sourcing price of R-LNG and revision in transmission charges which could not be passed on to its customers as well as higher maintenance charges during the period.

High level of system losses due to old network & unmetered connections: VGL incurred system loss of 38% in FY18. As the PNG network of VGL is very old (VMSS commenced natural gas distribution in the city in 1972), there are issues related to leakage in the network. Also, VGL has increased the pressure of gas supplied through this network which has further increased the system loss. Furthermore, around 10,000 un-metered domestic PNG connections were given long back in lower income group localities (on the basis of no. of members in family) which are now being changed to metered connections. All these factors resulted in high level of system loss which is a key reason for VGL's moderate PBILDT margin.

Large size predominantly debt funded capex plans: VGL has planned a capex of Rs.115 crore over the next three years till FY21 which is expected to be funded through a mix of term loan and internal accruals. The capex would be for addition of new CNG stations, expansion of pipeline infrastructure for addition of new industrial and commercial customers along with addition of PNG domestic customers. Achieving envisaged benefits from capex will be crucial for VGL's prospects.

Demand from industrial and commercial customers has close linkages with prevailing price of competing fuels: VGL faces higher susceptibility of change in demand for natural gas from industrial & commercial segments due to competition from alternate fuels. Combined sales volume from both these segments declined marginally during FY18 on account of competition faced from alternate 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.

Regulatory risk in the 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, considering 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 and accordingly, any adverse regulatory changes on this front can affect the profitability of CGD companies directly. However, as CNG & PNG Domestic segments are the focus areas for the government, it may result in continuation of adequate supply of APM gas to both these segments.

Liquidity: VGL does not have any sanctioned fund based working capital limits and working capital requirements are met through internal accruals. Also, operating cycle of VLG is short at 21 days during FY18, largely due to scheduled periodic collections (for PNG customers) and cash collection for CNG segment. VGL's scheduled term loan repayments are expected to be nominal over the next three years vis-à-vis the envisaged cash accruals. As on September 30, 2018, VGL had free cash and bank balance of Rs.14.64 crore, which could be utilized for meeting any exigencies.

Analytical approach: Standalone

Applicable Criteria
Criteria on assigning Outlook to Credit Ratings
CARE's Policy on Default Recognition
Rating Criteria for Short Term Instruments
Rating methodology for Infrastructure companies
Rating Methodology - Factoring Linkages in Ratings
Financial ratios - Non- Financial Sector

About the Company
VGL is a joint venture between GAIL, GGL & VMSS and is engaged in marketing and distribution of natural gas (piped and compressed). The company presently supplies PNG to industrial, commercial, domestic customers and CNG to transportation sector. VGL has presence in Vadodara district of Gujarat with user base of over 110,000 customers along with 8 CNG stations and 1,507 km of pipeline network as on September 30, 2018.

Brief Financials (Rs. crore)	FY17 (A)	FY18 (A)
Total operating income	117.47	129.08
PBILDT	16.11	18.02
PAT	7.18	7.78
Overall gearing (times)	0.09	0.08
Interest coverage (times)	7.90	11.32

A: Audited

Furthermore, as per H1FY19 provisional results, VGL has reported a TOI of Rs.80.20 crore with a PAT of Rs.3.84 crore as against a TOI of Rs.66.06 crore and PAT of Rs.7.45 crore in H1FY18.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

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

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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Annexure-1: Details of Instruments/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 - LT-Term Loan	-	-	March 2025	87.20	CARE A-; Stable
Non-fund-based - ST-Letter of credit	-	-	-	25.00	CARE A2+

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 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Fund-based - LT-Term Loan	LT	87.20	CARE A-; Stable	1)CARE A-; Stable (20-Feb-19)	1)CARE A-; Stable (16-Jan-18)	-	-
2.	Non-fund-based - ST-Letter of credit	ST	25.00	CARE A2+	1)CARE A2+ (20-Feb-19)	1)CARE A2+ (16-Jan-18)	-	-

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