

# India Ratings Revises Gujarat Gas' Outlook to Positive; Affirms 'IND AA'

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By **Harsha Sodhani**

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India Ratings and Research (Ind-Ra) has revised Gujarat Gas Limited's (GGL) Outlook to Positive from Stable while affirming its Long-Term Issuer Rating at 'IND AA'. The instrument-wise rating actions are as follows:

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Outlook	Rating Action
Bank loans*	-	-	-	INR32,000	IND AA/Positive/IND A1+	Affirmed; Outlook revised to Positive from Stable
Commercial paper**	-	-	7 to 365 days	INR350	IND A1+	Affirmed

\* Interchangeable with working capital limits

\*\*to be carved out of existing working capital limits

## KEY RATING DRIVERS

**Sustained Improvement in Credit Metrics:** The Positive Outlook reflects Ind-Ra's expectation of a sustained improvement in GGL's credit metrics in FY19-FY20, driven by continuous growth in sales volume resulting from network expansion/diversification and supportive policy actions, along with an improvement in EBITDA margin per unit as gas prices remain range bound. The agency expects the gross interest coverage (EBITDA/gross interest expense) to remain commensurate with the rating level in the medium term (9MFY19: 5.0x, FY18: 4.5x, FY17: 3.6x). Its net leverage (net debt/EBITDA) improved to 2.4x in FY18 (FY17: 3.1x).

The improvement in credit metrics was largely driven by a rise in EBITDA (9MFY19: INR7.3 billion, FY18: INR9 billion, FY17: INR7.4 billion) led by volume growth (9MFY19: up 8% yoy, FY18: up 15% yoy), given the recovery in industrial volumes supported by higher EBITDA/standard cubic meter-scm. GGL maintained its pricing power amid firm gas prices for most part of FY17-9MFY19. Also, the company's deleveraging over FY15-FY18 (FY18 gross debt: INR23.2 billion, FY15: INR32.5 billion) has contributed to the improvement in credit metrics, despite annual capex of about INR5 billion.

**Future Growth Drivers:** GGL was awarded 11 geographical areas (GAs) between FY15-FY17, one GA in the ninth city gas distribution round and six GAs in the 10th distribution round during FY19. All the GAs awarded between FY15-FY17 are operational as on date. As per management, these new areas could potentially add over 1-1.5mmscmd over the next three-to-five years and improve its segment mix.

Additionally, GGL's recent allocation of six new GAs spread across Haryana, Punjab, Madhya Pradesh and Rajasthan will augment its presence in the north and west of India and enable diversification of its portfolio. The Indian government's thrust on increasing the share of natural gas (currently about 7%) in the country's energy basket levels underpins the robust growth outlook of the sector. Also, Ind-Ra expects the supportive regulatory actions such as the one announced by National Green Tribunal on 8 March 2019 which prohibits the use of polluting fuels such as coal gas in Morbi will benefit the company in the medium term.

**Large Scale, High Entry Barriers:** GGL continues to be India's largest city gas distributor (CGD) with presence in 23 districts across Gujarat, Dadra Nagar Haveli and Maharashtra. The company benefits from the economies of scale, diversified customer and sourcing bases, and extensive infrastructure through large upfront capex. It has around 21,640km pipeline infrastructure, 291 compressed natural gas (CNG) stations and around 1.25 million domestic customers with sales of around 6.2mmscmd in FY18. Moreover, the CGD entities benefit from a favourable industry structure characterised by high entry barriers through marketing and infrastructure exclusivity for a period of 8 years and 25 years, respectively, along with regulatory support in the form of allocation of natural gas for piped natural gas (PNG)-household and CNG, ensuring a near-monopolistic nature of business. However, GGL remains vulnerable to government policies with regard to domestic gas allocation for CNG/PNG-household segments.

**Strong Liquidity:** GGL's cash & cash equivalents stood at INR1.4 billion at FYE18 (FYE17: INR0.6 billion). The company reported positive cash flow from operations over FY15-FY18, led by moderately stable volumes and operating margin supported by a short working capital cycle, inherent to the industry. Ind-Ra expects the cash flow from operations to remain sufficient to fund majority of the cash outflows in the form capex, debt repayments and dividend payments, limiting incremental debt and/or refinancing requirements. GGL has an annual capex plan of INR4.5 billion-5 billion for network expansion with scheduled debt repayments of INR1 billion-1.2 billion each year (5%-8% of outstanding debt at FYE18) over FY19-FY20. Furthermore, the company has fund-based working capital, with almost negligible utilisation in the last 12 months ended February 2019. The unutilised lines provide sufficient cushion for any liquidity mismatches.

**Strategic Importance to Parent, Although Rating Assessed on Standalone Basis:** Ind-Ra continues to assess the ratings based on GGL's standalone profile). The agency does not expect GGL to extend/receive any support to/from GSPL or any group entities. During 2018, Gujarat State Petroleum Corporation sold its majority shareholding in GGL to GSPL (erstwhile associate company of GGL).

**Cyclicality and Volatility in Earnings:** Industrial and commercial segments account for around 70% of GGL's volumes. These segments are characterised by high price elasticity due to ease of fuel substitution. With no preferential allotment of cheap domestic gas, industrial/commercial segments are almost completely reliant on imported liquefied natural gas. Thus, profitability is hostage to price differentials between imported liquefied natural gas and competing fuels – coal/furnace oil for industries and commercial LPG for the commercial segment. Input price volatility, significant rupee fluctuations and exposure to industrial segment introduce cyclicality and volatility to volume/margins. However, policy action supporting the adoption of natural gas will reduce cyclicality in industrial volumes to a large extent.

## RATING SENSITIVITIES

**Positive:** Higher than expected growth in volumes along with expansion in EBITDA margins per unit, leading to a sustained improvement in credit metrics will be positive for the ratings. Any supportive regulatory policy action and higher share of household PNG/CNG in the overall sales mix, resulting in improved business profile could also lead to a positive rating action.

**Negative:** A substantial fall in the operating margin or lower-than-expected volume growth, leading to deterioration in the credit metrics will be negative for the ratings. Unexpected debt-led capex leading to a sustained increase in net leverage and any adverse regulatory development could also lead to a negative rating action.

## COMPANY PROFILE

GGL was formed by the amalgamation of GSPC Gas Company Ltd, Gujarat Gas Company Ltd, Gujarat Gas Financial Services Ltd and Gujarat Gas Trading Company Ltd with GSPC Distribution Networks Ltd (now GGL) in April 2013.

### FINANCIAL SUMMARY

Particulars	FY18	FY17
Revenue (INR million)	61,743	50,926
EBITDA (INR million)	8,951	7,433
EBITDA margin (%)	14.5	15
Gross debt (INR million)	23,282	23,589
Gross interest coverage (x)	4.56	3.56
Cash (INR million)	1,401	608
Net leverage (x)	2.44	3.09
Source: Company, Ind-Ra		

## RATING HISTORY

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook		
	Rating Type	Rated Limits (million)	Rating	21 December 2017	2 December 2016	1 December 2015
Issuer rating	Long-term	-	IND AA/Positive	IND AA/Stable	IND AA/Stable	IND AA/Stable
Bank loans	Long-term/Short-term	INR32,000	IND AA/Positive/IND A1+	IND AA/Stable/IND A1+	IND AA/Stable/IND A1+	-
Commercial paper	Short-term	INR350	IND A1+	IND A1+	IND A1+	IND A1+

## COMPLEXITY LEVEL OF INSTRUMENTS

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## Applicable Criteria

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[Corporate Rating Methodology](#)

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## Analyst Names

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