Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 312**	
Price Target: **Rs. 400**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

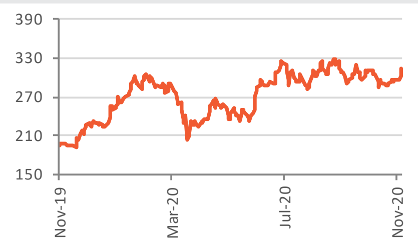
Company details

Market cap:	Rs. 21,495 cr
52-week high/low:	Rs. 335 / 189
NSE volume: (No of shares)	6.7 lakh
BSE code:	539336
NSE code:	GUJGASLTD
Free float: (No of shares)	26.9 cr

Shareholding (%)

Promoters	60.9
FII	9.1
DII	7.3
Others	22.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3	3	33	61
Relative to Sensex	-2	-7	0	58

Sharekhan Research, Bloomberg

Gujarat Gas Ltd.

Margins hit record high; volumes to fuel growth

Oil & Gas	Sharekhan code: GUJGASLTD	Result Update

Summary

- Q2FY21 operating profit/PAT at Rs. 733 crore/Rs. 475 crore, up 97.8%/2.4x y-o-y was much ahead of our estimates due to 72% and 4.6% beat in EBITDA margin at Rs. 8.1/scm (up 87.5% y-o-y) and volume at 9.8 mmscmd (up 5.5% y-o-y) respectively.
- Industrial PNG volumes increased by 9% y-o-y to 7.9 mmscmd due to improved demand from Morbi, CNG volumes recovered sharply to 1.3 mmscmd (up 88% q-o-q but down 13.2% y-o-y) while domestic PNG volumes grew 18% y-o-y to 0.6 mmscmd.
- GGAS is best-placed in the oil & gas space to benefit from India's robust gas demand outlook supported by regulatory push to curb pollution. Current volume run rate of 10.5mmscmd is 11.2% higher than FY2020 gas sales volumes.
- Consistent high volume growth to drive 19% PAT CAGR over FY20-FY23E along with RoE of 25-27% and GGAS to become net cash positive by FY22. Hence, we recommend Buy on GGAS with PT of Rs400. Valuation attractive at 14x FY23E EPS.

Gujarat Gas Limited (GGAS) reported strong Q2FY2021 results with an operating profit at Rs. 733 crore (up 97.8% y-o-y; up 3.9x q-o-q), which was sharply higher than our estimate of Rs. 408 crore led by a sharp beat in EBITDA margins at Rs. 8.1/scm (up 87.5% y-o-y; up 64.2% q-o-q and 72% above our expectation of Rs. 4.7/scm) and better-than-expected volumes at 9.8 mmscmd (up 5.5% y-o-y; up 137.7% q-o-q and 4.6% above our estimate of 9.4 mmscmd). The sharp improvement in EBITDA margin was led by higher gross margin at Rs. 10.2/scm (up 57.3% y-o-y; up 9% q-o-q) as the company retained some portion of the benefit of lower spot LNG price. Adjusted PAT of Rs475 crore (up 2.4x y-o-y) was also substantially above our estimate of Rs. 226 crore due to beat in margin & volume and lower interest cost. The current volume run rate of 10.5 mmscmd is 6.6%/11.2% higher than Q2FY2021/FY2020 gas sales volume and management guided exit rate of 11 mmscmd for FY2021 and expects sustainable 10-12% volume growth on the higher base of 10.5-11 mmscmd. Key volume growth drivers are sustained volume growth in existing GAs, development of 7 new GAs (2.5-3 mmscmd volume potential over 4-5 years) and NGT ban on critically polluted areas (volume potential of 2-2.5 mmscmd) in Gujarat. GGAS witnessed highest ever gross/EBITDA margin in Q2FY2021, which we believe is not sustainable given the recent cut in industrial PNG prices (through management indicated that it would roll-back price cuts in December as spot LNG and propane price has increased) and management has also guided for sustainable EBITDA margin of Rs5-5.5/scm over medium to long term. Strong volume growth outlook, stable-to-improving margins and GGAS is expected to become net cash company (given FCF generation of Rs. 3,091 crore over FY2021E-FY2023E) and thus we remain constructive on GGAS. We expect earnings CAGR of 19% over FY2020-FY2023E along with a robust RoE profile of 25-27%. Consistent high volume growth outlook over medium to long term makes valuation attractive at 14x FY2023E EPS. Hence, we recommend Buy on GGAS with PT of Rs. 400.

Key positives

- Highest-ever EBITDA margin of Rs. 8.1/scm (up 87.5% y-o-y; up 64.2% q-o-q) and substantially above our estimates of Rs. 4.7/scm led by beat in gross margins at Rs10.2/scm (up 57.3% y-o-y).
- Better-than-expected volume at 9.8 mmscmd (up 5.5% y-o-y) with industrial PNG volumes of 7.9 mmscmd (up 9% y-o-y) above pre-COVID-19 level and CNG volumes at 90% of pre-COVID levels currently.

Key negatives

- Commercial PNG volumes declined by 40% y-o-y to 0.6 mmscmd in Q2FY21 and are still at 70% of pre-COVID-19 levels.

Our Call

Valuation – Recommend Buy on GGAS with PT of Rs. 400: We have increased our FY2021-FY2023 earnings estimate to factor higher EBITDA margins and higher volume assumption given faster-than-expected recovery in gas sales volumes. Given a high exposure to industrial PNG (80% of overall gas sales volume), we believe that GGAS is best-placed in the oil & gas space to benefit from India's robust gas demand outlook supported by regulatory push to curb pollution and expectation of weak spot LNG prices, given a likely increase in LNG supply from the US. Moreover, GGAS's EBITDA margins are also expected to expand given low gas cost tailwinds. The management believes that the implementation of final regulation for open access in CGD space would not be easy as the matter is sub-judice. We expect strong earnings CAGR of 19% over FY2020-FY2023E along with robust RoE of 25-27%. Valuation of GGAS of 14x FY2023E EPS is at steep discount of 38% to that of IGL despite the best volume growth outlook in the CGD space and potential to become net cash positive by FY2022. Hence, we recommend Buy on GGAS with PT of Rs. 400.

Key Risks

Lower-than-expected gas sales volume in case of demand slowdown due to COVID-19. Delay in development of new GAs, sharp rise in LNG prices and adverse regulatory changes could impact outlook and valuations. Overhang on CGD stocks will stay until the open access regulations are finalised by PNGRB.

Valuations (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	7,754	10,300	9,650	12,298	14,730
OPM (%)	12.7	15.9	19.6	15.8	16.6
Adjusted PAT	418	910	1125	1161	1539
% YoY growth	*43.1*	*117.4*	*23.7*	*3.2*	*32.5*
Adjusted EPS (Rs.)	6.1	13.2	16.3	16.9	22.4
P/E (x)	51.4	23.6	19.1	18.5	14.0
P/B (x)	9.7	6.5	5.2	4.3	3.5
EV/EBITDA (x)	23.6	13.9	11.6	10.8	8.1
RoNW (%)	20.6	32.9	30.1	25.2	27.3
RoCE (%)	15.3	24.3	25.6	23.1	26.2

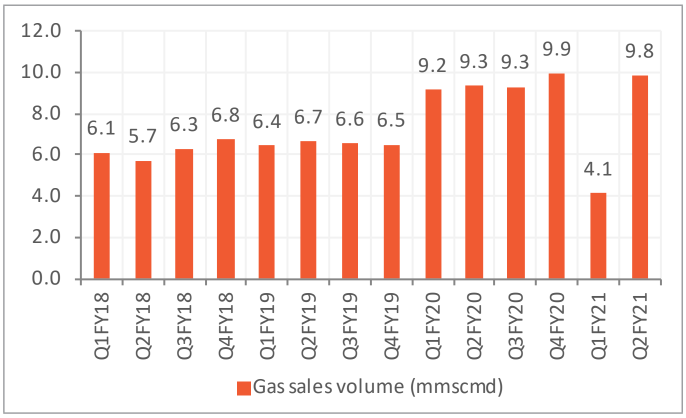
Source: Company; Sharekhan estimates

Note: We now convert GGAS into a Stock Update; It was earlier a 'Viewpoint' under our coverage

Sharp beat in PAT led by substantially higher-than-expected margin and decent beat in volumes

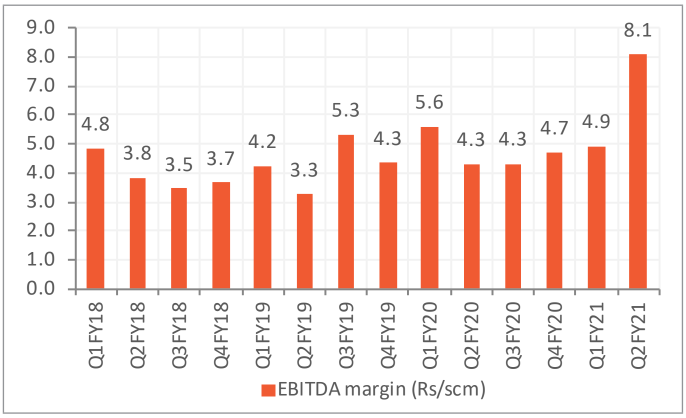
Q2FY2021 operating profit of Rs. 733 crore (up 97.8% y-o-y; up 3.9x q-o-q) was 80% above our estimate of Rs408 crore. The beat was primarily led by surprisingly high EBITDA margin at Rs. 8.1/scm (up 87.5% y-o-y; up 64.2% q-o-q) and versus our estimate of Rs. 4.7/scm) and higher-than-expected gas sales volume at 9.8mmscmd (up 5.5% y-o-y; up 137.7% q-o-q). The sharp jump in EBITDA margin was on the account of improvement in gross margin by 57.3% y-o-y to Rs. 10.2/scm given benefit of low LNG prices while opex was normalised to Rs. 2.1/scm (down 52.2% q-o-q) with a sharp recovery in the volumes. The management indicated that lower spot LNG prices was passed on to customers only in the latter part of September and thus some portion of lower gas cost was retained by the company. Adjusted profit after tax (PAT) of Rs. 475 crore (up 2.4x y-o-y) was also above our estimate at Rs. 226 crore given sharp beat in margin & volume, higher-than-expected other income and lower interest cost.

Gas sales volume recovered above pre-COVID level



Source: Company, Sharekhan Research

EBITDA/scm of Rs. 8.1/scm at record high level



Source: Company, Sharekhan Research

Key takeaways from discussion with management

- **Business update:** GGAS witnessed a faster-than-expected recovery in gas sales volumes with current industrial PNG volume (80% of overall volumes of Gujarat Gas) at 10.5mmscmd is above pre-COVID-19 level, CNG volume at 90% of pre-COVID level while commercial PNG volume is at 70% of pre-lockdown level. Within industrial PNG segment, Morbi volumes stood at 5.8 mmscmd (versus 5.3 mmscmd in Q2FY2020) and non-Morbi volume at 2.1mmscmd led by strong gas demand recovery witnessed from chemical and pharma belt in Southern Gujarat. The current sales volume run-rate of 10.5 mmscmd, is 6.6%/11.2% higher compared toQ2FY2021/FY2020 gas sales volume.
- **Volume and margin guidance:** The management has guided for a volume growth of 10-15% y-o-y for 9MFY2021 and expects average volume of 8.4mmscmd in FY2021E with an exit rate of 11mmscmd. Management expects volume growth of 10-12% annually in FY2022-FY2023 on the high base of 10.5-11mmscmd. The EBITDA margin is expected to moderate from high level of Q2FY2021 to ~Rs. 4.5-5/scm in Q3FY2021 due to price cut of Rs. 2/scm in July and Rs. 2.5/scm in September for Industrial PNG but the management said that they could reverse price cuts given rise in spot LNG and propane prices. Management has guided for sustainable medium to long term EBITDA margin of Rs5-5.5/scm.
- **Capex guidance:** The company has maintained its capex guidance of Rs. 600-700 crore for FY2021E and have spent Rs272 crore on capex in H1FY2020. The company and has added 51 new CNG station in H1FY2021 as against target to add 100 new CNG stations during FY2021. The capex guidance for FY2022 is at Rs. 700-800 crore.
- **Update on new GAs:** All 7 GAs won in the 9th and 10th CGD bidding rounds has become operational but any meaningful volume would be visible only after two years given ramp-up of CGD infrastructure in new GAs would take time. New GAs have volume potential of 2.5-3 mmscmd over next 4-5 years.
- **Debt:** Net debt fell sharply to Rs. 867 crore as on September as compared to ~Rs. 1,400 crore as on June 30, 2020 as compared to Rs. 1,834 crore as on March 31, 2020.
- **Management's view on open access regulations:** The management hinted that implementation of open-access regulation is not practically possible given low gas penetration and share of gas at only 6% in overall energy mix of India and open access in current scenario would be detrimental to investment in the CGD space.

Results (Standalone) **Rs cr**

Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Net Sales	2,513	2,513	0.0	1,083	132.1
Total Expenditure	1,780	2,142	-16.9	897	98.4
Reported operating profit	**733**	**371**	**97.8**	**186**	**294.6**
Adjusted operating profit	**733**	**371**	**97.8**	**186**	**294.6**
Other Income	21	24	-12.4	15	39.4
Interest	34	53	-35.8	40	-15.5
Depreciation	86	80	6.8	82	4.1
Exceptional income/(expense)	0	0	NA	0	NA
Reported PBT	634	261	142.7	78	710.3
Adjusted PBT	634	261	142.7	78	710.3
Tax	160	-256	NA	20	713.0
RPAT	475	517	-8.2	59	709.3
Adjusted PAT	475	196	142.7	59	709.3
Equity Cap (cr)	69	69		69	
Reported EPS (Rs)	6.9	7.5	-8.2	0.9	709.3
Adjusted EPS	6.9	2.8	142.7	0.9	709.3
Margins (%)			**bps**		**bps**
OPM	29.2	14.7	1442	17.2	1202
Effective tax rate	25.1	-97.9	NA	25.1	9
NPM	18.9	7.8	1111	5.4	1348

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)
Volume (mmscmd)	9.8	9.3	5.5%	4.1	137.7%
Gross margin (Rs/scm)	10.2	6.5	57.3%	9.4	9.0%
EBITDA margin (Rs/scm)	8.1	4.3	87.5%	4.9	64.2%

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector View – Gas demand at inflection point; Gujarat-based players well-placed given access to gas infrastructure**

City-gas distribution (CGD) sector in India is at inflection point being a priority sector (allocation of cheap domestic gas and focus on rapid expansion of CGD infrastructure) for the government. With government focus to increase the share of gas in the India energy mix to 15% by 2030 (from 6% currently), consumption growth for the CGD sector is estimated at 10% annually till FY2030. Gujarat is at the forefront of CGD development in India supported by availability of the State gas grid, access to LNG terminals and robust natural gas infrastructure. Post the ninth CGD bidding round all the districts of Gujarat has been authorized for CGD development and after completion of minimum work program (MWP) 100% of its geographical area and population would be covered by CGD network. Gujarat accounts for 29% of India's CNG station & CNG vehicles, 35% of domestic PNG connections, 65% of PNG connections and 50% of industrial PNG connection. With massive investment lined up over next 5-8 years and crackdown of critically/severally polluted industrial areas would provide huge volume growth opportunity to Gujarat-based CGD players like GGAS. Additionally, margins also expected to remain strong given weak domestic gas and LNG prices (both spot and contracted LNG).

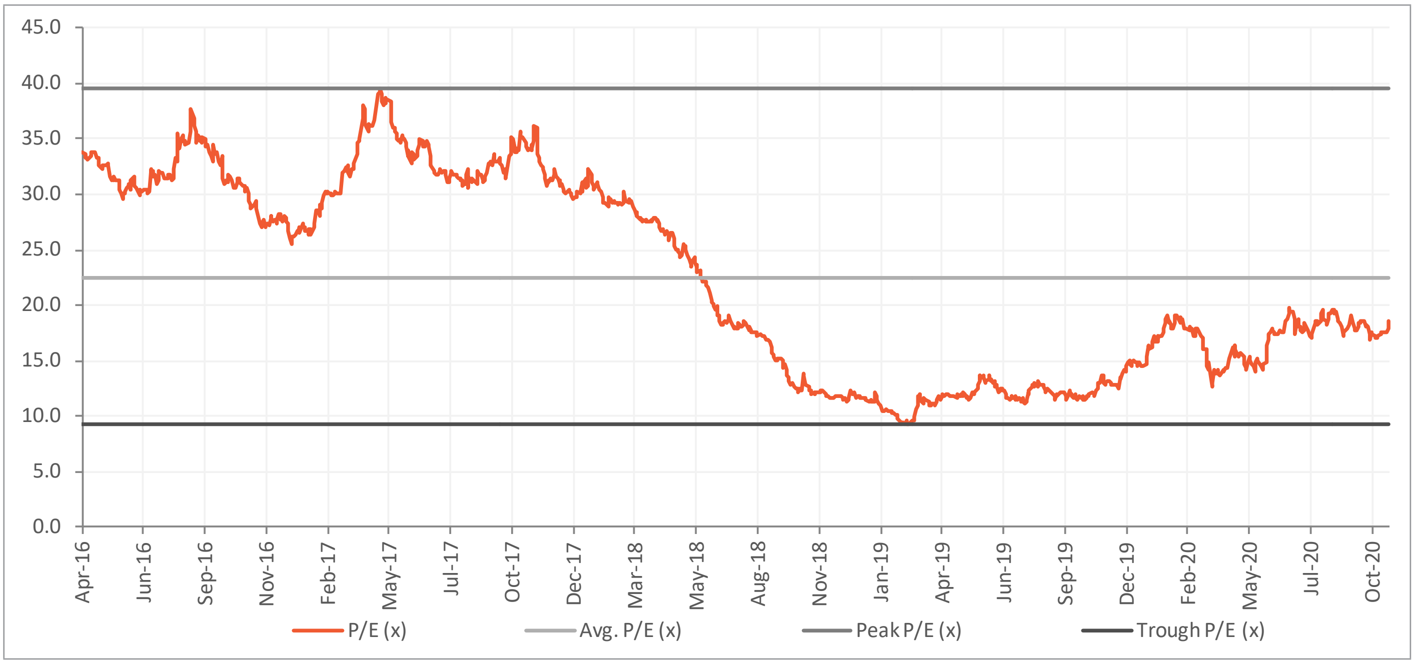
■ **Company outlook - Structural gas demand drivers well placed to drive volume growth**

For Gujarat Gas, we see a large gas sales volume opportunity of 2.5 mmscmd from the National Green Tribunal's (NGT) recent strict directions to curb pollution in the identified polluted areas of Gujarat and 2.5-3 mmscmd from development of six new GAs in Punjab, Haryana, Madhya Pradesh and Rajasthan. Given structural gas demand drivers, we expect sharp 20% volume growth in FY2022E post contraction in FY2021E due to COVID-19. Low spot LNG prices of $3-5/mmBtu would help drive up EBITDA margin to Rs. 5.1-5.4/scm over FY2022E-FY2023E as compared to Rs. 4.7/scm in FY2020.

■ **Valuation - Recommend Buy on GGAS with PT of Rs. 400**

We have increased our FY2021-FY2023 earnings estimate to factor higher EBITDA margins and higher volume assumption given faster-than-expected recovery in gas sales volumes. Given a high exposure to industrial PNG (80% of overall gas sales volume), we believe that GGAS is best-placed in the oil & gas space to benefit from India's robust gas demand outlook supported by regulatory push to curb pollution and expectation of weak spot LNG prices, given a likely increase in LNG supply from the US. Moreover, GGAS's EBITDA margins are also expected to expand given low gas cost tailwinds. The management believes that the implementation of final regulation for open access in CGD space would not be easy as the matter is sub-judice. We expect strong earnings CAGR of 19% over FY2020-FY2023E along with robust RoE of 25-27%. Valuation of GGAS of 14x FY2023E EPS is at steep discount of 38% to that of IGL despite the best volume growth outlook in the CGD space and potential to become net cash positive by FY2022. Hence, we recommend Buy on GGAS with PT of Rs. 400.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

Gujarat Gas Limited (GGAS) is India's gas distribution company with a volume of 9.5 mmscmd in FY2020. GGAS derives around 77% of volumes from industrial PNG, 16% from CNG, 6% from domestic PNG and remaining from commercial PNG. The company has presence spread across 23 districts in Gujarat, the Union Territory of Dadra & Nagar Haveli and Thane Geographical Area (GA) (excluding already authorised areas). GGAS' gas requirement is largely met through imported LNG as it derives majority of its volume from industrial customers. In the recently concluded 10th CGD bidding round, the company has won 6 GAs in 17 cities in the Punjab, Haryana, Madhya Pradesh and Rajasthan.

Investment theme

The gas volumes has recovered to pre-COVID-19 level and robust margin bodes well for speedy earnings recovery for GGAS. Moreover, India's long term gas demand outlook remains robust supported by low LNG prices, regulatory push to curb pollution and the government's thrust to increase share of gas in India's energy mix to ~15% by 2025 (from 6% currently) Additionally, the development of six new GAs (won in 10th CGD bidding round) have a volume potential of 4-5mmscmd over next 4-5 years. Overall, we expect strong volume growth traction for GGAS. Moreover, weak spot LNG prices would help expand margin of Gujarat Gas.

Key Risks

- Sharp rise in the LNG price and adverse regulatory changes could impact volume growth and margin.
- Delay in ramp-up of gas volume from new GAs.

Additional Data

Key management personnel

Anil Mukim	Chairman
Sanjeev Kumar	Managing Director
Nitesh Bhandari	Chief Financial Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Gujarat State Fertilizers & Chemic	6.8
2	Gujarat Industrial Development Cor	3.9
3	Gujarat Alkalies & Chemicals Ltd	3.1
4	FIL Ltd	1.7
5	UTI Asset Management Co Ltd	1.5
6	Standard Life Aberdeen PLC	1.2
7	Vanguard Group Inc/The	0.9
8	Canara Robeco Asset Management Co	0.8
9	Invesco Asset Management India Pvt	0.8
10	Kotak Mahindra Asset Management Co	0.7

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;