



Gujarat Gas Limited

Green focus to lead to earnings, valuation upgrades

Oil & Gas

Sharekhan code: GUJGASLTD

Company Update

3R MATRIX

| | + | = | - |
|----------------------|---|---|---|
| Right Sector (RS) | ✓ | ✗ | ✗ |
| Right Quality (RQ) | ✓ | ✗ | ✗ |
| Right Valuation (RV) | ✓ | ✗ | ✗ |

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

| | Old | | New |
|----|-----|---|-----|
| RS | ✓ | ↔ | ✓ |
| RQ | ✓ | ↔ | ✓ |
| RV | ✓ | ↔ | ✓ |

Reco/View

Change

| | |
|-----------------------|---|
| Reco: Buy | ↔ |
| CMP: Rs. 517 | |
| Price Target: Rs. 630 | ↑ |

↑ Upgrade ↔ Maintain ↓ Downgrade

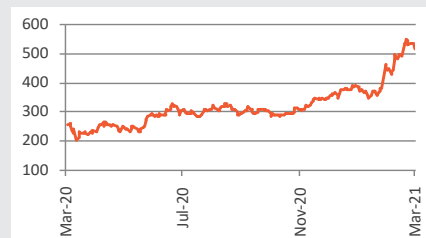
Company details

| | |
|-------------------------------|---------------|
| Market cap: | Rs. 35,614 cr |
| 52-week high/low: | Rs. 568/191 |
| NSE volume: (No of shares) | 10.7 lakh |
| BSE code: | 539336 |
| NSE code: | GUJGASLTD |
| Free float: (No of shares) | 26.9 cr |

Shareholding (%)

| | |
|-----------|------|
| Promoters | 60.9 |
| FII | 9.0 |
| DII | 7.3 |
| Others | 22.8 |

Price chart



Price performance

| (%) | 1m | 3m | 6m | 12m |
|--------------------|----|----|----|-----|
| Absolute | 20 | 44 | 73 | 100 |
| Relative to Sensex | 23 | 34 | 42 | 51 |

Sharekhan Research, Bloomberg

Summary

- GGAS is expected to post highest volume CAGR of 22.4% over FY21E-FY23E among CGD players, which warrants an upgrade of valuation multiple. We thus increase our PE multiple to 24x; raise PT to Rs. 630 and retain Buy on GGAS.
- Morbi gas volumes could increase further as Morbi Ceramic Association expects growth of 25-30% in FY22 with addition of 60 new units. Crackdown of polluting industrial areas and volume ramp-up from new GAs provides strong volume impetus.
- Potential inclusion of natural gas under GST could be game changer for GGAS as the same is expected significantly boost industrial PNG demand (80% of GGAS's overall volume) as customers would be able to avail benefit of input tax credits.
- We expect GGAS's valuation gap with IGL to narrow down as GGAS has much better volume growth outlook, superior RoE and strong FCF generation. GGAS trades at 11% discount to IGL.

Gujarat Gas (GGAS) has clearly outperformed the peers with 13.8% volume CAGR over FY2016-FY2020 as compared to a 12.7% for IGL and 4.5% for MGL. Even post lockdown in Q1FY2021, GGAS has shown very strong volume growth of 6%/23% y-o-y in Q2FY2021/Q3FY2021. GGAS's volume growth to continue outpace its peers with our expectation of 22.4% volume CAGR over FY2021-FY2023 led by strong demand for industrial PNG from Morbi ceramic cluster and Chemical and Pharma belt in Gujarat. Management has guided for Morbi's peak volume potential of 10mmcmd versus 6.5mmcmd currently and 8%-10% annual growth from pharma/chemical customers. Volume growth pace would further gain momentum in case of potential NGT crackdown of polluting industrial areas in Gujarat (volume potential of 2mmcmd-2.5mmcmd) and ramp-up of volume from its 7 new GAs (which have already been commercialised with volume potential of 3mmcmd-3.5mmcmd). Potential inclusion of natural gas under GST regime would benefit GGAS most among in CGD players as gas demand from industrial customers would increase as customers would be able to avail benefit of input tax credits. Also, GGAS would be able to take tax credit on operating cost and its capital expenditure, which would boost its profitability. Industry leading volume growth outlook, high RoE of 30% and robust FCF generation of Rs. 1,400-1,650 crore annually warrants upgrade of valuation multiple for GGAS. We thus increase our price target to Rs630 (valued at 24x FY2023E EPS) and retain Buy on GGAS given possibility of further earnings upgrade (regulatory push to increase penetration of greener fuels especially natural gas).

Our Call

Valuation – Maintain Buy on GGAS with a revised PT of Rs. 630: GGAS's stock price has run-up sharply by 73% in last six months but still GGAS's valuation of 19.8x FY2023E EPS is at 11% discount to that of IGL based on our estimate. We expect GGAS's valuation gap with IGL to close going forward given a better volume growth outlook (expectation of 22.4% volume CAGR over FY2021E-FY2023E versus 17.1% for IGL) and best return ratios in CGD space (RoE of 30% versus 22% for IGL). Also, given high share of industrial PNG at 80% in overall volume mix, GGAS' gas volumes would benefit the most from the government efforts to crack down on polluting industrial areas and likely inclusion of natural gas under the GST regime. All the above factors warrant an upgrade of valuation multiples for GGAS and thus we increase our price target to Rs. 630 (valued at 24x FY2023E EPS) and maintain a Buy rating on GGAS.

Key Risks

Lower-than-expected gas sales volume in case of COVID-19 led economic slowdown. Delay in development of new GAs, sharp rise in LNG prices, and adverse regulatory changes could impact outlook and valuations.

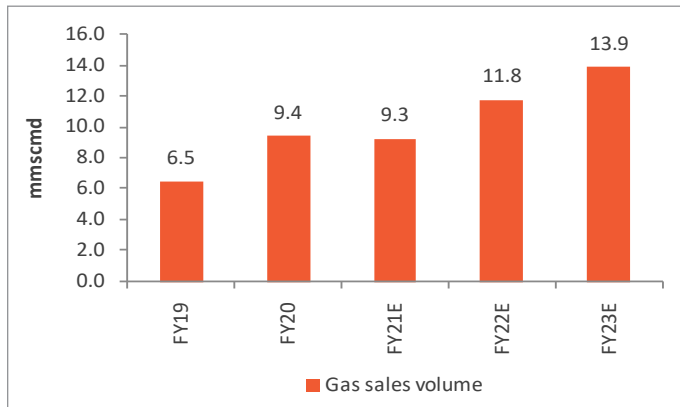
Valuation (Consolidated)

| Particulars | FY19 | FY20 | FY21E | FY22E | FY23E |
|--------------------|-------|--------|-------|--------|--------|
| Revenues | 7,754 | 10,300 | 9,827 | 13,957 | 16,426 |
| OPM (%) | 12.7 | 15.9 | 21.1 | 16.4 | 17.0 |
| Adjusted PAT | 418 | 910 | 1,260 | 1,423 | 1,803 |
| % YoY growth | 43.1 | 117.4 | 38.6 | 12.9 | 26.7 |
| Adjusted EPS (Rs.) | 6.1 | 13.2 | 18.3 | 20.7 | 26.2 |
| P/E (x) | 85.1 | 39.2 | 28.3 | 25.0 | 19.8 |
| P/B (x) | 16.1 | 10.7 | 8.3 | 6.7 | 5.3 |
| EV/EBITDA (x) | 38.0 | 22.5 | 17.3 | 15.1 | 11.9 |
| RoNW (%) | 20.6 | 32.9 | 33.2 | 29.6 | 29.9 |
| RoCE (%) | 15.3 | 24.3 | 28.2 | 27.1 | 29.0 |

Source: Company; Sharekhan estimates

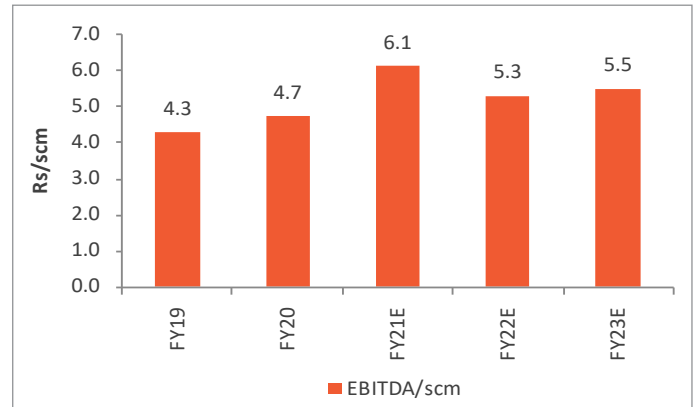
Financials in charts

Strong volume growth, led by regulatory push



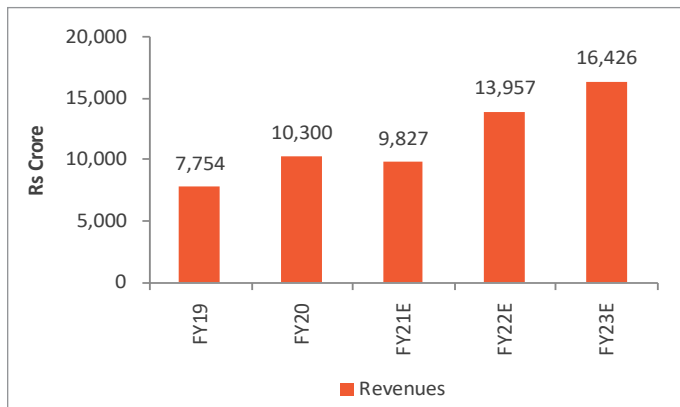
Source: Company, Sharekhan Research

Resilient margin given improved pricing competitiveness



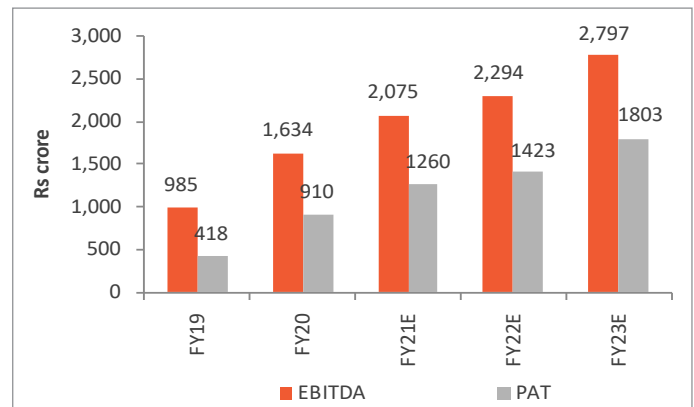
Source: Company, Sharekhan Research

Robust volume growth to drive up revenue



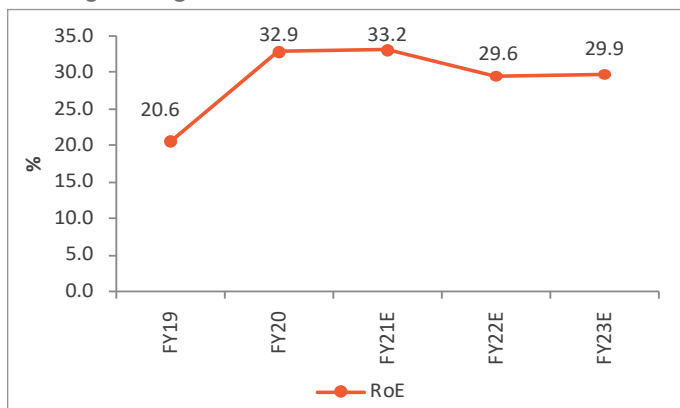
Source: Company, Sharekhan Research

EBITDA/PAT to post 16%/20% CAGR over FY21E-FY23E



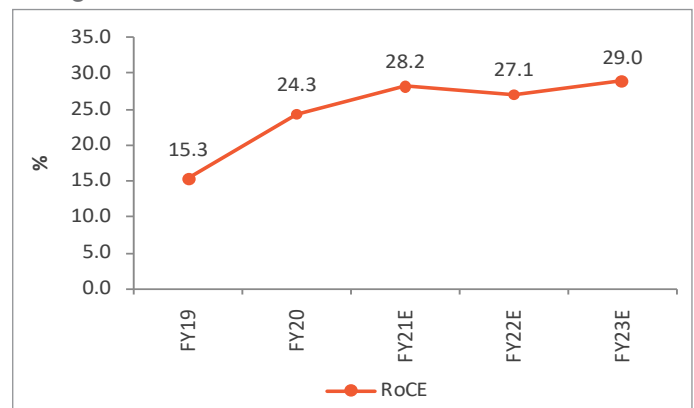
Source: Company, Sharekhan Research

Industry leading RoE



Source: Company, Sharekhan Research

Strong RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

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

The Indian CGD sector is at an inflection point as it is a priority sector (allocation of cheap domestic gas and focus on rapid expansion of CGD infrastructure) for the government. With the government's focus to increase the share of gas in India energy mix to 15% by 2025 (from 6% currently), consumption growth for the CGD sector is estimated at 10% annually in the next 5 years. Gujarat is at the forefront of CGD development in India supported by availability of the state gas grid, access to LNG terminals, and natural gas infrastructure. Post the ninth CGD bidding round, all districts of Gujarat have been authorised for CGD development; and after completion of minimum work program (MWP), 100% of its GA and population would be covered by CGD network. Gujarat accounts for 29% of India's CNG station and CNG vehicles, 35% of domestic PNG connections, 65% of PNG connections, and 50% of industrial PNG connection. Massive investment linked up over the next 5-8 years and crackdown of critically/severely polluted industrial areas would provide huge volume growth opportunity to Gujarat-based CGD players such as GGAS.

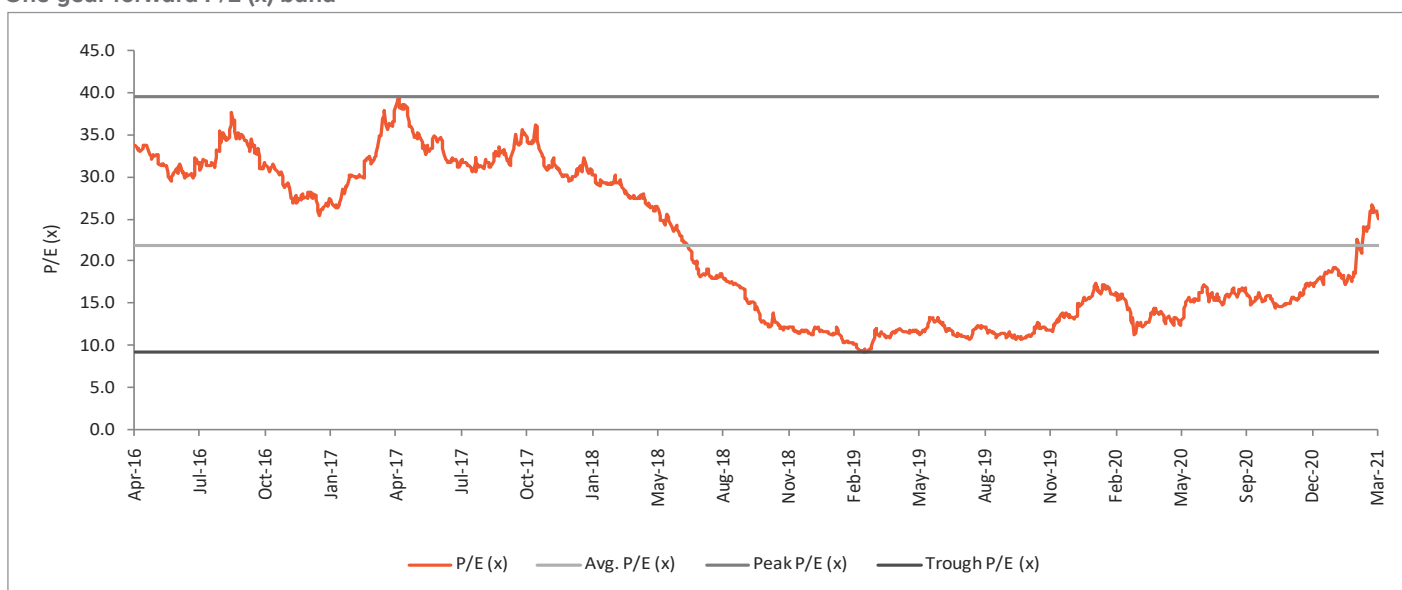
■ Company outlook - Structural gas demand drivers well placed to drive volume growth

For GGAS, we see large gas sales volume opportunity of 2.5 mmscmd from the National Green Tribunal's (NGT's) recent strict directions to curb pollution in the identified polluted areas of Gujarat and 3-3.5 mmscmd from the development of seven new GAs in Punjab, Haryana, Madhya Pradesh, and Rajasthan. Given structural gas demand drivers, we expect a sharp 27% volume growth in FY2022E post contraction in FY2021E due to COVID-19. We expect GGAS to sustain EBITDA margin at Rs. 5-5.5/scm as the company is implementing frequent price hikes for industrial PNG customers.

■ Valuation - Maintain Buy on GGAS with a revised PT of Rs. 630

GGAS's stock price has run-up sharply by 73% in last six months but still GGAS's valuation of 19.8x FY2023E EPS is at 11% discount to that of IGL based on our estimate. We expect GGAS's valuation gap with IGL to close going forward given a better volume growth outlook (expectation of 22.4% volume CAGR over FY2021E-FY2023E versus 17.1% for IGL) and best return ratios in CGD space (RoE of 30% versus 22% for IGL). Also, given high share of industrial PNG at 80% in overall volume mix, GGAS' gas volumes would benefit the most from the government efforts to crack down on polluting industrial areas and likely inclusion of natural gas under the GST regime. All the above factors warrant an upgrade of valuation multiples for GGAS and thus we increase our price target to Rs. 630 (valued at 24x FY2023E EPS) and maintain a Buy rating on GGAS.

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

Gas volumes have recovered above pre-COVID-19 level and decent margin outlook (led by price hikes for industrial PNG) bode well for strong earnings growth for GGAS. Moreover, India's long-term gas demand outlook remains robust supported by 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 seven new GAs (won in the 9th and 10th CGD bidding round) has volume potential of 3mmscmd-3.5mmscmd over the next 3-5 years. Moreover, GGAS is expected to be biggest beneficiary of potential inclusion of natural gas under GST as the same would substantially improve industrial PNG demand. Overall, we expect strong volume growth traction for GGAS.

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

Top 10 shareholders

| Sr. No. | Holder Name | Holding (%) |
|---------|---|-------------|
| 1 | Gujarat State Fertilizers & Chemical | 6.8 |
| 2 | Gujarat State Fertilizers & Chemical | 3.9 |
| 3 | Gujarat State Fertilizers & Chemical | 3.1 |
| 4 | UTI Asset Management Co Ltd | 1.4 |
| 5 | FIL Ltd | 1.3 |
| 6 | Standard Life Aberdeen PLC | 1.2 |
| 7 | DSP Investment Managers Pvt Ltd | 0.9 |
| 8 | Vanguard Group Inc/The | 0.9 |
| 9 | Canara Robeco Asset Management Company | 0.8 |
| 10 | Kotak Mahindra Asset Management Company | 0.7 |

Source: Bloomberg; Note: Shareholding as on February 05, 2021

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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 deteriorating 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

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