Gujarat Gas Ltd

Margins power Q1; earnings outlook stays bright

Oil & Gas	Sharekhan code: GUJGASLTD	Result 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. 772**	
Price Target: **Rs. 890**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

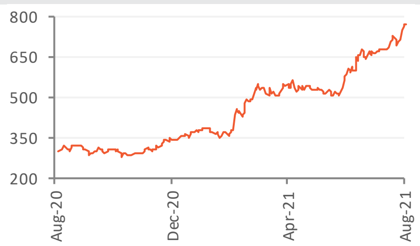
Company details

Market cap:	Rs. 53,161 cr
52-week high/low:	Rs. 787 / 281
NSE volume: (No of shares)	18.9 lakh
BSE code:	539336
NSE code:	GUJGASLTD
Free float: (No of shares)	26.9 cr

Shareholding (%)

Promoters	60.9
FII	8.2
DII	7.9
Others	23.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	15	44	77	155
Relative to Sensex	12	33	71	111

Sharekhan Research, Bloomberg

Summary

- Q1FY22 PAT at Rs. 476 crore, up 36% q-o-q and beat of 30% versus our estimate led by stronger-than-expected EBITDA margin at Rs. 7.9/scm (up 56% q-o-q) offsetting the miss in volume at 10 mmscmd (down 17.5% q-o-q).
- Robust margin performance was driven by full benefit of the Rs. 9/scm price hikes taken in Jan-Feb, and lower gas cost on account of decline in spot LNG price and higher use of domestic gas. Industrial PNG volume declined by 19% q-o-q to 7.8 mmscmd as demand from Morbi customers fell by 23% q-o-q to 5.6 mmscmd.
- Management maintained its 10% p.a. volume growth guidance for next 3-4 years and FY22 margin guidance of Rs. 5.5-6/scm. Volumes recovered to 12 mmscmd but EBITDA margin likely to fall to Rs. 4-4.5/scm on recent surge in spot LNG price.
- We maintain a Buy on Gujarat Gas with a revised PT of Rs. 890. GGAS' industry leading volume/earnings growth outlook (expect 24% PAT CAGR over FY21-FY24E), high RoE of 30% and robust FCF justified premium valuation.

Gujarat Gas Limited (GGAS) reported strong Q1FY2022 results with a sharp 26% beat in operating profit at Rs. 723 crore (up 30.4% q-o-q) led by stronger-than-expected EBITDA margin at Rs. 7.9/scm (up 56.3% q-o-q) offsetting miss in volumes at 10 mmscmd (down 17.5% q-o-q). Strong margin performance was driven by: 1) full impact of price hike of Rs9/scm taken over January-February and 2) 7.2% q-o-q decline in gas cost as spot LNG price declined by $2/mmBtu q-o-q and higher use of domestic gas price. The second wave of COVID-19 impacted volumes across segments with 17%/9%/19%/21% q-o-q decline in gas sales volume from Industrial PNG/CNG/D-PNG/C-PNG to 7.8 mmscmd/1.5 mmscmd/0.6 mmscmd/0.1 mmscmd. The sharp decline in Industrial PNG volumes was due to lower offtake by Morbi ceramic customers at 5.6 mmscmd (down 23.3% q-o-q) while non-Morbi volume remained resilient at 2.2 mmscmd (versus 2.3 mmscmd in Q4FY2021). A profit after tax (PAT) of Rs. 476 crore (up 36.1% q-o-q) also substantially higher than our estimate at Rs. 365 crore given a sharp beat in margins and higher-than-expected other income (up 13% q-o-q). GGAS's gas sales volume has recovered to 12mmscmd level (reflects an increase of 20% q-o-q) with Morbi volume at 7mmscmd currently. The management remains confident of strong volume growth potential and reiterated its guidance of 10% annual gas volume growth (on current high base of 12 mmscmd) over next 3-4 years led by 10/15% growth in Morbi/Non-Morbi gas demand and ramp-up of 7 new GAs. Acquisition of new GAs of Amritsar and Bhatinda (volume potential of 0.8 mmscmd) from the parent could further aid to volume growth and likely inclusion of natural gas under the GST regime would mean a secular long-term volume growth story. Although high spot LNG price of $14/mmBtu in Q2FY2022 would result in margin contraction to the level of Rs. 4-4.5/scm, the management maintained its FY2022 margin guidance of Rs. 5.5-6/scm given efficient gas sourcing mix (tied up domestic gas supply of 2.5 mmscmd at better pricing terms). Historically, GGAS has exceeded its volume guidance and we expect the company's volume growth to continue to outpace that of its peers with our expectation of a 20% CAGR over FY2021-FY2024E led by deeper penetration in existing GAs and ramp-up of volumes at seven new GAs. GGAS's industry leading volume/earnings growth outlook (expect 24% PAT CAGR over FY21-FY24E), high RoE of 30% and robust FCF generation of Rs. 1,800-2000 crore annually, justifies its premium valuation. Hence, we maintain a Buy rating on GGAS with a revised PT of Rs. 890.

Key positives

- Better-than-expected gross/EBITDA margin at Rs. 10.4/Rs. 7.9 per scm, up 48.2%/56.3% q-o-q.
- Net debt declined to negligible level of Rs. 67 crore as of June 2021 versus Rs449 crore as of March 2021.

Key negatives

- Lower-than-expected gas sales volume of 10 mmscmd (down 17.5% q-o-q).

Our Call

Valuation – Maintain Buy on GGAS with a revised PT of Rs. 890: We maintain our FY2022-FY2024 earnings estimate. Given high exposure to industrial PNG (78% of overall gas sales volume), we believe 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 likely inclusion of natural gas under the GST regime. Best earnings growth potential (expect 24% PAT CAGR over FY21-24E) among CGDs led by superior volume growth and healthy margins along with a high RoE of 30% justifies the stock's premium valuation of 27x FY2023E EPS and 21.8x FY2024E EPS. We maintain a Buy rating on GGAS with a revised PT of Rs. 890.

Key Risks

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

Valuation (Consolidated) Rs cr

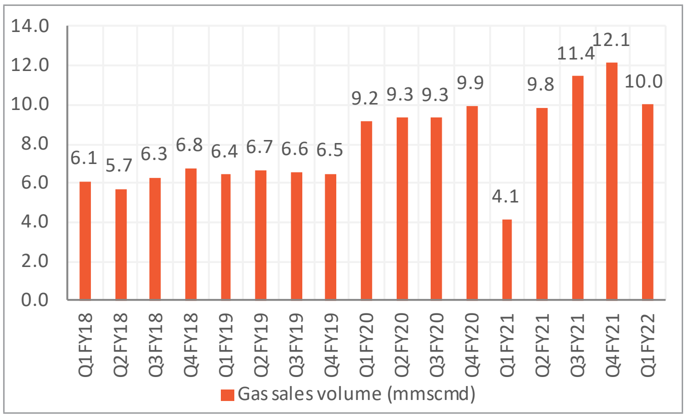
Particulars	FY20	FY21	FY22E	FY23E	FY24E
Revenue	10,300	9,854	13,956	16,425	19,020
OPM (%)	15.9	21.2	17.4	18.0	18.8
Adjusted PAT	910	1,278	1,575	1,966	2,435
% YoY growth	*117.4*	*40.5*	*23.2*	*24.8*	*23.9*
Adjusted EPS (Rs.)	13.2	18.6	22.9	28.6	35.4
P/E (x)	58.4	41.6	33.8	27.0	21.8
P/B (x)	16.0	11.8	9.3	7.4	5.9
EV/EBITDA (x)	33.2	25.7	21.5	17.1	13.7
RoNW (%)	32.9	32.6	30.8	30.5	30.0
RoCE (%)	24.3	29.7	31.8	32.9	33.6

Source: Company; Sharekhan estimates

Sharp beat in PAT led by stronger-than-expected margin, volume below estimate

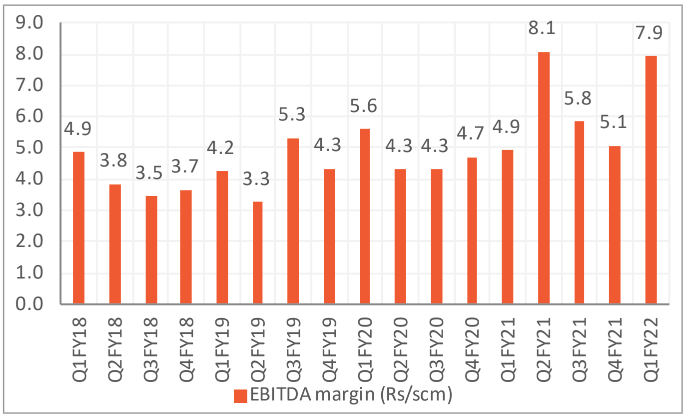
Gujarat Gas Limited (GGAS) reported strong Q1FY22 results with a sharp 26% beat in operating profit of Rs. 723 crore (up 30.4% q-o-q) led by stronger-than-expected EBITDA margin at Rs. 7.9/scm (up 56.3% q-o-q) offsetting miss in volumes at 10 mmscmd (down 17.5% q-o-q). Strong margin performance was driven by: 1) full impact of price hike of Rs9/scm taken over January-February and 2) 7.2% q-o-q decline in gas cost as spot LNG price declined by $2/mmBtu q-o-q and higher use of domestic gas price. The second wave of COVID-19 impacted volumes across segments with 17%/9%/19%/21% q-o-q decline in gas sales volume from Industrial PNG/CNG/D-PNG/C-PNG to 7.8 mmscmd/1.5 mmscmd/0.6 mmscmd/0.1 mmscmd. The sharp decline in Industrial PNG volumes was due to lower offtake by Morbi ceramic customers at 5.6 mmscmd (down 23.3% q-o-q) while non-Morbi volume remained resilient at 2.2 mmscmd (versus 2.3 mmscmd in Q4FY2021). A profit after tax (PAT) of Rs. 476 crore (up 36.1% q-o-q) also substantially higher than our estimate at Rs. 365 crore given a sharp beat in margins and higher-than-expected other income (up 13% q-o-q).

Gas sales volume fall 17.5% q-o-q to 10 mmscmd



Source: Company, Sharekhan Research

EBITDA/scm of Rs. 7.9/scm significantly above estimate



Source: Company, Sharekhan Research

Key takeaways from discussion with management

- **Gas demand recovered close to Q4FY21 level:** The management has said that overall gas sales volume recovered to 12 mmscmd (close to Q4FY21 level of 12.1 mmscmd) with Morbi volumes at 7.1 mmscmd currently and remaining from non-Morbi customers (pharma/chemicals belt in Gujarat).
- **Volume guidance:** The management maintained its guidance of 10% volume growth annually over next 3-4 years led by 10%/15% growth in Morbi/Non-Morbi demand and ramp-up volumes are new GAs (at 0.7-0.8 mmscmd currently versus average of 0.3 mmscmd in FY2021.
- **Margin guidance:** The management guided that margin to contract sequentially in Q2FY2022 to $4-4.5/scm due to sharp increase in the spot LNG price to $14/mmBtu in Q2FY2022. However, remains confident to meet is annual margin guidance of Rs5.5-6/scm. The management has indicated that it would bid for more domestic gas auction to secure gas at better pricing.
- **Gas sourcing mix:** Contracted term gas at 6 mmscmd (includes 2.5 mmscmd of domestic gas), spot LNG at 1.5 mmscmd and remaining APM gas for CNG/Domestic PNG.
- **Capex guidance:** The company maintained its FY2022 capex guidance of Rs. 800-900 crore. Our of which, ~40% would be spent on setting-up of CNG stations, 40-45% of steel pipeline and remaining 10-15% on maintenance capex.
- **CNG station addition:** The company and has added 11 new CNG station and thus taking total 564 CNG stations as of June 2021 and targets to add 150 new CNG stations in FY2022 with 70-80% to be set up in new GAs.
- **Update on new GAs:** All 7 GAs won in the 9th and 10th CGD bidding rounds has become operational with current volume of ~0.7-0.8 mmscmd and have large volume potential of 3-3.5 mmscmd over next 3-5 years.
- **Debt:** Net debt is now negligible at Rs67 crore as of June 2021 versus Rs. 449 crore in FY2021. The company has partly paid term loan of Rs170 crore in Q1FY22 and gross debt stood at Rs. 700 crore.

Results (Standalone) **Rs cr**

Particulars	Q1FY22	Q1FY21	Y-o-Y %	Q4FY21	Q-o-Q %
Net Sales	**3,011**	**1,083**	**178.0**	**3,429**	**-12.2**
Total Expenditure	2,288	897	155.0	2,875	-20.4
Reported operating profit	**723**	**186**	**289.2**	**554**	**30.4**
Adjusted operating profit	**723**	**186**	**289.2**	**554**	**30.4**
Other Income	21	15	42.7	19	13.0
Interest	16	40	-60.4	18	-11.9
Depreciation	91	82	10.1	87	4.3
Exceptional income/(expense)	0	0	NA	0	NA
Reported PBT	638	78	714.7	468	36.2
Adjusted PBT	638	78	714.7	468	36.2
Tax	162	20	723.5	118	36.6
RPAT	476	59	711.7	350	36.1
Adjusted PAT	**476**	**59**	**711.7**	**350**	**36.1**
Equity Cap (cr)	69	69		69	
Reported EPS (Rs)	6.9	0.9	711.7	5.1	36.1
Adjusted EPS	6.9	0.9	711.7	5.1	36.1
Margins (%)			**BPS**		**BPS**
OPM	24.0	17.2	686	16.2	785
Effective tax rate	25.3	25.1	27	25.3	7
NPM	15.8	5.4	1040	10.2	561

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q1FY22	Q1FY21	Y-o-Y %	Q4FY21	Q-o-Q %
Volume (mmscmd)	10.0	4.1	141.6%	12.1	-17.5%
Gross margin (Rs/scm)	10.4	9.4	11.4%	7.0	48.2%
EBITDA margin (Rs/scm)	7.9	4.9	61.1%	5.1	56.3%

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 2030 (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 investments linked up over the next 5-8 years and crackdown of critically/severally polluted industrial areas would provide huge volume growth opportunity for Gujarat-based CGD players such as GGAS.

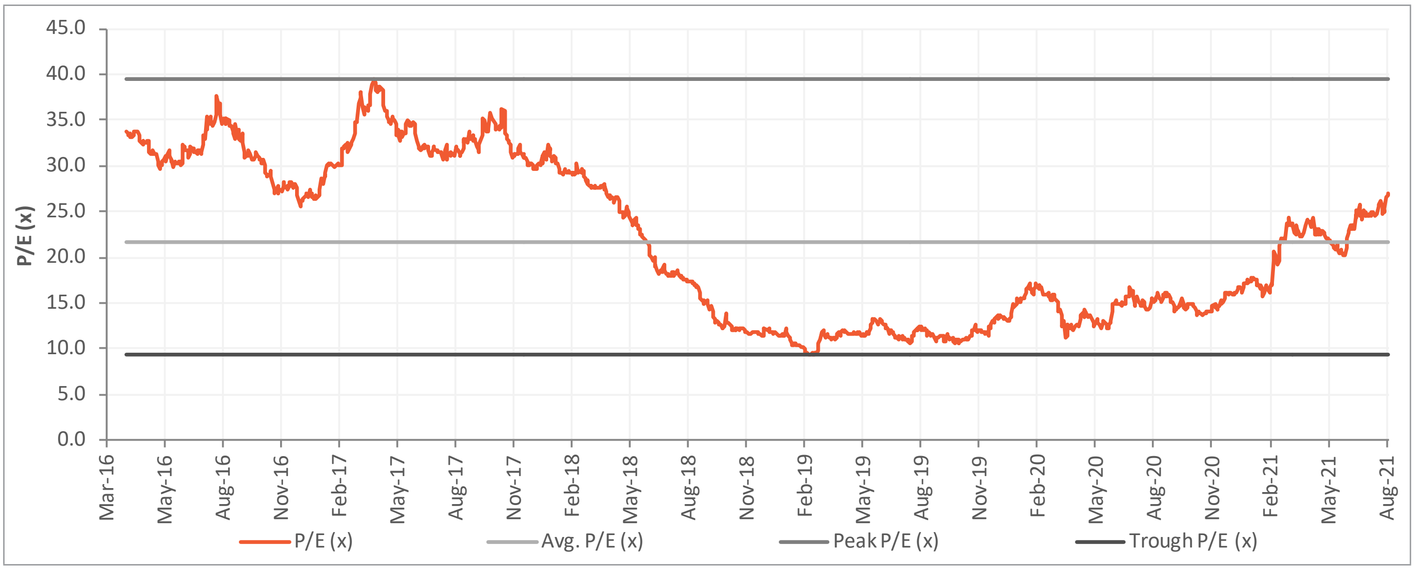
■ **Company outlook - Structural gas demand drivers well placed to drive volume growth**

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 26% y-o-y volume growth in FY2022E post flat volume in FY2021 due to COVID-19 impact on volumes in Q1FY2021. Overall, we expect 20% volume CAGR over FY2021-FY2024E. We expect GGAS's EBITDA margin to improve to Rs. 5.6-6.1/scm over FY2022E-FY2024E as the company is implementing frequent price hikes for industrial PNG customers.

■ **Valuation - Maintain Buy on GGAS with a revised PT of Rs. 890**

We maintain our FY2022-FY2024 earnings estimate. Given high exposure to industrial PNG (78% of overall gas sales volume), we believe 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 likely inclusion of natural gas under the GST regime. Best earnings growth potential (expect 24% PAT CAGR over FY21-24E) among CGDs led by superior volume growth and healthy margins along with a high RoE of 30% justifies the stock's premium valuation of 27x FY2023E EPS and 21.8x FY2024E EPS. We maintain a Buy rating on GGAS with a revised PT of Rs. 890.

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 9.4 mmscmd in FY2021. GGAS derives around 78% of volumes from industrial PNG, 14% from CNG, 7% 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). 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

Strong gas volume growth outlook and likely margin expansion (led by price hikes for industrial PNG and efficient gas sourcing) 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 2030 (from 6% currently). Additionally, the development of seven new GAs (won in the 9th and 10th CGD bidding round) has volume potential of 3 mmscmd-3.5 mmscmd 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	FIL Limited	1.6
2	DSP Investment Managers Pvt. Ltd.	1.4
3	Vanguard Group Inc	1.0
4	UTI Asset Management Co. Ltd	0.9
5	Aberdeen PLC	0.9
6	Canara Robeco Asset Management Co. Ltd	0.9
7	Axis Asset Management Co. Ltd	0.9
8	Kotak Mahindra Asset Management Co. Ltd	0.8
9	Aditya Birla Sun Life Asset Management Co. Ltd	0.6
10	BlackRock Inc	0.4

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

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