Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Gujarat Gas Ltd

Weak Q3; volume led earnings growth remain intact

Oil & Gas	Sharekhan code: GUJGASLTD

Reco/View: Buy	↔	CMP: **Rs. 665**	Price Target: **Rs. 840**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 31.85

Updated Jan 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

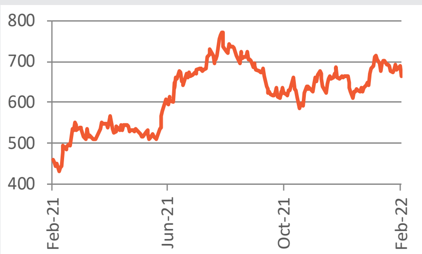
Company details

Market cap:	Rs. 45,750 cr
52-week high/low:	Rs. 787 / 408
NSE volume: (No of shares)	13.9 lakh
BSE code:	539336
NSE code:	GUJGASLTD
Free float: (No of shares)	26.9 cr

Shareholding (%)

Promoters	60.9
FII	7.7
DII	8.0
Others	23.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4	3	-8	44
Relative to Sensex	0	7	-14	31

Sharekhan Research, Bloomberg

Summary

- Q3FY22 results were weak with a sharp 20%/23% miss in operating profit/PAT at Rs. 237 crore/Rs. 122 crore, down 61.4%/68.8% y-o-y as lower-than-expected EBITDA margin offset a slight beat in gas sales volume at 11.4 mmscmd (flat q-o-q).
- EBITDA margin of Rs. 2.3/scm, down 61.1% y-o-y was 24% below our estimate due to a steep 18% y-o-y rise in per unit opex and continued pressure on gross margin at Rs. 4.6/scm (down 41.3% y-o-y) due to elevated gas cost.
- Q4 volumes would be soft due to the temporary effect of higher industrial PNG price of Rs. 106/scm for Morbi volume >5.5mmscmd. However, GGAS has withdrawn differential pricing and added contractual volume of 1 mmscmd and thus see normalized volume of 12mmscmd by Mar'22. Likely lower spot LNG price by $10/mmBtu for March 2022 would aid margins.
- We believe that recent stock price correction factors in near-term margin concerns and once spot LNG prices normalise, we expect earnings momentum to pick up. Hence, we maintain Buy rating on Gujarat Gas with an unchanged PT of Rs. 840.

Gujarat Gas Limited (GGAS) reported weak Q3FY22 results with 20%/23% miss in operating profit/PAT at Rs. 237 crore/Rs. 122 crore, down 61.4%/68.8% y-o-y. The sharp miss in earnings was on the account of weaker-than-expected EBITDA margin at Rs. 2.3/scm (down 61.1% y-o-y; down 43.2% q-o-q) offsetting slight beat in gas sales volume at 11.4 mmscmd (largely flat q-o-q). EBITDA margins missed our estimate due to higher-than-expected opex per unit (up 18.2% y-o-y) on account of: 1) rise in operating cost for CNG stations (added 58 stations in Q3FY22) and bidding-related expenses for 11th CGD auction round and 2) lower-than-expected gross margin at Rs. 4.6/scm (down 41.3% y-o-y; down 25.9% q-o-q) due to a surge in gas costs by 133%/57% y-o-y/q-o-q to Rs. 45/scm given elevated spot LNG prices. Steady volumes reflect an 11%/5% q-o-q increase in CNG/D-PNG volume to 2.2 mmscmd/0.7 mmscmd offsetting a 3% q-o-q decline in industrial PNG volumes to 8.4 mmscmd. Within the Industrial PNG segment, gas sales volume to Morbi cluster's ceramic customers stood at 6 mmscmd (down 6% q-o-q) while non-Morbi volumes grew by 4.3% q-o-q to 2.4 mmscmd.

Key positives

- Robust growth of 11%/5% q-o-q in CNG/D-PNG volume to 2.2 mmscmd/0.7 mmscmd.

Key negatives

- A sharp miss in EBITDA margin at Rs. 2.3/, down 61% y-o-y on higher opex and steep rise in spot LNG prices.

Management Commentary

- **Volume outlook –** Q4FY22 gas sales volumes would be lower sequentially given temporary impact of higher industrial price of Rs. 106/scm for Morbi volume above 5.5 mmscmd and some impact of third wave of Covid. The management expects volumes to normalise at 12 mmscmd by March 2022 as the company has withdrawn differential pricing and added new industrial customer with contractual volume of 1mmscmd. The January 2022 volume run-rate of 10 mmscmd is 12% lower than Q3FY22 volume of 11.4 mmscmd.
- **Margin Outlook –** GGAS' current industrial PNG price of Rs. 59/scm covers spot LNG price of $32-33/mmBtu. The management indicated that margin concern is largely over, and spot LNG prices is also decline to $25/mmBtu in March 2022 versus $35/mmBtu currently and this EBITDA margin would improve in Q4FY22 and reach normalised levels of Rs. 4.5-5/scm.
- **Capex guidance –** 9MFY22 capex spends are at Rs.738 crore and FY22 capex guidance is increased to Rs. 1,000 crore. Plan to add 150 plus CNG stations in FY22 versus 95 CNG stations until now.
- **Gas sourcing mix –** Spot LNG/contracted LNG at 2.4 mmscmd/6 mmscmd and remaining through domestic gas for CNG/D-PNG requirement.

Revision in estimates – We have lowered our FY22E earnings estimate to factor in lower volume/margin assumption and have fine-tuned our FY23-24 earnings estimate.

Our Call

Valuation – Maintain Buy on GGAS with an unchanged PT of Rs. 840: The recent correction in GGAS' stock price factors in near-term concern on earnings due to high spot LNG prices and believe that long-term double-digit volume growth outlook remains intact supported by regulatory push to curb pollution and ramp-up of new GAs. Hence, we expect a strong 22% PAT CAGR over FY21-24E and superior RoE/RoCE of 31%/34% in FY24E. Hence, we maintain a Buy rating on GGAS with an unchanged PT of Rs. 840. At CMP, the stock trades at 25.2x/19.8x its FY23E/FY24E EPS.

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

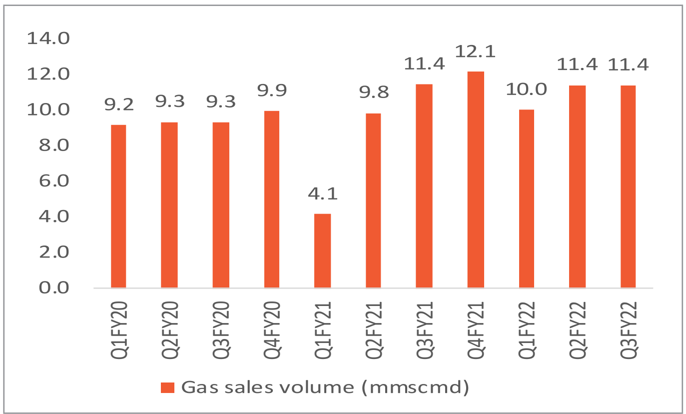
Particulars	FY21	FY22E	FY23E	FY24E
Revenue	9,854	16,503	16,006	19,044
OPM (%)	21.2	10.5	17.2	17.9
Adjusted PAT	1,278	1,051	1,817	2,308
% YoY growth	40.5	-17.8	73.0	27.0
Adjusted EPS (Rs.)	18.6	15.3	26.4	33.5
P/E (x)	35.8	43.5	25.2	19.8
P/B (x)	10.1	8.6	6.8	5.4
EV/EBITDA (x)	22.1	26.0	15.9	12.4
RoNW (%)	32.6	21.4	30.3	30.5
RoCE (%)	29.7	22.2	32.3	33.8

Source: Company; Sharekhan estimates

Sharp miss in PAT due to weak margin; slight beat in gas sales volume at 11.4 mmscmd (flat y-o-y)

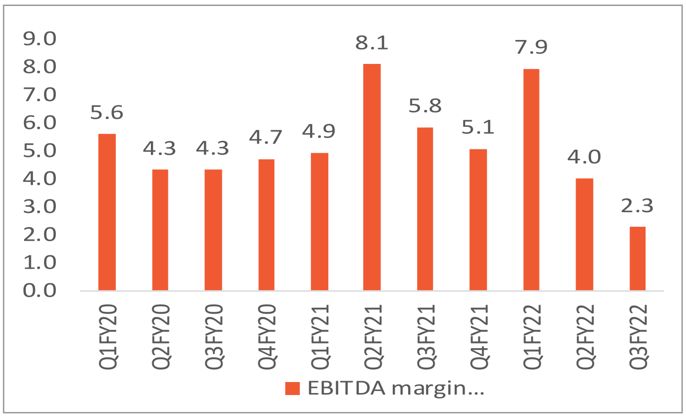
Weak Q3FY22 results with 20%/23% miss in operating profit/PAT at Rs. 237 crore/Rs. 122 crore, down 61.4%/68.8% y-o-y. The sharp miss in earnings was on the account of weaker-than-expected EBITDA margin at Rs. 2.3/scm (down 61.1% y-o-y; down 43.2% q-o-q) offset slight beat in gas sales volume at 11.4 mmscmd (largely flat q-o-q). EBITDA margins missed our estimate due to higher-than-expected opex per unit (up 18.2% y-o-y) and lower-than-expected gross margin at Rs. 4.6/scm (down 41.3% y-o-y; down 25.9% q-o-q) due to a steep rise in gas cost by 133%/57% y-o-y/q-o-q to Rs. 45/scm given elevated spot LNG price. The steady volume reflects 11%/5% q-o-q increase in CNG/D-PNG volume to 2.2 mmscmd/0.7 mmscmd, offsetting a 3% q-o-q decline in industrial PNG volume to 8.4 mmscmd.

Steady gas sales volume at 11.4 mmscmd



Source: Company, Sharekhan Research

EBITDA/scm of Rs. 2.3/scm significantly below estimate



Source: Company, Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Revenue	**5,144**	**2,833**	**81.6**	**3,625**	**41.9**
Total Expenditure	4,907	2,219	121.2	3,206	53.1
Operating profit	**237**	**614**	**-61.4**	**419**	**-43.3**
Other Income	35	19	85.9	18	98.5
Interest	14	24	-42.7	12	13.0
Depreciation	97	87	11.6	95	2.3
PBT	162	522	-69.0	330	-50.9
Tax	40	131	-69.6	84	-52.6
Reported PAT	**122**	**391**	**-68.8**	**245**	**-50.3**
Equity Cap (cr)	69	69	BPS	69	BPS
EPS (Rs.)	1.8	5.7	-68.8	3.6	-50.3
Margins (%)			**BPS**		**BPS**
OPM	4.6	21.7	-1,707	11.6	-694
Effective tax rate	24.7	25.2	-48	25.6	-88
NPM	2.4	13.8	-1,142	6.8	-440

Source: Company; Sharekhan Research

Key operating metrics

Particulars	Q3FY22	Q3FY21	YoY (%)	Q2FY22	QoQ (%)
Volume (mmscmd)	11.4	11.5	-0.6%	11.4	-0.2%
Gross margin (Rs. /scm)	4.6	7.8	-41.3%	6.2	-25.9%
EBITDA margin (Rs. /scm)	2.3	5.8	-61.1%	4.0	-43.2%

Source: Company; Sharekhan Research

Outlook and Valuation

Sector outlook – 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's energy mix to 15% by 2030 (from 6% currently), consumption growth for the CGD sector is estimated at 10% annually in the next five 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 the minimum work program (MWP), 100% of its GA and population would be covered by the 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 connections. Massive investments linked up over the next 5-8 years and crackdown on critically/severally polluted industrial areas would provide huge volume growth opportunity for Gujarat-based CGD players such as GGAS.

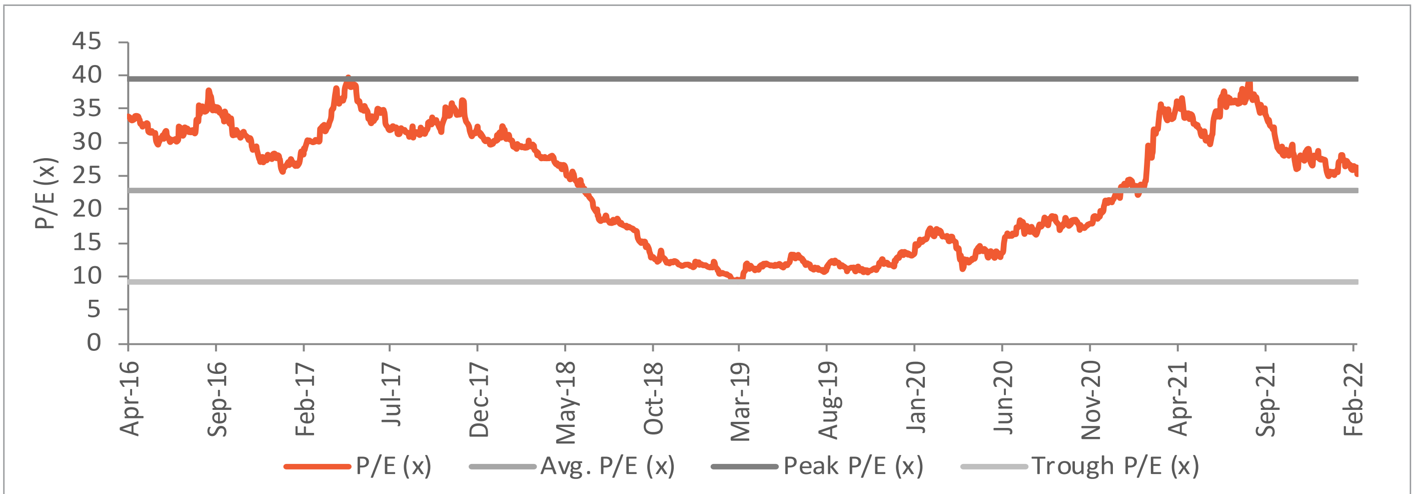
Company outlook – Structural gas demand drivers to drive double digit volume growth

For GGAS, we see a 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 17% y-o-y volume growth in FY2022E post flat y-o-y volumes 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 margins to improve to Rs. 5.6-5.8/scm over FY2023E-FY2024E led by recent price hikes and likely moderation in spot LNG prices.

Valuation – Maintain Buy on GGAS with an unchanged PT of Rs. 840

The recent correction in GGAS' stock price factors in near-term concern on earnings due to high spot LNG prices and believe that long-term double-digit volume growth outlook remains intact supported by regulatory push to curb pollution and ramp-up of new GAs. Hence, we expect a strong 22% PAT CAGR over FY21-24E and superior RoE/RoCE of 31%/34% in FY24E. Hence, we maintain a Buy rating on GGAS with an unchanged PT of Rs. 840. At CMP, the stock trades at 25.2x/19.8x its FY23E/FY24E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

About the 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	DSP Investment Managers Pvt. Ltd.	1.6
2	Vanguard Group Inc	1.0
3	Canara Robeco Asset Management Co. Ltd	1.0
4	FIL Limited	1.0
5	Axis Asset Management Co. Ltd	0.9
6	UTI Asset Management Co. Ltd	0.8
7	Motilal Oswal Asset Management Company Ltd	0.8
8	Aberdeen PLC	0.6
9	Aditya Birla Sun Life Asset Management Co. Ltd	0.6
10	Invesco Asset Management India Private Limited	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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