Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Gujarat Gas Ltd

Weak Q1; volume outlook improves

Oil & Gas	Sharekhan code: GUJGASLTD

Reco/View: Buy	↔	CMP: Rs. 455	Price Target: Rs. 555	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Q1FY24 performance was weak as PAT missed the mark by 33% at Rs. 215 crore (down 42% q-o-q) due to 24%/3% miss in EBITDA margin/gas sales volume.
- Industrial PNG (I-PNG) price cut to drive Morbi volumes, in fact dragged down EBITDA margins by 34% q-o-q to Rs. 4.6/scm (at lower end of guidance). I-PNG volume grew by 10% q-o-q to 5.9 mmscmd as Morbi volume improved to 4 mmscmd; CNG volume posed modest 3% q-o-q growth while D-PNG/C-PNG volume declined by 28%/7% q-o-q.
- The recent surge in propane price to $470/tonne (expected to further increase in winters) and increase in propane import duty to 19.3% would improve economics of I-PNG versus propane and drive volume shift to natural gas in Morbi (potential of 6.5 mmscmd for GGAS). We thus expect robust gas sales volume CAGR of 26% over FY23-25E.
- Valuation of 16x FY25E EPS is attractive considering improved volume growth outlook and high RoE of 23%. Hence, we maintain a Buy on GGAS with a revised PT of Rs. 555.

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 27.83

Updated Jul 08, 2023

High Risk

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

Source: Morningstar

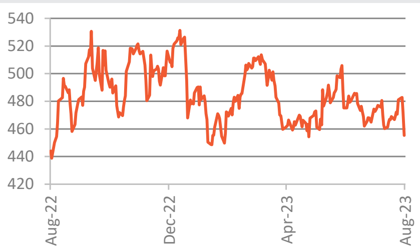
Company details

Market cap:	Rs. 31,339 cr
52-week high/low:	Rs. 539/434
NSE volume: (No of shares)	11.8 lakh
BSE code:	539336
NSE code:	GUJGASLTD
Free float: (No of shares)	26.9 cr

Shareholding (%)

Promoters	60.9
FII	4.5
DII	13.3
Others	21.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	(3.7)	(3.8)	(4.1)	2.5
Relative to Sensex	(3.3)	(9.4)	(12.0)	(9.4)

Sharekhan Research, Bloomberg

Gujarat Gas Limited's (GGAS) Q1FY24 results were weak with a steep miss of 26%/33% in its standalone operating profit/PAT at Rs. 388 crore/Rs. 215 crore, down 31%/42% q-o-q due to 24%/3% miss in EBITDA margin/gas sales volume. The large miss in margin at Rs. 4.6/scm (down 34% q-o-q) was primarily on account of I-PNG price cuts to make it competitive versus propane and drive up gas demand from Morbi ceramic customers. Higher-than-expected per unit opex also led to miss in EBITDA margin. Gas sales volume grew by 4% q-o-q to 9.2 mmscmd but was below our estimate of 9.5 mmscmd due to subdued D-PNG/C-PNG of 0.6 mmscmd/0.1 mmscmd, down 28%/7% q-o-q. On the other hand, I-PNG/CNG volume grew by 10%/3% q-o-q to 5.9 mmscmd/2.6 mmscmd. Within I-PNG, Morbi/Non-Morbi volume stood at 4 mmscmd/1.9 mmscmd, up 11%/7% q-o-q.

Key positives

- Improved economics of I-PNG versus propane bodes well for volume recovery.
- I-PNG volumes recovered to 4 mmscmd, up 11% q-o-q.

Key negatives

- Steep 24% miss in EBITDA margin at Rs. 4.6/scm, down 34% q-o-q.

Management Commentary

- Morbi volumes could reach 6.5 mmscmd (out of 8.5 mmscmd of total Morbi demand) as economics of I-PNG versus propane to turn favourable given surge in propane price and higher import duty. Margin guidance of Rs. 4.5-5.5/scm.
- Focus on new GAs of Ahmedabad Rural, Thane Rural and some areas in Rajasthan (Jalore, Sirohi and Dungarpur). Volume from new GAs expected to reach 1 mmscmd by FY25.
- Overall gas mix at 32% APM, 20% non-APM domestic, 34% contracted LNG and 14% spot LNG.
- Equity investment of Rs. 100 crore done in GSPC LNG Limited (operates 5 mtpa LNG terminal at Mundra).
- Capex guidance of Rs. 1,000-1,200 crore annually for the next three years.
- **Other updates –** 1) I-PNG price at Rs. 38.5/scm versus propane price of Rs. 35/scm, which would increase from September 2023, 2) Q1FY24 capex of Rs. 200-250 crore, 3) CNG/D-PNG volume share at 35% versus 31% in Q1FY23.

Revision in estimates: We have lowered our FY24-25 earnings estimate to factor lower margin assumption.

Our Call

Valuation – Maintain Buy on GGAS with a revised PT of Rs. 555: We believe that GGAS's valuation of 16x FY25E EPS is attractive and expect strong volume recovery as recent surge in propane price and soft LNG price would make I-PNG economics favourable versus propane. We expect a healthy 12% PAT CAGR over FY23-25E and a superior RoE/RoCE of 23%/27% in FY25E. Hence, we maintain a Buy on GGAS but with a revised PT of Rs. 555 (cut in PT reflect downward revision in earnings).

Key Risks

Lower-than-expected gas sales volume in case of economic slowdown and higher gas prices. Delay in developing new GAs, a sharp rise in LNG prices and adverse regulatory changes could affect outlook and valuations.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	16,456	16,759	17,667	23,414
OPM (%)	12.6	14.3	12.3	12.8
Adjusted PAT	1,287	1,528	1,325	1,913
% YoY growth	0.8	18.7	-13.3	44.4
Adjusted EPS (Rs.)	18.7	22.2	19.2	27.8
P/E (x)	24.3	20.5	23.7	16.4
P/B (x)	5.6	4.5	4.0	3.4
EV/EBITDA (x)	15.3	12.8	14.0	9.6
RoNW (%)	25.4	24.1	17.8	22.6
RoCE (%)	26.6	27.2	21.1	27.1

Source: Company; Sharekhan estimates

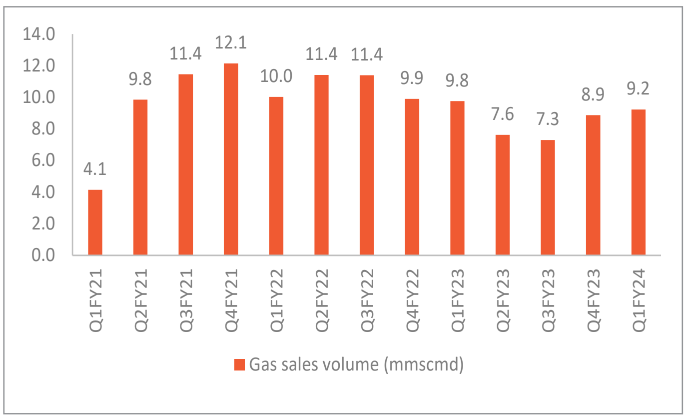
Weak Q1; sharp earnings miss due to subdued margin

Standalone operating profit of Rs. 388 crore (down 36% y-o-y; down 31% q-o-q), was 26% below our estimate of Rs. 522 crore. The large miss in earnings was due to 3%/24% miss in volume/EBITDA margin at 9.2 mmscmd/ Rs. 4.6 per scm. EBITDA margin missed estimate due to lower-than-expected gross margin of Rs. 8.2/scm (down 23% q-o-q) and higher opex per unit opex. The gas sales volume grew by 4% q-o-q to 9.2 mmscmd but lagged our estimate of 9.5 mmscmd due to subdued D-PNG/C-PNG of 0.6 mmscmd/0.1 mmscmd, down 28%/7% q-o-q. On the other hand, Industrial PNG/CNG volume grew by 10%/3% q-o-q to 5.9 mmscmd/2.6 mmscmd. Within I-PNG, Morbi/Non-Morbi volume stood at 4 mmscmd/1.9 mmscmd, up 11%/7% q-o-q. Standalone PAT of Rs. 215 crore (down 44% y-o-y; 42% q-o-q) was 33% below our estimate of Rs. 323 crore due to weak volume/ margin performance.

Q1FY24 earnings conference call highlights

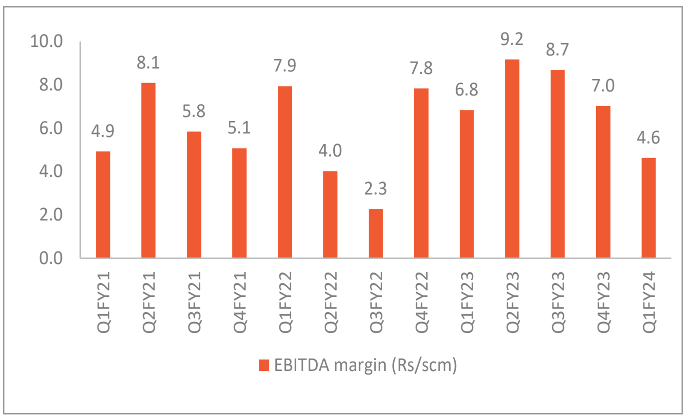
- **I-PNG price to turn attractive versus propane - to drive volume/margin improvement:** The recent surge in propane price and hike in propane import duty to 19.3% would make economics of I-PNG prices favourable versus propane. Focus would be to balance between volume and margin (guidance of Rs. 4.5-5.5/scm).
- **Morbi volume potential:** Morbi total gas demand of 8-8.5 mmscmd. Current consumption is at 7.5 mmscmd, out of which natural gas is 4 mmscmd and the balance is propane. Higher propane prices would drive the switch shift to natural gas. Thus, at peak GGAS's Morbi volume can go up to 6.5 mmscmd.
- **Gas sourcing mix –** Priority sector (CNG and D-PNG) getting 90% of gas requirement through APM and remaining 10% through HP-HT/spot LNG. Overall gas mix at 32% APM, 20% non-APM domestic, 34% contracted LNG and 14% spot LNG.
- **Capex guidance:** The company guided for a capex of Rs. 1000-1200 crore annually for the next three years and would be equally split between new GAs, existing GAs and CNG infrastructure (like building spur pipelines for both exiting as well as new GAs).
- **Equity investments in GSPC LNG:** Gujarat Gas made an equity investment of Rs. 100 crore in GSPC LNG Limited operates 5 mtpa LNG terminal at Mundra). This would translate into 7.87% equity stake. The investment can help cater to the gas requirement of other sectors and LNG demand for long haul trucks.
- **Other updates –** 1) I-PNG prices at Rs. 38.5/scm versus propane price of Rs. 35/scm, which would increase from sep'23, 2) Q1FY24 capex of Rs. 200-250 crore, 3) CNG/D-PNG volume share at 35% versus 31% in Q1FY23, 4) new GAs current volume at 0.5 mmscmd and could go up to 1 mmscmd over next two years, 5) over last three years has double CNG station to 800 and plan to add 60-70 new CNG station annually for next two years.

Q1FY24 sales volume recovers but below estimate



Source: Company, Sharekhan Research

Sharp miss in margin given I-PNG price cut



Source: Company, Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Revenue	**3,782**	**5,170**	**-26.9**	**3,929**	**-3.7**
Total Expenditure	3,394	4,563	-25.6	3,368	0.7
Operating profit	**388**	**607**	**-36.0**	**560**	**-30.8**
Other Income	24	19	25.7	32	-25.0
Interest	7	14	-45.6	6	22.0
Depreciation	115	103	11.6	109	5.2
PBT	289	509	-43.1	477	-39.3
Tax	74	128	-41.9	107	-30.9
Reported PAT	**215**	**381**	**-43.6**	**369**	**-41.7**
Equity Cap (cr)	69	69		69	
Reported EPS (Rs.)	3.1	5.5	-43.6	5.4	-41.7
Margins (%)			**BPS**		**BPS**
OPM	10.3	11.7	-147	14.3	-400
Tax rate	25.7	25.1	56	22.5	313
NPM	5.7	7.4	-168	9.4	-371

Source: Company; Sharekhan Research

Key operating performance

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Volume (mmscmd)	9.2	9.8	-5.4%	8.9	4.1
Gross margin (Rs. /scm)	8.2	9.8	-16.8%	10.6	-23.1
EBITDA margin (Rs. /scm)	4.6	6.8	-32.4%	7.0	-34.2

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector View – Supportive policies, lower LNG price to remove high gas cost overhang for CGDs; APM gas allocation/ EVs a concern**

Capping of domestic gas price at $6.5/mmBtu (versus $8.6/mmBtu for H2FY23) and recent sharp fall in spot price could remove gas cost overhang for CGDs in FY24. Lower gas prices would improve volume growth visibility for both CNG and I/C-PNG in the coming quarters. Moreover, India's long-term gas demand potential is very strong, given regulatory support to curb pollution and the government's aim to increase the share of gas in India's overall energy mix to 15% by 2030 (from 6% currently) would substantially improve gas penetration and boost its consumption. Having said that, with rising volumes, CGDs would have to source incremental gas requirement from either HP-HT gas or volatile spot LNG as a likely increase in APM gas allocation would be difficult. Moreover, a gradual shift towards EVs could affect CNG volume growth potential in the long term.

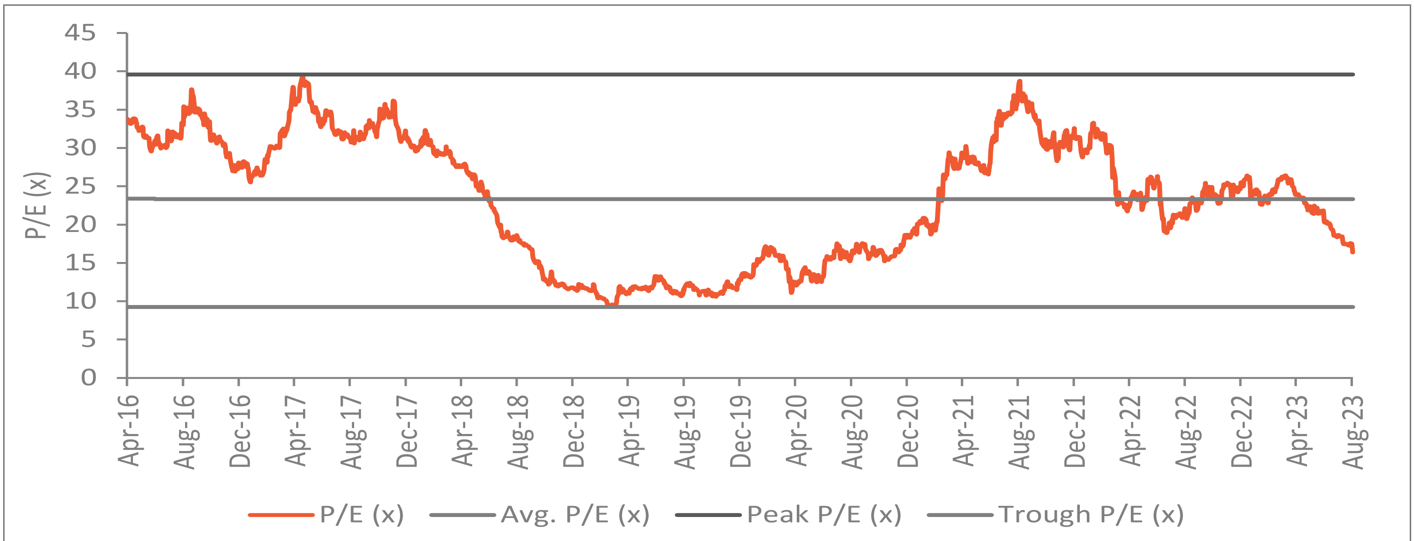
■ **Company Outlook – Expect volume led earnings recovery over FY24-25**

We expect that a recovery in I-PNG volumes as higher propane price would drive swift towards natural gas demand in Morbi ceramic cluster. Structural gas demand drivers remain intact and GGAS has large gas sales volume opportunity of 2.5 mmscmd from the National Green Tribunal's (NGT's) strict directions to curb pollution in identified polluted areas of Gujarat and 3-3.5 mmscmd from development of seven new GAs in Punjab, Haryana, Madhya Pradesh and Rajasthan. Overall, we expect a 26 volume CAGR over FY2023-FY2025E and see GGAS' EBITDA margins stabilise at Rs. 5.5-6.1/scm over FY2024E-FY2025E versus Rs.7.8/scm in FY23.

■ **Valuation – Maintain Buy on GGAS with a revised PT of Rs. 555**

We believe that GGAS's valuation of 16x FY25E EPS is attractive and expect strong volume recovery as recent surge in propane price and soft LNG price would make I-PNG economics favourable versus propane. We expect a healthy 12% PAT CAGR over FY23-25E and a superior RoE/RoCE of 23%/27% in FY25E. Hence, we maintain a Buy on GGAS but with a revised PT of Rs. 555 (cut in PT reflect downward revision in earnings).

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 8.4 mmscmd in FY2023. GGAS derives around 61% of volumes from industrial PNG, 29% from CNG, 8% from domestic PNG and the remaining from commercial PNG. The company has a 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 Punjab, Haryana, Madhya Pradesh and Rajasthan cities.

Investment theme

Strong medium to long-term gas volume growth outlook and resilient margins bodes well for strong earnings growth for GGAS. Moreover, India's long-term gas demand outlook remains robust, supported by the regulatory push to curb pollution and the government's thrust to increase the 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 a volume potential of 3 mmscmd-3.5 mmscmd over the next 3-5 years. Moreover, GGAS is expected to be the biggest beneficiary of potential inclusion of natural gas under GST as the same would substantially improve industrial PNG demand. The recent sharp fall in spot LNG price and rise in propane prices bodes well for strong I-PNG volume recovery 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

Raj Kumar	Chairman
Nitesh Bhandari	Chief Financial Officer
Sandeep Dave	Company Secretary & Compliance 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	Life Insurance Corp of India	3.2
4	Gujarat Alkalies & Chemicals Ltd	3.1
5	DSP Investment Managers Pvt Ltd	1.5
6	ICICI Prudential Asset Management	1.1
7	UTI Asset Management Co Ltd	1.0
8	Vanguard Group Inc/The	0.9
9	Axis Asset Management Co Ltd/India	0.9
10	Canara Robeco Asset Management Co	0.9

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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Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Correspondence/Administrative Office: Gigaplex IT Park, Unit No 1001, 10th Floor, Building No.9, TTC Industrial Area, Digha, Airoli-West, Navi Mumbai – 400 708. Tel: 022 61169000 / 61150000, Fax No. 61169699.

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Compliance Officer: Ms. Binkle Oza; Tel: 022-62263303; email id: complianceofficer@sharekhan.com

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