Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Gujarat Gas Ltd

Strong Q2; decent volume growth guidance

Oil & Gas	Sharekhan code: GUJGASLTD

Reco/View: Buy	↔	CMP: Rs. 419	Price Target: Rs. 490	↓

↑ 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 27.83

Updated Aug 08, 2023

Medium Risk

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

Source: Morningstar

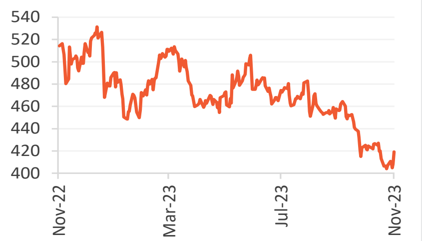
Company details

Market cap:	Rs. 28,857 cr
52-week high/low:	Rs. 539/397
NSE volume: (No of shares)	8.6 lakh
BSE code:	539336
NSE code:	GUJGASLTD
Free float: (No of shares)	26.9 cr

Shareholding (%)

Promoters	60.9
FII	3.8
DII	13.1
Others	22.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.6	-7.1	-11.4	-18.5
Relative to Sensex	0.7	-5.0	-15.6	-24.1

Sharekhan Research, Bloomberg

Summary

- Q2 performance was strong with a sharp 67% beat in PAT at Rs. 298 crore, led by robust EBITDA margin performance.
- Magin expansion of 25% q-o-q to Rs5.8/scm was led by lower spot LNG price. Volume remained flat q-o-q at 9.3 mmscmd.
- Recent I-PNG price hike to sustain current margin without impact on volume as Morbi customers are willing to pay some premium given convenience of natural gas. Volume growth/EBITDA margin guidance of 10% p.a./Rs. 4.5-5.5/scm.
- The steep fall of 15% in the stock price in CY2023YTD factors in volume/margin volatility and valuation of 15x its FY2026E EPS is attractive. Hence, we maintain Buy on GGAS with a revised PT of Rs. 490.

Gujarat Gas Limited's (GGAS) Q2FY24 results were strong. The company reported a large beat of 44%/67% in operating profit/PAT at Rs. 497 crore/Rs. 298 crore, up 28%/38% q-o-q, led by beat of 45% in EBITDA margin and higher other income (up 61% y-o-y). We are surprised by the very strong EBITDA margin improvement of 25% q-o-q to Rs. 5.8/scm and the same was led by benefit of a decline in spot LNG price and marginally lower per unit opex (down 2.3% q-o-q). Gas sales volume was flat q-o-q (up 22% y-o-y on a low base) to 9.3 mmscmd. I-PNG/CNG/D-PNG/C-PNG volume stood at 5.9 mmscmd/2.6 mmscmd/0.7 mmscmd/0.1 mmscmd, flat/flat/+17%/+8% q-o-q. Within the I-PNG segment, Morbi/Non-Morbi volume stood at 3.91 mmscmd/1.95 mmscmd, largely stable q-o-q.

Key positives

- Sharp beat of 45% in EBITDA margin at Rs. 5.8/scm, up 25% q-o-q.

Key negatives

- Largely flat q-o-q I-PNG volume at 5.9 mmscmd.

Management Commentary

- I-PNG price is at a marginal premium of Rs2-3/scm post the recent price hike of Rs2.3/scm. Morbi customers are willing to pay such a premium, given the convenience of natural gas. Morbi volume is expected to sustain at 4 mmscmd currently (overall potential of 8.5 mmscmd but currently working at 70-75% utilisation).
- Management has retained its margin guidance of Rs. 4.5-5.5/scm and expects volume growth of 10% p.a.; CNG is likely to grow at a higher rate. Non-Morbi volume potential is at 2.5-3 mmscmd.
- Fast-track investment in high-growth markets of Ahmedabad district, Thane Rural, UT of DNH, and Jhagadia Phase II.
- Gas sourcing mix – Contracted long-term LNG/Spot LNG at 65%/35%.
- Capex plan of Rs. 1,000-1,200 crore annually.
- Other updates – 1) I-PNG price at Rs. 41-42/scm for Morbi and Rs. 48/scm for non-Morbi customers, 2) Rs. 3-4/scm commission to OMCs for CNG, 3) CNG station at 806, D-NG connections at 20.3 lakh, I-PNG customers at 4,300+ and C-PNG customers at 14,700+, 4) debt-free company, 5) spot LNG price gone up to $15-16/mmbtu versus $12-13/mmbtu earlier.

Revision in estimates – We have lowered our FY2024-FY2025 earnings estimate to factor in lower volume assumption and have introduced our FY2026 earnings estimate.

Our Call

Valuation – Maintain Buy on GGAS with a revised of Rs. 490: We believe that GGAS's valuation of 15x FY26E EPS is attractive and expect a strong volume recovery in earnings over FY25-26 post expectation of steep fall in FY24. We expect a PAT to grow by 26%/34% y-o-y in FY25/FY26 along with a healthy RoE/RoCE of 21%/25% in FY26E. Hence, we maintain a Buy on GGAS but with a revised PT of Rs. 490.

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	FY26E
Revenue	16,456	16,759	16,322	19,881	23,344
Operating profit	2,076	2,392	1,914	2,355	3,044
OPM (%)	12.6	14.3	11.7	11.8	13.0
Adjusted PAT	1,287	1,528	1,135	1,434	1,922
YoY growth (%)	0.8	18.7	-25.7	26.4	34.0
Adjusted EPS (Rs.)	18.7	22.2	16.5	20.8	27.9
P/E (x)	22.4	18.9	25.4	20.1	15.0
P/B (x)	5.1	4.1	3.7	3.3	2.9
EV/EBITDA (x)	14.1	11.8	14.6	11.5	8.6
RoNW (%)	25.4	24.1	15.4	17.5	20.7
RoCE (%)	26.6	27.2	18.2	21.0	25.1

Source: Company; Sharekhan estimates

Robust Q2 on large margin beat

Standalone operating profit of Rs. 497 crore (up 28% q-o-q), was 44% above our estimate of Rs. 345 crore. The large beat in earnings was led by surprisingly higher-than-expected EBITDA margin of Rs. 5.8/scm (up 25% q-o-q and versus our estimate of Rs. 4/scm). Recovery in gas sales volume at only 1% q-o-q was below expectation with total gas sales volume at 9.3 mmscmd. I-PNG/CNG volume was flat q-o-q at 5.9 mmscmd/2.6 mmscmd, while D-PNG/C-PNG volume was up by 17%/8% q-o-q to 0.7 mmscmd/0.1 mmscmd. Gross margin was up 13% q-o-q to Rs. 9.2/scm. Standalone PAT of Rs. 298 crore (up 39% q-o-q) was 67% above our estimate of Rs. 178 crore due to the large margin beat and higher other income (up 61% y-o-y).

We are surprised by the very strong EBITDA margin improvement, which was led by the benefit of a decline in spot LNG price and marginally lower per unit opex (down 2.3% q-o-q). Within the I-PNG segment, Morbi/Non-Morbi volume stood at 3.91 mmscmd/1.95 mmscmd, largely stable q-o-q.

Results (Standalone) Rs cr

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Revenue	**3,845**	**3,976**	**-3.3**	**3,782**	**1.7**
Total Expenditure	3,349	3,334	0.5	3,394	-1.3
Operating profit	**497**	**643**	**-22.7**	**388**	**28.0**
Other Income	30	19	60.9	24	24.9
Interest	8	13	-40.5	7	5.6
Depreciation	118	106	10.8	115	2.4
PBT	401	542	-26.0	289	38.5
Tax	103	138	-25.4	74	38.6
Reported PAT	**298**	**404**	**-26.3**	**215**	**38.5**
Equity Cap (cr)	69	69		69	
Reported EPS (Rs.)	4.3	5.9	-26.3	3.1	38.5
Margins (%)			**BPS**		**BPS**
OPM	12.9	16.2	-325	10.3	265
Tax rate	25.7	25.4	23	25.7	1
NPM	7.7	10.2	-241	5.7	206

Source: Company, Sharekhan Research

Key operating metrics

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Volume (mmscmd)	9.3	7.6	22.3%	9.2	1.1%
Gross margin (Rs./scm)	9.2	13.0	-28.7%	8.2	12.8%
EBITDA margin (Rs./scm)	5.8	9.2	-36.8%	4.6	25.2%

Source: Company, Sharekhan Research

Volume break-up mmscmd

Particulars	Q2FY24	Q2FY23	YoY (%)	Q1FY24	QoQ (%)
Industrial	5.9	4.5	31.1%	5.9	-0.3%
CNG	2.6	2.3	12.9%	2.6	0.4%
Domestic PNG	0.7	0.7	1.4%	0.6	16.7%
PNG – Commercial	0.1	0.1	0.0%	0.1	7.7%
Total gas sales volume	**9.3**	**7.6**	**22.3%**	**9.2**	**1.1%**

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 the domestic gas price at $6.5/mmBtu (versus $8.6/mmBtu for H2FY2023) and the recent sharp fall in spot price could remove a gas cost overhang for CGDs in FY2024. 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), which 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.

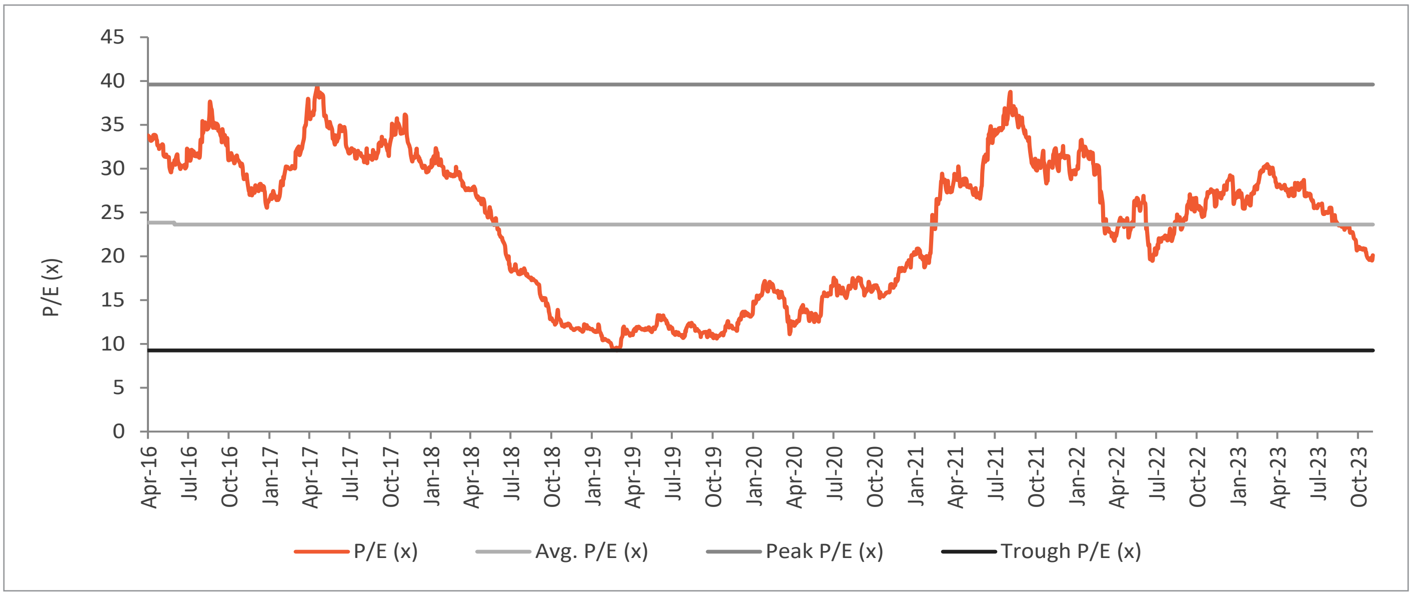
■ **Company outlook - Expect volume to witness strong recovery over FY2024-FY2026**

We expect recovery in I-PNG volumes as higher propane prices would drive the shift towards natural gas demand in Morbi ceramic cluster. Structural gas demand drivers remain intact and GGAS has a large gas sales volume opportunity of 2.5 mmscmd from the National Green Tribunal's (NGT) strict directions to curb pollution in identified polluted areas of Gujarat and 3-3.5 mmscmd from the development of seven new GAs in Punjab, Haryana, Madhya Pradesh, and Rajasthan. Overall, we expect a 17% volume CAGR over FY2023-FY2026E and see GGAS's EBITDA margins stabilise at Rs. 5.6-6.1/scm versus Rs. 7.8/scm in FY23.

■ **Valuation - Maintain Buy on GGAS with a revised of Rs. 490**

We believe that GGAS's valuation of 15x FY26E EPS is attractive and expect a strong volume recovery in earnings over FY25-26 post expectation of steep fall in FY24. We expect a PAT to grow by 26%/34% y-o-y in FY25/FY26 along with a healthy RoE/RoCE of 21%/25% in FY26E. Hence, we maintain a Buy on GGAS but with a revised PT of Rs. 490.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

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's presence is spread across 23 districts in Gujarat, the Union Territory of Dadra and 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

A strong medium to long-term gas volume growth outlook and resilient margins bode 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 surge in propane prices bodes well for strong I-PNG volume recovery for GGAS.

Key Risks

- A 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

Sanjeev Kumar	Managing Director
Nitesh Bhandari	Chief Financial Officer
Sandeep Dave	Company Secretary and Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Gujarat State Fertilizers & Chemic	6.82
2	Gujarat Industrial Development Cor	3.87
3	Life Insurance Corp of India	3.22
4	Gujarat Alkalies & Chemicals Ltd	3.1
5	ICICI Prudential Asset Management	1.99
6	Vanguard Group Inc/The	1.11
7	UTI Asset Management Co Ltd	0.83
8	DSP Investment Managers Pvt Ltd	0.75
9	Axis Asset Management Co Ltd/India	0.46
10	Canara Robeco Asset Management Co	0.38

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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