Gujarat Gas

Oil & Gas

Margin strength helps offset flat QoQ volumes

Gujarat Gas (GUJGA) has delivered muted Q2FY24 earnings, with 23% YoY dip in EBITDA / 26% YoY dip in PAT to INR 5bn/INR 3bn, beating I-Sec's estimates of EBITDA/PAT of INR 3.8/2.1bn, respectively. Earnings beat estimates despite a miss on volumes (9.3mmscmd vs estimates of 9.6mmscmd) with stronger margins offsetting the volumes miss. While margins came ahead of estimates, they remain well below FY23 levels, with drop of ~INR 13/scm in blended sales realisation (vs Q1FY23) offsetting the INR 12.8/scm decline in average gas costs over the period. GUJGA remains on track to improve volume growth, driven by i) continued improvement in gas: propane economics in Morbi, ii) aggressive infra build-out in new areas, especially in CNG segment, iii) moderate spot LNG prices and iv) positive infra developments in Gujarat. We remain cautious on the stock with lower margin guidance, continued volume volatility at Morbi and weakening return ratios offsetting long-term volume prospects. Maintain **HOLD**.

Volumes steady QoQ, management optimistic for long-term prospects

Volumes of 9.3mmscmd shows sharp 22% YoY growth but that is also driven by the very low base of FY23, with low propane prices dragging volumes at Morbi sharply lower Q2FY23 onwards. QoQ performance was flat, with industrial/commercial volumes of 6mmscmd (Morbi 3.9, other areas 2.1) same as Q1FY24. Going forward, spike in propane prices has been matched by a corresponding rise in Morbi gas prices, keeping the economics relatively constant. With some recovery in Morbi and higher CNG/non–morbi industrial areas, H2 volumes should average 9.7-9.8mmscmd. Aggressive industrialisation in Gujarat, higher CNG expansion and monetisation of investment done in new areas over the last 3 years should support ~10% growth (as guided), but volatility in areas with alternate fuels like propane/FO and naphtha maintain uncertainties.

FY24E price mix of propane to gas is improving, but margin guidance is muted

Extrapolating the current trend in LPG prices (LPG prices declined to USD 400/t for Aug'23 before recovering to USD 610/t now and likely to dip again <USD 600/t over next 6 months), equivalent propane prices are likely to be in ~INR 40-42/scm range over the rest of FY24E. With aggressive price increases already taken to INR 45.5/scm at Morbi, there is little leeway to increase prices to protect margins without losing volumes, given spot LNG prices may rise from current levels of USD 12-13/MMBtu to USD 15-16/MMbtu for H2FY24E. Management's guidance of EBITDA/scm of INR 4.5-5.5/scm underscores the fact and has led to a downward revision for FY25 EPS even as beat this quarter drives a material jump in FY24 EPS.

Financial Summary

Y/E March (INR mn)	FY23A	FY24E	FY25E	FY26E
Net Revenue	1,67,594	1,64,779	2,04,153	2,29,338
EBITDA	23,920	19,381	19,849	22,217
EBITDA %	14.3	11.8	9.7	9.7
Net Profit	15,255	11,596	11,508	12,861
EPS (INR)	22.2	16.8	16.7	18.7
EPS % Chg YoY	17.8	(24.0)	(0.8)	11.8
P/E (x)	18.9	24.9	25.1	22.5
EV/EBITDA (x)	11.6	14.2	13.6	11.9
RoCE (Pre-tax) (%)	29.3	19.3	17.4	17.8
RoE (%)	24.2	15.6	13.9	14.0

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Market Data

Market Cap (INR)	289bn
Market Cap (USD)	3,468mn
Bloomberg Code	GUJGA IN
Reuters Code	GGAS.BO
52-week Range (INR)	539 /397
Free Float (%)	25.0
ADTV-3M (mn) (USD)	8.3

Price Performance (%)	3m	6m	12m
Absolute	(6.5)	(9.9)	(17.6)
Relative to Sensex	(5.5)	(16.2)	(24.8)

ESG Disclosure	2021	2022	Change
ESG score	29.8	36.6	6.8
Environment	1.6	21.9	20.4
Social	21.6	21.6	-
Governance	66.1	66.1	-

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

Earnings Revisions (%)	FY24E	FY25E
Revenue	(1.4)	(2.0)
EBITDA	9.8	(6.2)
EPS	12.7	(8.0)

Previous Reports

04-09-2023: Company Update
04-08-2023: Q1FY24 results review

GSPC LNG acquisition appears cheap, but brings limited strategic benefits, in our view

The Board has approved equity investment of INR 1bn in equity shares of GSPC LNG (operating company of 5mtpa Mundra LNG regas terminal). GUJGA's stake would be 7.87% post the acquisition. At current prices, PLNG with ~19mt of effective operational capacity (17.5mt Dahej, and offtake restricted capacity of ~1.5mt at Kochi) had an equity valuation of INR 337.5bn on announcement date (2nd Aug'23) (the company has negligible debt). With a metric of like-for-like capacity (5mt to ~19mt), implied value for GSPC LNG comes to ~INR 87.7bn, with the stake bought by GUJGA implying a value of INR 5bn vs INR 1bn paid. However, we note as per FY22 annual report, the company has outsized debt of INR 29.6bn, which makes like-for-like comparison impossible. Also, operations for the terminal seem to be at a nascent stage (FY22 revenue was only INR 1.5bn, with net loss of INR 2.8bn), hence, the apparent valuation benefit for this stake purchase may be illusory.

Management has pointed towards two key benefits of this stake buy: i) Ability to reduce logistics cost of LNG being supplied to Morbi as it can directly transport LNG from Mundra now and ii) access to loading and storage facilities of the terminal to service other segments such as fleet operators of long haul vehicles as the scale becomes material. However, we remain cautious with operational scale of this terminal at sub-optimal levels as of now. While absolute contribution from GUJGA side is not that material (annual operating cashflow over FY24-25E estimated at INR 36bn, annual core capex at INR 14bn), we would be wary of any additional capital contribution required by GSPC LNG to de-leverage its balance sheet until the terminal attains breakeven utilisation.

Valuations are not cheap, risk reward not in favour; reiterate HOLD

Despite the recent 6.5% fall in the stock price (last 3 months), GUJGA does not present a compelling risk-reward ratio, in our view. While steady volumes at Morbi (and correspondingly for the I/C segment) are a positive and some improvement is envisaged for H2, we note the premium of gas to propane expands again post Nov'23, which is the basic underlying premise for our caution (volume growth hostage to propane price volatility). Additionally, ability to match this price is restricted over H2, with some spike in spot LNG prices, and therefore, severe margin pressure is likely if GUJGA decides to decrease prices to match propane. Overall, at our revised estimates, the stock trades at 25x FY25E EPS, which we believe does not leave much room for outperformance from here. HOLD rating stays.

Key upside risks: i) Sharper recovery in LPG (propane) prices, ii) faster execution of expansion plans in new areas, iii) sharp drop in LNG prices.

Key downside risks: i) Longer sustained weakness in propane prices, ii) slower ramp up of volumes from new areas, iii) sudden spike in spot LNG prices.

Key takeaways from Q2FY24 conference call

- The recent EV policy in Delhi emphasised the need for CGD companies to have a balanced business portfolio which GUJGA has always focused on. The company remains the least vulnerable to EV moves, given > 65% of its volumes are still from I/C segment.
- During the quarter, the company added 53,000 domestic PNG connections, 221 commercial customers and 61 industrial customers (with a cumulative volume potential of 0.083mmscmd). As on Sep 30, '23, it has a signed volume of 0.54mmsmcd which is yet to be commissioned. It should take 3-6 months for

commissioning signed volumes depending on brownfield or greenfield expansion by the customer.

- GUJGA has 26 GAs (geographical areas) in six states and one GA in the Union Territory of Dadra & Nagar Haveli. It has pipeline network of >37,200km with dom PNG connection to > 0.2mn households, 4,300 industrial customers, 14,700 commercial customers and 806 CNG stations servicing 0.38mn vehicles per day as on Sept'30.
- Out of 806 CNG stations - 554 CNG stations operated in Gujarat and balance 252 CNG stations in non-Gujarat GAs like Punjab, Madhya Pradesh, Rajasthan, Maharashtra, Haryana and Dadra & Nagar Haveli. The company has achieved the highest ever CNG sales in the quarter, with total connections crossing 0.2mn.
- It has commissioned its fourth LNG storage and degasification facility for PNG supply to predominantly industrial customers, along with domestic and commercial customers at Alang (in Gujarat).
- Management has guided volume growth @10% annually for the next couple of years.
  - It expects Morbi volume of ~4mmscmd.
  - Thane Rural, Ahmedabad district and UT of DNH, Jhagadia phase II are the potential areas for industrial volume.
  - The company also expects sustainable long-term growth from new markets won in 9th & 10th CGD bid round and CNG usage in LCV/HCV/dumpers.
  - Also, government's industrialisation effort on Vibrant Gujarat, DMIC/DFC/Dhorela SIR, etc. should contribute to additional growth avenues.
- Non-Morbi industrial potential volume after 3 years would be ~2.5-3mmscmd and depends on green initiatives and ban on polluting fuels being implemented in spirit and letter.
- The company continues to maintain long-term guidance of EBITDA INR 4.5-5.5/scm in the long run with its strategy of balancing volume and margin.
- During the quarter, Morbi's realisation for ceramic stood at ~INR 41-42/scm and non-ceramic stood at INR 48-49/scm. The company took a price hike of 2.25/scm excluding tax wef Nov 1, '23. As of now, ceramic realisation is INR 45/scm and INR 48.5/scm in non–ceramic space.
- In Q2, gas cost per unit declined as spot price was much better vs Q1. Gross margin grew in Q2, primarily in industrial segment on the back of spot prices while CNG remained flattish.
- Morbi market demand for gas at full capacity utilisation is ~8.5mmmscmd. However, cluster units are running at 70-80% utilisation due to continued weakness in domestic consumption. At current levels, GUJGA serves ~4mmsmcd of demand and balance is met by propane.
- On sourcing mix, company has long-term contracts with BG and PLNG of ~3.4mmmscmd (cumulative) which expires in FY25 (pricing is at 13-14% linkage to Brent). Spot LNG mix for the quarter was 35% and should keep varying depending on total demand.
- The company expects to achieve better pricing for long-term contracts in medium term (to reduce dependency on spot), given higher liquefaction capacities are under construction. It is scouting for HPHT gas coming up in Dec'23 to augment sourcing portfolio. In the longer run, it would like to achieve a mix of 75:25% towards long term:short term /spot contracts.
- In Q2, APM shortfall of 10-12% was full filed by spot as it was cheaper than HPHT (high pressure high temperature). However, HPHT prices have been reduced by

USD 2/MMBtu for H2FY24; the company has started sourcing it for priority segment shortfall in Q3.

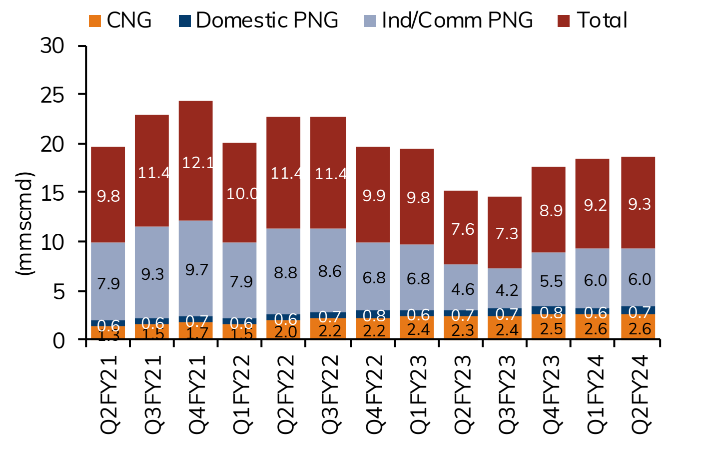
- 90% of total volume comes from Gujarat and the rest from non-Gujarat, as of now.
- The company has total gross block of INR 100bn of which allocation of CNG would be 20-25%. A major part of gross block would be of pipeline which would also include infrastructure supporting CNG segment
- CNG has variable cost attached to it like compressing cost that includes power cost, operation and maintenance, while daughter station or daughter booster would have MCV and transportation cost as variable cost.
- A mix of CNG station is tilted towards OMC due to readily available infrastructure. Nearly 80% of CNG stations of GUJGA are operated by OMCs, 12-15% by franchise and the rest 7-10% are COCO (company owned and operated).
- Management has guided capex of INR 10-12bn each for FY24 and FY25.

Exhibit 1: Q2FY24 result snapshot

Particulars (INR mn)	Q2FY24	Q2FY23	YoY chg %	Q1FY24	QoQ chg %	H1FY24	H1FY23	YoY chg %
Net Sales	**38,454**	**39,765**	**(3.3)**	**37,815**	**1.7**	**76,269**	**91,465**	**(16.6)**
EBITDA	4,966	6,427	(22.7)	3,880	28.0	8,846	12,494	(29.2)
Other income	298	185	60.9	239	24.9	537	375	43.1
PAT	2,978	4,039	(26.3)	2,151	38.5	5,129	7,850	(34.7)
Adj PAT	**2,978**	**4,039**	**(26.3)**	**2,151**	**38.5**	**5,129**	**7,850**	**(34.7)**
Volumes (mmscmd)	**9.3**	**7.6**	**22.3**	**9.2**	**1.1**	**9.3**	**8.7**	**6.8**
CNG	2.6	2.3	12.9	2.6	0.4	2.6	2.4	9.9
Residential PNG	0.7	0.7	1.4	0.6	16.7	0.7	0.6	4.8
Industrial/Commercial	6.0	4.6	30.2	6.0	(0.2)	6.0	5.7	5.7
Gross margin (INR/scm)	9.2	13.0	(28.7)	8.2	12.8	8.7	11.2	(22.2)
EBITDA margin (INR/scm)	5.8	9.2	(36.8)	4.6	25.2	5.2	7.9	(33.7)
EPS	**4.3**	**5.9**	**(26.3)**	**3.1**	**38.5**	**7.5**	**11.4**	**(34.7)**

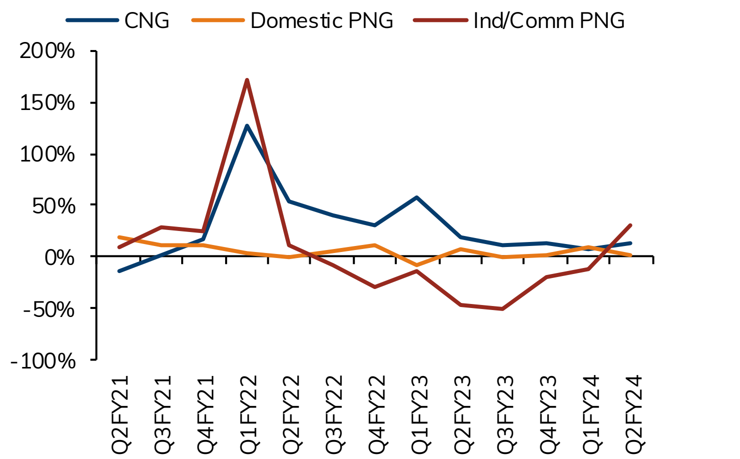
Source: Company data, I-Sec research

Exhibit 2: Volumes jumped sharply YoY, but flattish QoQ



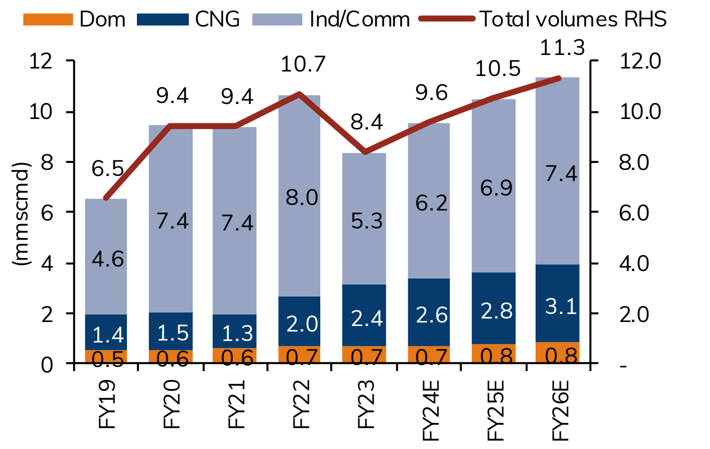
Source: Company data, I-Sec research

Exhibit 3: Strong YoY growth in industrial segment after a couple of quarters



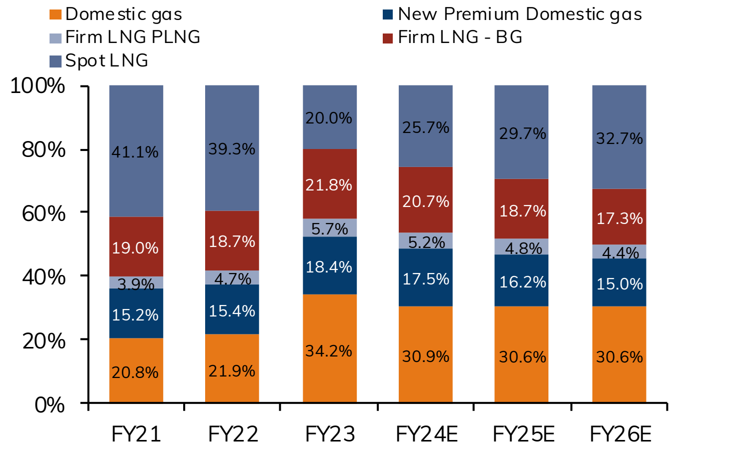
Source: Company data, I-Sec research

Exhibit 4: Volume growth to pick up over FY23-FY26E



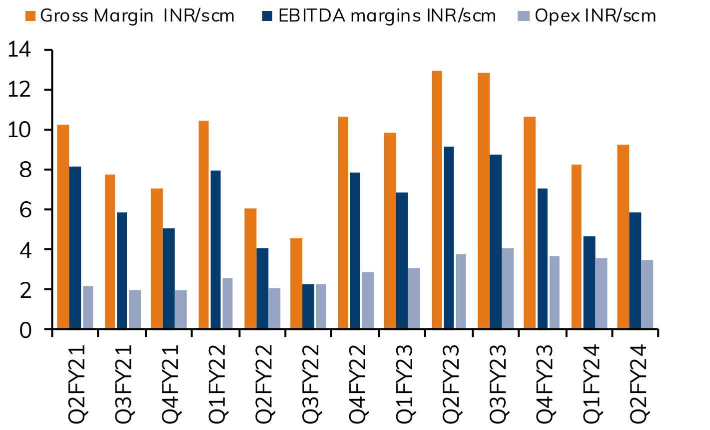
Source: Company data, I-Sec research

Exhibit 5: Sourcing mix more varied than before



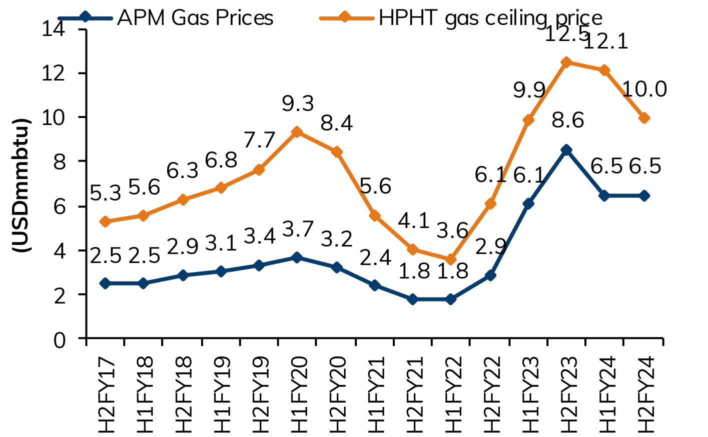
Source: Company data, I-Sec research

Exhibit 6: YoY margins remained weak in Q2



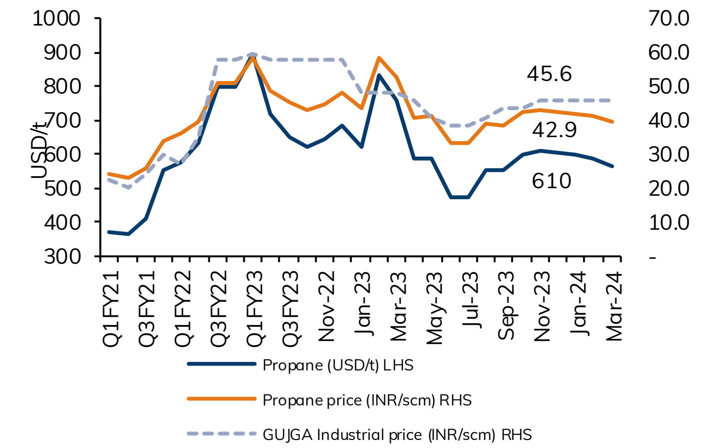
Source: Company data, I-Sec research

Exhibit 7: APM (GCV) gas price capped at USD 6.5/mmbtu and HPHT gas price reduced by 18% in H2FY24 vs H1



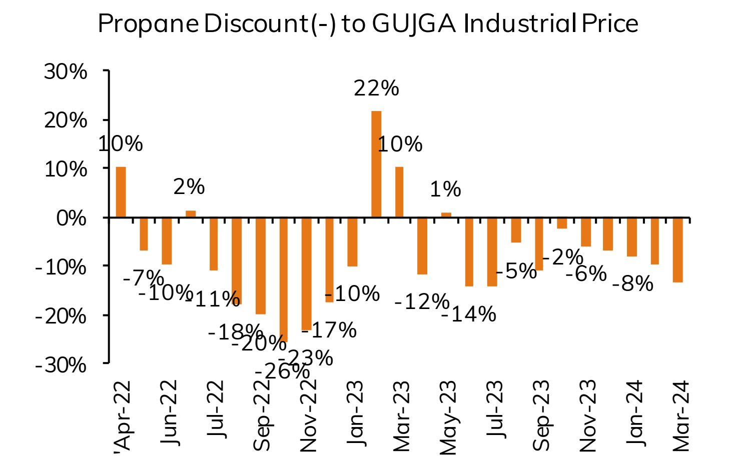
Source: Company data, I-Sec research

Exhibit 8: Propane prices have recovered from Jul'23 lows…



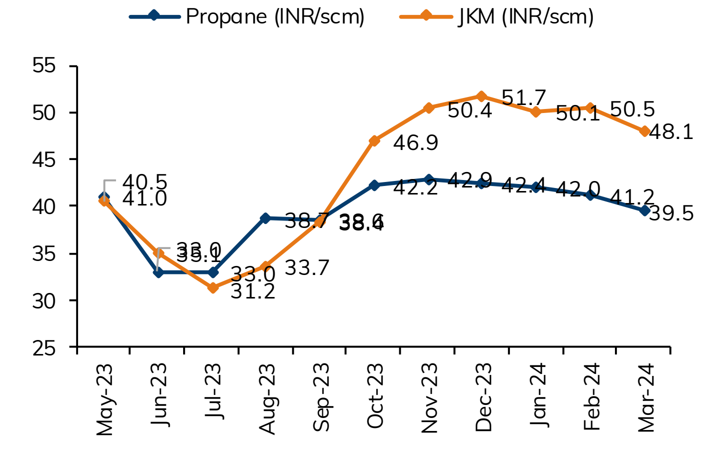
Source: Company data, I-Sec research, Note : Future prices from Nov'23 onwards

Exhibit 9: …but price hikes by GUJGA to expand premium over propane in H2



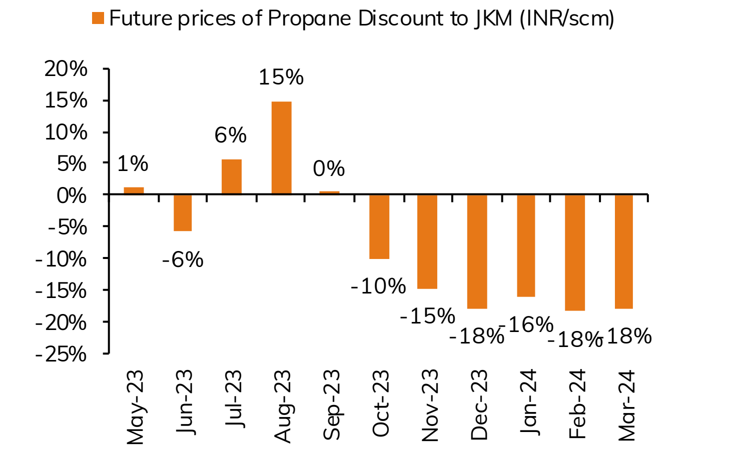
Source: Company data, I-Sec research, Note : Future prices from Nov'23 onwards

Exhibit 10: Futures prices imply a moderating trend again Jan'24 onwards



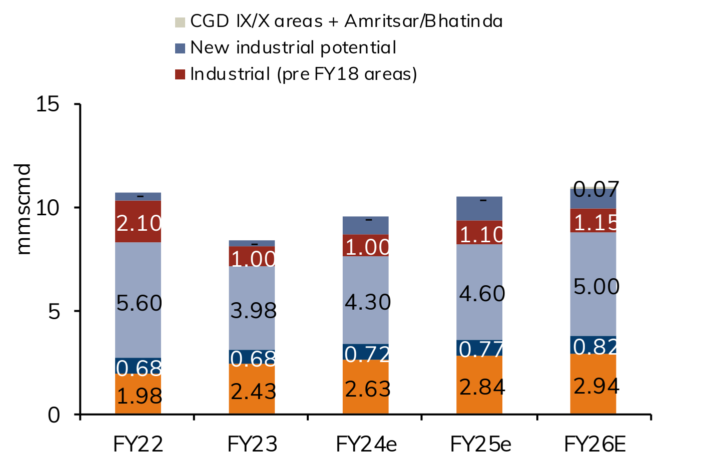
Source: Company data, I-Sec research, Note : Future prices from Nov'23 onwards

Exhibit 11: Propane discount to JKM may increase in H2FY24E due to higher LNG prices in winter



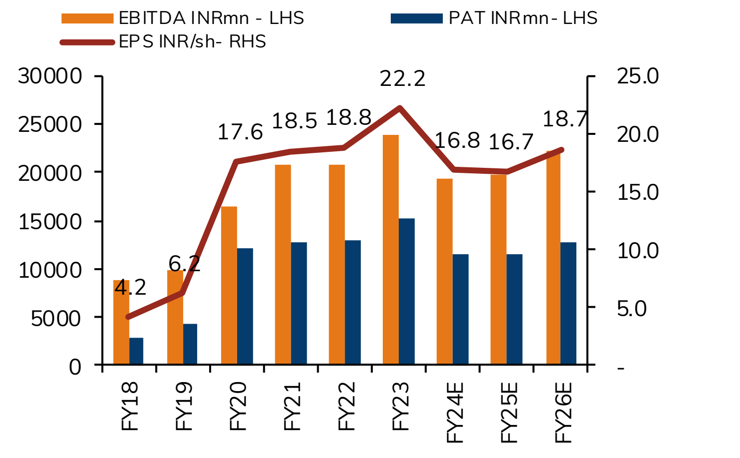
Source: Company data, I-Sec research, Note : Future prices from Nov'23 onwards

Exhibit 12: Volume potential in medium term



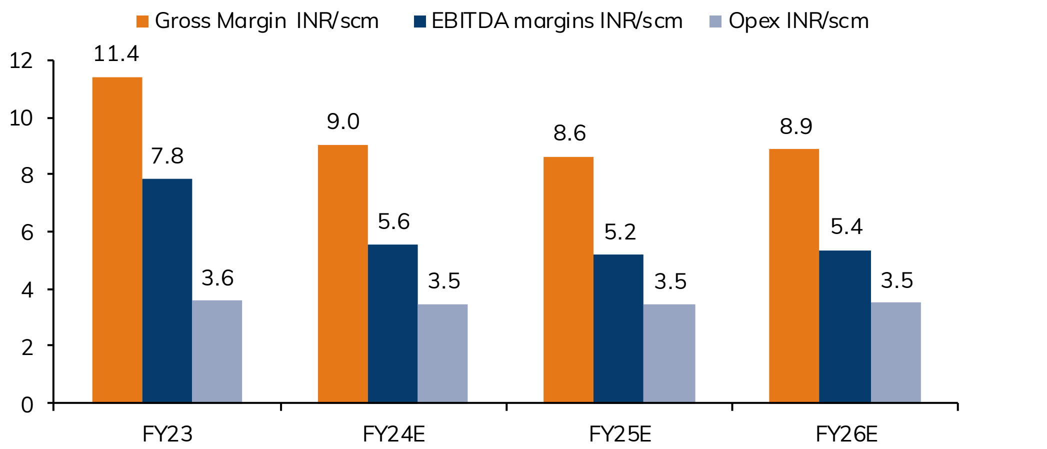
Source: Company data, I-Sec research

Exhibit 13: Decline in EBITDA/EPS growth at a CAGR of 2.4/5.5% over FY23-FY26E



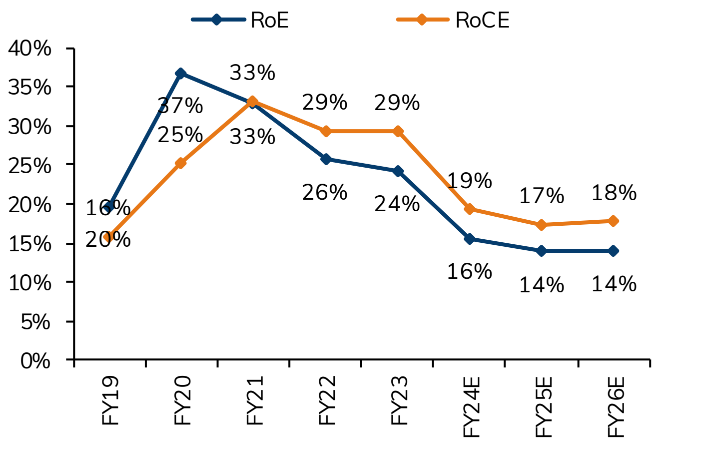
Source: Company data, I-Sec research

Exhibit 14: GUJGA's margin to sharply dip over FY23-FY26E



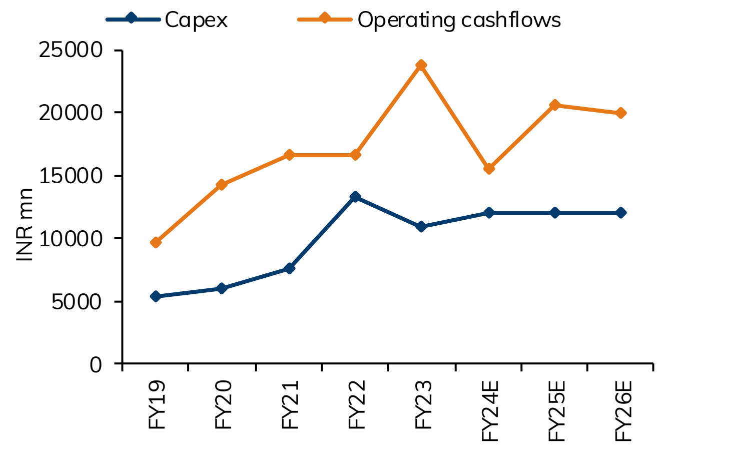
Source: Company data, I-Sec research

Exhibit 15: Return ratios decreasing



Source: Company data, I-Sec research

Exhibit 16: Capex of INR 36.0bn estimated over FY24-FY26E



Source: Company data, I-Sec research

Valuations: Target price of INR 425/sh implies 1% upside

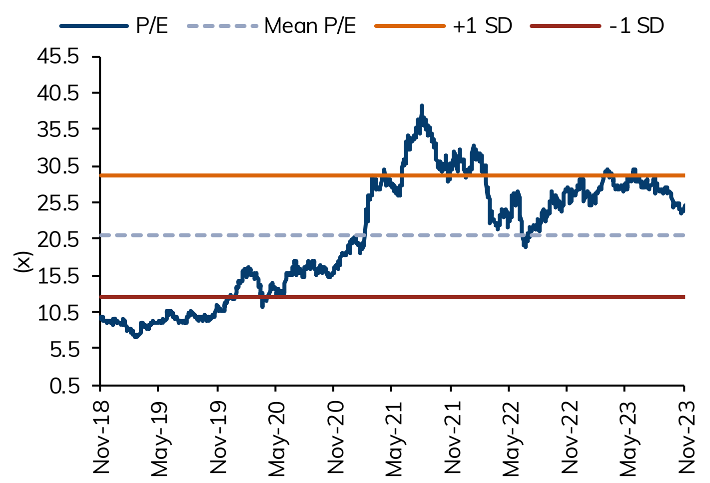
We value GUJGA on DCF methodology, using a WACC of 10.9%, debt equity ratio (DER) of 25%, long-term EBITDA assumption of INR 5.5/scm. The gradual build up in volumes from multiple new areas under development and new areas won recently in bidding rounds IX/X imply returns from the same would flow through only over long term. Our DCF valuation delivers a target price of INR 425/sh, offering 1% upside from CMP.

Exhibit 17: Valuation summary

	Assumption
Cost of Equity	12.5%
Cost of Debt	6.2%
Average D/E ratio	25.0%
WACC	10.9%
Terminal Growth rate	4.8%
Total NPV potential (INR/sh)	2,92,529
Target Price (INR/sh)	425
CMP (INR/sh)	419
Upside (downside) %	1%

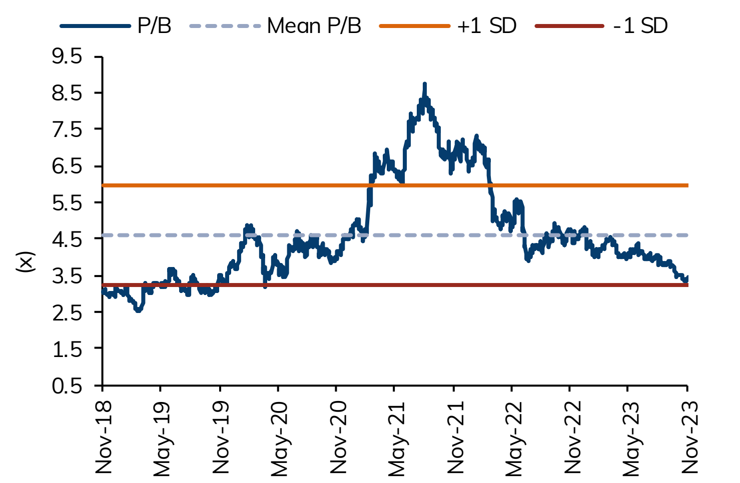
Source: Company data, I-Sec research

Exhibit 18: Gujarat Gas' P/E is trading near higher band



Source: Company data, I-Sec research

Exhibit 19: Gujarat Gas' P/B is trading below 5-year band



Source: Company data, I-Sec research

Exhibit 20: Shareholding pattern

%	Mar'23	Jun'23	Sep'23
Promoters	60.9	60.9	60.9
Institutional investors	17.9	17.7	16.9
MFs and others	9.8	8.4	6.6
FIs/Banks	0.0	0.0	0.0
Insurance	3.2	4.7	6.5
FIIs	4.9	4.6	3.8
Others	21.2	21.4	22.2

Source: Bloomberg

Exhibit 21: Price chart

Source: Bloomberg

ICICI Securities

Financial Summary

Exhibit 22: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Net Sales	**1,67,594**	**1,64,779**	**2,04,153**	**2,29,338**
EBITDA	**23,920**	**19,381**	**19,849**	**22,217**
EBITDA Margin (%)	14.3	11.8	9.7	9.7
Depreciation & Amortization	4,283	4,787	5,291	5,795
EBIT	19,637	14,594	14,558	16,422
Interest expenditure	404	82	42	2
Other Non-operating Income	1,013	878	757	649
PBT	**20,247**	**15,391**	**15,273**	**17,069**
Profit / (Loss) from Associates	-	-	-	-
Less: Taxes	4,992	3,795	3,766	4,208
PAT	15,255	11,596	11,508	12,861
Less: Minority Interest	-	-	-	-
Net Income (Reported)	**15,255**	**11,596**	**11,508**	**12,861**
Extraordinaries (Net)	-	-	-	-
Recurring Net Income	**15,255**	**11,596**	**11,508**	**12,861**

Source Company data, I-Sec research

Exhibit 25: Cashflow statement

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Cash Flow from operation before working Capital	**24,336**	**19,381**	**19,849**	**22,217**
Working Capital Changes	4,052	(153)	4,475	1,944
Tax	(4,608)	(3,795)	(3,766)	(4,208)
Operating Cashflow	**23,780**	**15,434**	**20,558**	**19,952**
Capital Commitments	(10,915)	(12,000)	(12,000)	(12,000)
Free Cashflow	**34,694**	**27,434**	**32,558**	**31,952**
Others CFI	518	378	257	149
Cashflow from Investing Activities	**(10,397)**	**(11,622)**	**(11,743)**	**(11,851)**
Inc (Dec) in Borrowings	(4,779)	(500)	(500)	(500)
Interest Cost	(381)	(82)	(42)	(2)
Others	(1,624)	(2,899)	(2,877)	(3,215)
Cash flow from Financing Activities	**(6,784)**	**(3,481)**	**(3,419)**	**(3,717)**
Chg. in Cash & Bank balance	**6,599**	**331**	**5,397**	**4,384**
Closing cash & balance	6,810	7,141	12,537	16,921

Source Company data, I-Sec research

Exhibit 23: Balance sheet

(INR mn, year ending March)

	FY23A	FY24E	FY25E	FY26E
Total Current Assets	19,792	19,065	25,784	30,522
of which cash & bank	6,810	7,141	12,537	16,921
Total Current Liabilities & Provisions	27,750	26,514	32,286	34,558
Net Current Assets	**(7,958)**	**(7,449)**	**(6,502)**	**(4,035)**
Other Non Current Assets	-	-	-	-
Net Fixed Assets	73,364	80,577	87,287	93,492
Other Fixed Assets	-	-	-	-
Capital Work in Progress	9,831	9,831	9,831	9,831
Non Investment	-	-	-	-
Current Investment	5,964	6,464	6,964	7,464
Deferred Tax assets	(8,461)	(8,461)	(8,461)	(8,461)
Total Assets	**72,740**	**80,962**	**89,119**	**98,291**
Liabilities				
Borrowings	**1,523**	**1,023**	**523**	**23**
Deferred Tax Liability	**-**	**-**	**-**	**-**
Lease Liability	-	-	-	-
Other Liabilities	1,261	1,286	1,312	1,338
Equity Share Capital	1,377	1,377	1,377	1,377
Reserves & Surplus*	68,579	77,276	85,907	95,553
Total Net Worth	**69,956**	**78,653**	**87,284**	**96,930**
Minority Interest	-	-	-	-
Total Liabilities	**72,740**	**80,962**	**89,119**	**98,291**

Source Company data, I-Sec research

Exhibit 26: Key ratios

(Year ending March)

	FY23A	FY24E	FY25E	FY26E
Per Share Data (INR)				
Recurring EPS	22.2	16.8	16.7	18.7
Diluted EPS	22.2	16.8	16.7	18.7
Recurring Cash EPS	28.4	23.8	24.4	27.1
Dividend per share (DPS)	6.6	4.2	4.2	4.7
Book Value per share (BV)	101.6	114.3	126.8	140.8
Dividend Payout (%)	30.0	25.0	25.0	25.0
Growth (%)				
Net Sales	1.8	(1.7)	23.9	12.3
EBITDA	15.2	(19.0)	2.4	11.9
EPS	17.8	(24.0)	(0.8)	11.8
Valuation Ratios (x)				
P/E	18.9	24.9	25.1	22.5
P/CEPS	14.8	17.6	17.2	15.5
P/BV	4.1	3.7	3.3	3.0
EV / EBITDA	11.6	14.2	13.6	11.9
EV / Operating Income	13.4	17.8	17.6	15.5
Dividend Yield (%)	1.6	1.0	1.0	1.1
Operating Ratios				
EBITDA Margins (%)	14.3	11.8	9.7	9.7
Effective Tax Rate (%)	24.7	24.7	24.7	24.7
Net Profit Margins (%)	9.1	7.0	5.6	5.6
NWC / Total Assets (%)	(10.9)	(9.2)	(7.3)	(4.1)
Fixed Asset Turnover (x)	1.7	1.5	1.7	1.7
Working Capital Days	5.8	17.7	19.9	18.7
Net Debt / Equity %	(16.1)	(16.0)	(21.7)	(25.1)
Profitability Ratios				
RoCE (%)	22.0	14.5	13.1	13.4
RoCE (Pre-tax) (%)	29.3	19.3	17.4	17.8
RoE (%)	24.2	15.6	13.9	14.0

Source Company data, I-Sec research

Exhibit 24: Quarterly trend

(INR mn, year ending March)

	Dec-22	Mar-23	Jun-23	Sep-23
Net Sales	36,843	39,286	37,815	38,454
% growth (YOY)	-28.4%	-15.9%	-26.9%	-3.3%
EBITDA	5,823	5,603	3,880	4,966
Margin %	15.8%	14.3%	10.3%	12.9%
Other Income	320	320	239	298
Extraordinaries				
Adjusted Net Profit	3,713	3,694	2,151	2,978

Source Company data, I-Sec research

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