Sharekhan by BNP PARIBAS

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Gujarat Gas Ltd

Margin tailwinds from fall in spot LNG price

Oil & Gas	Sharekhan code: GUJGASLTD	
Reco/View: Buy ↔	CMP: **Rs. 535**	Price Target: **Rs. 615** ↑

↑ 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		↔	

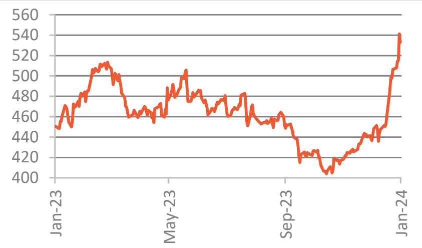
Company details

Market cap:	Rs. 36,794 cr
52-week high/low:	Rs. 549/397
NSE volume: (No of shares)	12.9 lakh
BSE code:	539336
NSE code:	GUJGASLTD
Free float: (No of shares)	26.9 cr

Shareholding (%)

Promoters	60.9
FII	3.3
DII	14.0
Others	21.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	22.1	24.9	15.1	18.3
Relative to Sensex	17.8	15.4	4.4	-2.1

Sharekhan Research, Bloomberg

Summary

- A sharp fall of 34% in spot LNG price to $11/mmBtu since November 2023 could act as margin tailwinds for Gujarat Gas. Asian spot LNG March 2024 futures show further decline of 10% to $10/mmBtu.
- Propane prices stay firm at $580-600/tonne and a likely improvement in I-PNG's competitiveness versus propane could drive volume recovery from Morbi ceramic cluster as customers may switch to natural gas from propane.
- Likely lower gas costs and volume recovery would drive solid 30% earnings CAGR over FY2024E-FY2026E along with RoE of 21%.
- We maintain a Buy with a revised PT of Rs. 615 as we rollover PE multiple to FY26E EPS. At CMP, the stock trades at 19x FY26E EPS.

The recent sharp decline in the Asian spot LNG is a positive for Gujarat Gas (GGAS) as it improves margin outlook given it sources 28-30% of gas requirement form spot LNG. The March 2024 spot LNG price indicates further fall of 10% to $10/mmBtu and thus low gas cost tailwinds are expected to continue in near term. A potential volume/margin recovery would drive a strong 30% PAT CAGR over FY24E-26E on low base of FY24E. Rising share of high-margin CNG volumes is also a positive with respect to earnings quality. We maintain our Buy rating on GGAS with a revised PT of Rs. 615.

- **Lower spot LNG price – A margin tailwind:** Spot LNG price has witnessed steep 34% fall since Nov'23 due to rise in inventory levels in Europe and March 2024 futures show further decline of 10% to $10/mmBtu. We highlight here that GGAS sources ~28-30% of its gas requirement from spot LNG. For every $1/mmBtu fall in gas cost would mean incremental gross margin of Rs. 2/scm assuming there is no pass through of lower spot LNG prices. Thus, the current situation of fall in spot LNG prices and rising volume share of CNG bodes well for margin improvement for Gujarat Gas over H2FY24-FY25.
- **Potential partial pass-through of likely lower gas cost could improve volume growth outlook:** Propane price remains firm at $580-600/tonne and if GGAS's implements partial pass through of lower gas cost then it could improve I-PNG's competitiveness versus propane. This could drive volume recovery from Morbi ceramic cluster as customers may switch to natural gas from propane. We highlight here that Morbi volumes stood at 3.9 mmscmd in Q2FY24 as compared to a peak of 7.3 mmscmd in Q4FY21 and thus any pricing power versus propane bodes well for strong volume growth in the coming quarters.
- **Robust earnings growth outlook:** We expect GGAS's gas sales volume to report a robust 16% CAGR over FY2024E-FY2026E, led by sustained recovery in I-PNG volume and double digit growth in CNG volume. Management's EBITDA margin guidance of Rs. 4.5-5.5/scm has room for improvement given tailwinds from steep decline in spot LNG price and thus we model margin of Rs. 5.3-6/scm over FY24E-26E. Hence, we expect a solid 30% PAT CAGR over FY2024E-FY2026E and RoE of 21%.

Our Call

Valuation – Maintain Buy on GGAS with a revised PT of Rs. 615: We see tailwinds to margin/volume growth given fall in spot LNG price and valuation of 19x its FY2026E EPS is reasonable given strong earnings growth outlook. If tailwinds of lower spot LNG prices and firm propane prices sustain then it would make case for earnings upgrade for GGAS. Hence, we maintain our Buy rating on GGAS with a revised PT of Rs. 615 (rollover of PE multiple to FY2026E EPS).

Key Risks

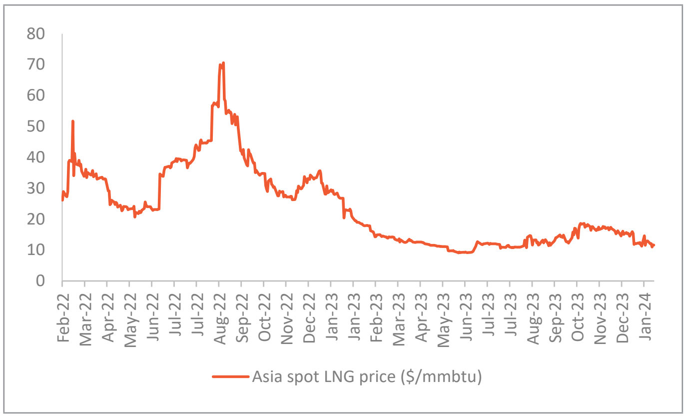
Lower-than-expected gas sales volume in case of economic slowdown and higher gas prices. Delay in developing new GAs, a sharp rise in LNG prices and adverse regulatory changes could affect outlook and valuations.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenue	16,456	16,759	16,322	19,881	23,344
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)	28.6	24.1	32.4	25.7	19.1
P/B (x)	6.5	5.2	4.7	4.2	3.7
EV/EBITDA (x)	17.9	15.1	18.8	14.9	11.2
RoNW (%)	25.4	24.1	15.4	17.5	20.7
RoCE (%)	26.6	27.2	18.2	21.0	25.1

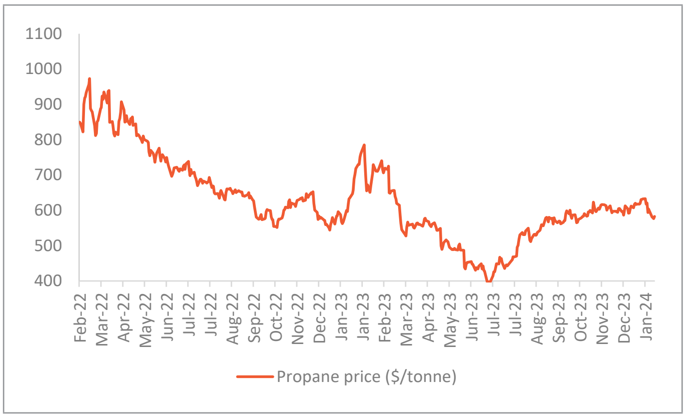
Source: Company; Sharekhan estimates

Spot LNG price falls sharply to $11/mmBtu



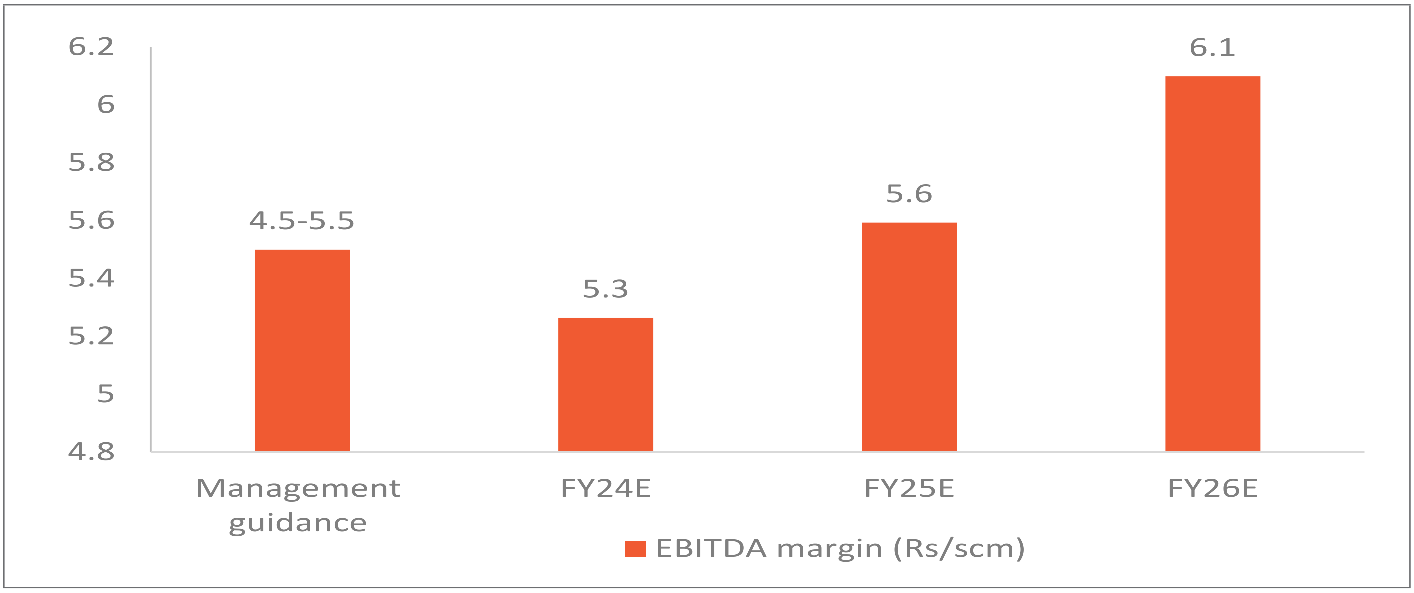
Source: Bloomberg; Sharekhan Research

Propane price firm



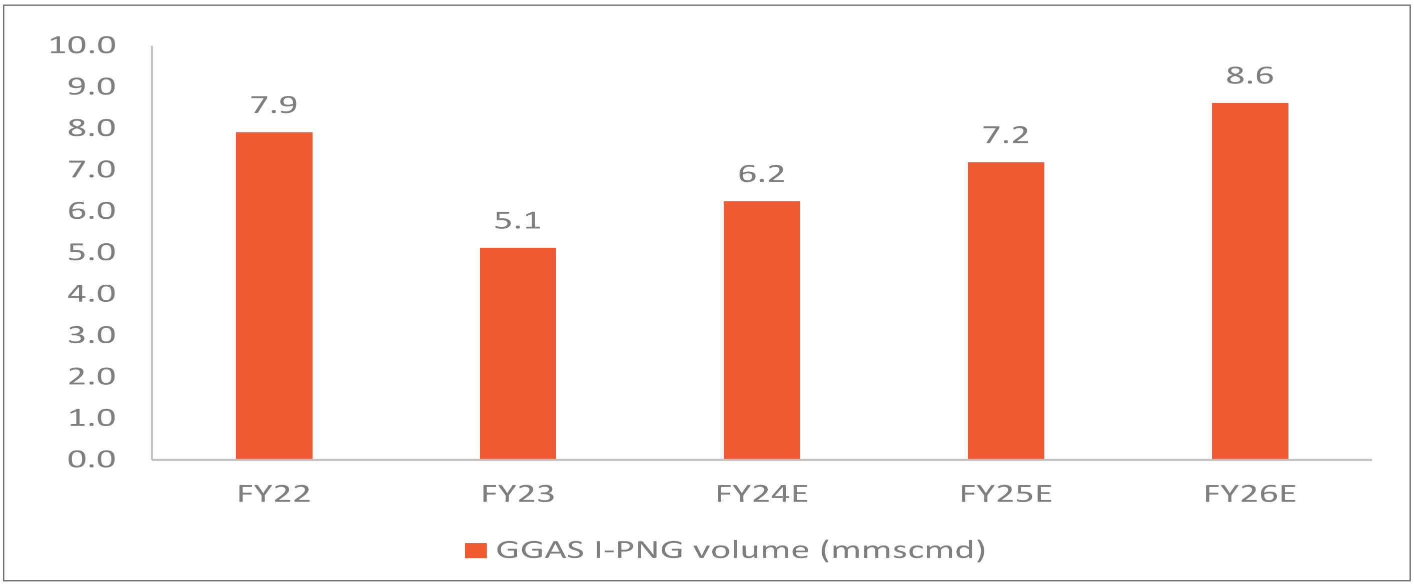
Source: Bloomberg; Sharekhan Research

Margin has upside to management's guidance range given soft LNG price



Source: Company; Sharekhan Research

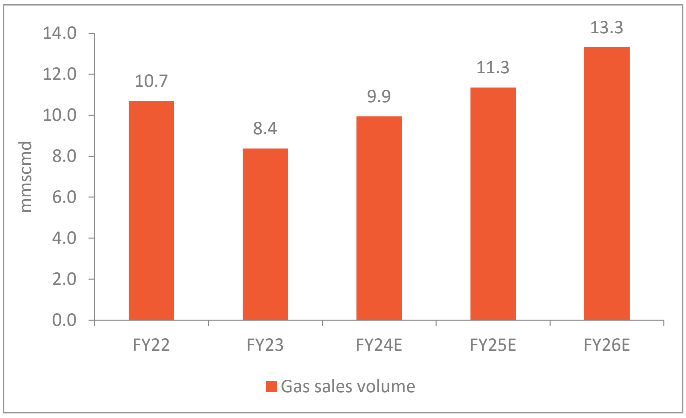
GGAS's I-PNG volume to see a sharp recovery as gas demand to shift back to I-PNG from propane



Source: Company; Sharekhan Research

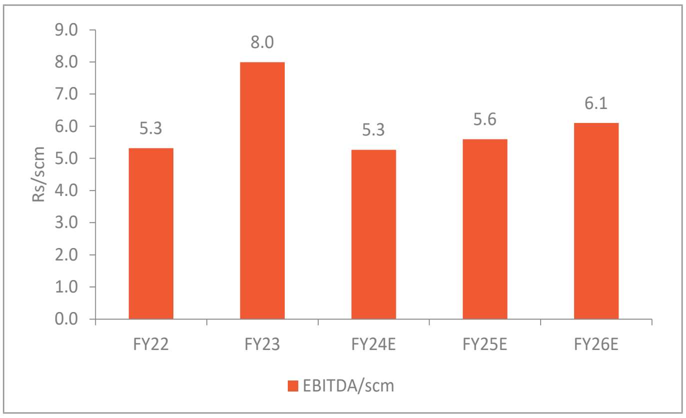
Financials in charts

Strong volume growth



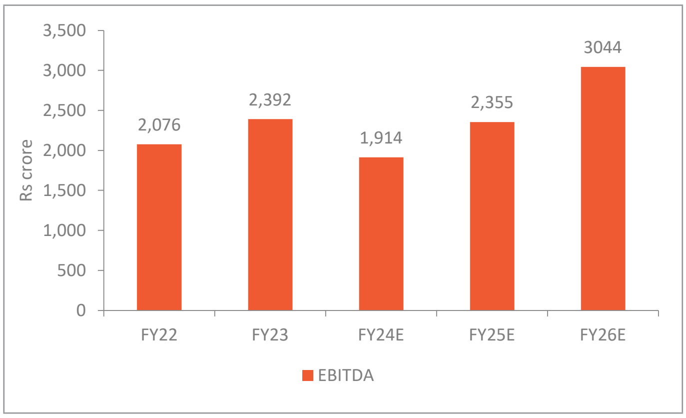
Source: Company, Sharekhan Research

Margin to remain resilient given the steep decline in LNG prices



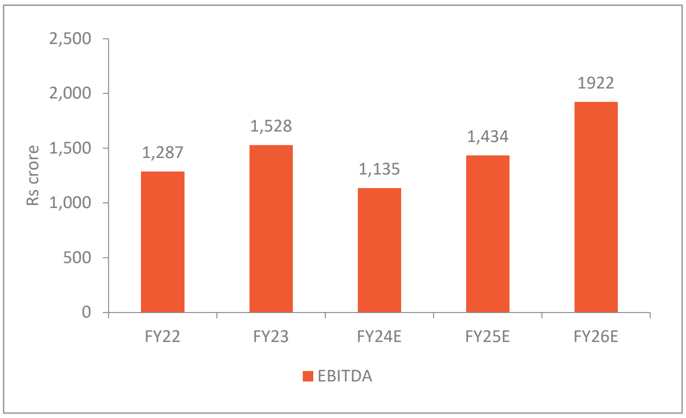
Source: Company, Sharekhan Research

EBITDA to report a 26% CAGR over FY2024E-FY2026E



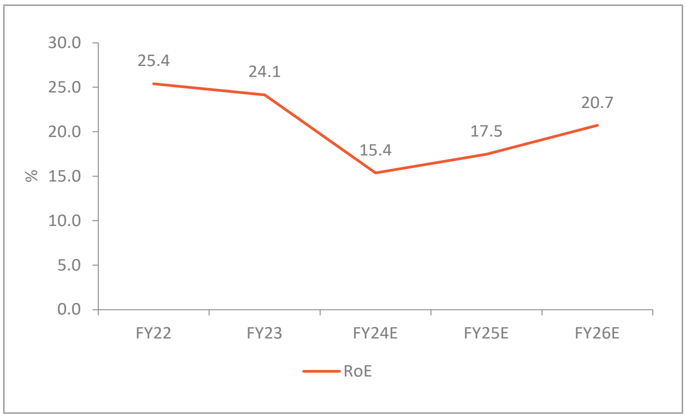
Source: Company, Sharekhan Research

PAT to post a 30% CAGR over FY2024E-FY2026E



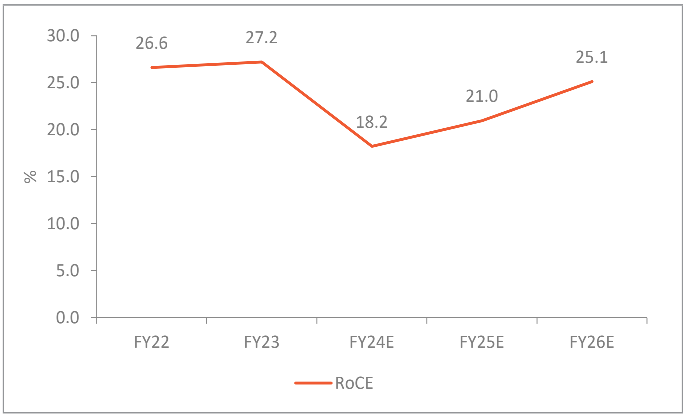
Source: Company, Sharekhan Research

RoE trend



Source: Company, Sharekhan Research

RoCE trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Supportive policies, lower LNG prices 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 the 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.

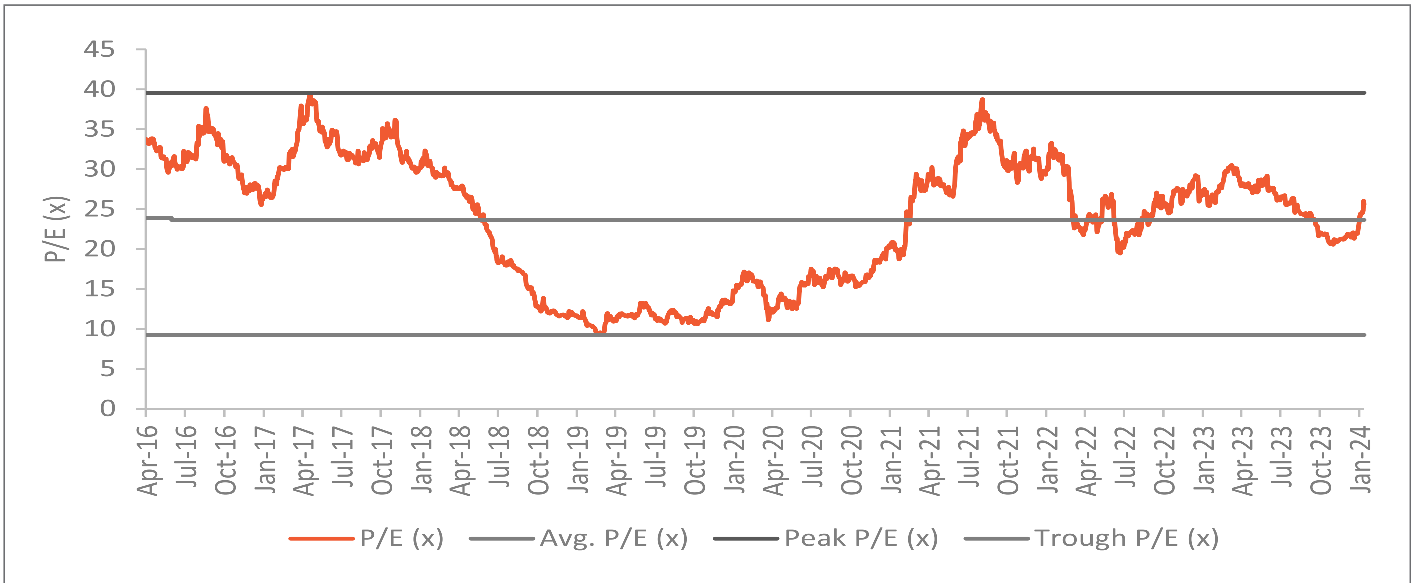
■ Company Outlook – Expect volume to witness strong recovery over FY24-26

We expect that a recovery in industrial 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 16% volume CAGR over FY2024E-FY2026E and see GGAS' 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 PT of Rs. 615

We see tailwinds to margin/volume growth given fall in spot LNG price and valuation of 19x its FY2026E EPS is reasonable given strong earnings growth outlook. If tailwinds of lower spot LNG prices and firm propane prices sustain then it would make case for earnings upgrade for GGAS. Hence, we maintain our Buy rating on GGAS with a revised PT of Rs. 615 (Rollover of PE multiple to FY2026E 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 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.

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

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

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	5.2
2	ICICI Prudential Asset Management	3.7
3	Vanguard Group Inc/The	1.1
4	Kotak Mahindra Asset Management Co	0.8
5	UTI Asset Management Co Ltd	0.7
6	DSP Investment Managers Pvt Ltd	0.6
7	BlackRock Inc	0.5
8	FundRock Management Co SA	0.3
9	Tata Asset Management Pvt Ltd	0.3
10	Norges Bank	0.2

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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