

**BUY**

TP: Rs 270 | ▲ 32%

**GUJARAT GAS**

| Oil &amp; Gas

| 05 November 2019

## Margins decline, robust volumes

**Gujarat Gas (GUJGA) reported Q2 FY20 earnings below estimates at Rs 2.2bn (Adjusted for Rs 2.9 bn tax write-back; +5.3x YoY). Key highlights: a) higher than estimated volumes at 9.3 mmscmd (+38% YoY) and b) lower than estimated EBITDA margins at Rs4.3/scm (+67% YoY, -23% QoQ). It was surprising that GUJGA was able to grow volumes QoQ, despite high competition from alternate fuels. We raise FY20E earnings by 27.5% on low tax rates (marginal change for FY21/22), retaining Sept'20 TP at Rs 270.**

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**Buoyant volumes:** GUJGA reported better than estimated volumes at 9.3 mmscmd, retaining volumes from Morbi. GUJGA management sees more volume potential from Morbi, expecting to average at ~9.5 mmscmd levels in H2 FY20. Although ceramic units have challenged the NGT order in higher courts, we see limited options for them to alter this order considering stringent legal standing for pollution control.

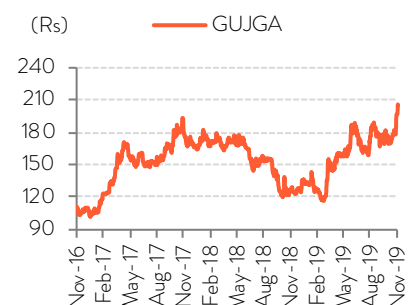
**Margins decline:** EBITDA margins under-performed at Rs4.3/scm in Q2 FY20, despite tepid spot LNG prices (at ~US\$4.5/mmmbtu). GUJGA had to resort to price cuts in Jul'19 to retain ceramic customers, as LPG prices had crashed to levels below spot LNG. Recent recovery in oil prices (>US\$60/bbl) has made spot LNG again attractive relative to LPG, that could ensure some margin recovery in H2 FY20. GUJGA management expects to sustain EBITDA at ~Rs5/scm levels, as customers in Morbi have become more sticky post the court order.

**Undemanding valuations:** At 11.7x FY22E EPS, GUJGA's valuations remain one of the lowest among CGD peers (~16x for IGL/MAHGL). This gap may get bridged gradually, given stability in volumes and margins.

Ticker/Price	GUJGA IN/Rs 205
Market cap	US\$ 2.0bn
Shares o/s	688mn
3M ADV	US\$ 1.2mn
52wk high/low	Rs 213/Rs 115
Promoter/FPI/DII	61%/12%/27%

Source: NSE

## STOCK PERFORMANCE



Source: NSE

## KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	61,743	77,544	120,558	138,467	146,207
EBITDA (Rs mn)	8,951	9,836	15,593	18,407	19,326
Adj. net profit (Rs mn)	2,914	4,160	11,502	11,103	12,097
Adj. EPS (Rs)	4.2	6.0	16.7	16.1	17.6
Adj. EPS growth (%)	32.7	42.8	176.5	(3.5)	9.0
Adj. ROAE (%)	16.7	20.6	44.2	36.5	38.5
Adj. P/E (x)	48.5	34.0	12.3	12.7	11.7
EV/EBITDA (x)	18.3	16.5	10.2	8.5	7.9

Source: Company, BOBCAPS Research

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**FIG 1 – QUARTERLY PERFORMANCE**

(Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20	H1FY19	YoY (%)
<b>Net sales</b>	<b>25,129</b>	<b>19,643</b>	<b>27.9</b>	<b>26,146</b>	<b>(3.9)</b>	<b>51,275</b>	<b>37,295</b>	<b>37.5</b>
Gas Purchased	19,550	16,423	19.0	19,522	0.1	39,072	29,927	30.6
% of sales	77.8	83.6	-	74.7	-	76.2	80.2	-
Other expenditure	1,873	1,613	16.1	1,960	(4.4)	3,833	3,274	17.0
% of sales	7.5	8.2	-	7.5	-	7.5	8.8	-
<b>EBITDA</b>	<b>3,706</b>	<b>1,607</b>	<b>130.6</b>	<b>4,665</b>	<b>(20.6)</b>	<b>8,371</b>	<b>4,093</b>	<b>104.5</b>
<b>EBITDA (Rs/scm)</b>	<b>4.3</b>	<b>2.6</b>	<b>67.0</b>	<b>5.6</b>	<b>(23.0)</b>	<b>4.9</b>	<b>3.4</b>	<b>46.0</b>
<b>EBITDA margin (%)</b>	<b>14.7</b>	<b>8.2</b>	<b>-</b>	<b>17.8</b>	<b>-</b>	<b>16.3</b>	<b>11.0</b>	<b>-</b>
Depreciation and amortisation	802	724	10.8	779	3.0	1,580	1,430	10.5
Interest	528	494	6.8	510	3.6	1,037	980	5.8
Other income	237	188	26.1	225	5.4	462	772	(40.2)
<b>PBT</b>	<b>2,614</b>	<b>578</b>	<b>352.5</b>	<b>3,602</b>	<b>(27.4)</b>	<b>6,215</b>	<b>2,455</b>	<b>153.2</b>
Exceptional item (as reported)	-	-	-	-	-	0	-	-
Provision for tax	(2,559)	167	(1,633.1)	1,265	(302.3)	(1,294)	831	(255.8)
<b>PAT (reported)</b>	<b>5,173</b>	<b>411</b>	<b>1,159.4</b>	<b>2,337</b>	<b>121.3</b>	<b>7,509</b>	<b>1,625</b>	<b>362.2</b>
<b>PAT (adjusted)</b>	<b>2,192</b>	<b>411</b>	<b>433.7</b>	<b>2,337</b>	<b>(6.2)</b>	<b>4,529</b>	<b>1,625</b>	<b>178.8</b>
<b>NPM (%)</b>	<b>8.7</b>	<b>2.1</b>	<b>-</b>	<b>8.9</b>	<b>-</b>	<b>14.6</b>	<b>4.4</b>	<b>-</b>
<b>EPS adj. (Rs)</b>	<b>3.2</b>	<b>0.6</b>	<b>433.7</b>	<b>3.4</b>	<b>(6.2)</b>	<b>6.6</b>	<b>2.4</b>	<b>178.8</b>

Source: Company, BOBCAPS Research

**FIG 2 – SEGMENT WISE VOLUME BREAK-UP**

Volumes (mmscmd)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)	H1FY20	H1FY19	YoY (%)
CNG Volume (mmscm)	136	128	6.3	135	0.7	271	256	5.9
PNG Volume (mmscm)	723	485	49.1	698	3.6	1,421	943	50.7
Domestic	50	49	2.0	45	11.1	95	88	8.0
Industrial	663	425	56.0	644	3.0	1,307	835	56.5
Commercial	10	11	(9.1)	9	11.1	19	20	(5.0)
<b>Total Volume (mmscm)</b>	<b>859</b>	<b>613</b>	<b>40.1</b>	<b>833</b>	<b>3.1</b>	<b>1,692</b>	<b>1,199</b>	<b>41.1</b>
<b>Total Volume (mmscmd)</b>	<b>9.3</b>	<b>6.8</b>	<b>38.1</b>	<b>9.2</b>	<b>2.0</b>	<b>9.2</b>	<b>6.6</b>	<b>40.1</b>

Source: Company, BOBCAPS Research

## Valuation methodology

We raise FY20E earnings by 27.5% on low tax rates (marginal change for FY21/22), retaining Sept'20 TP at Rs270

At 11.7x FY22E EPS, GUJGA's valuations remain one of the lowest among CGD peers (~16x for IGL/MAHGL). This gap may get bridged gradually, given stability in volumes and margins

Key assumptions for our DCF-based fair value are as under:

- Cost of equity of 11.4% and terminal growth of 5%
- Long-term average of EBITDA margins at Rs5/scm

### FIG 3 – VALUATION SUMMARY

Valuation type	Value (Rs mn)
PV of FCFE	85,938
PV of terminal value	118,167
Less: Net Debt (FY19)	(17,623)
Equity value	185,942
<b>Equity value (Rs/share)</b>	<b>270</b>

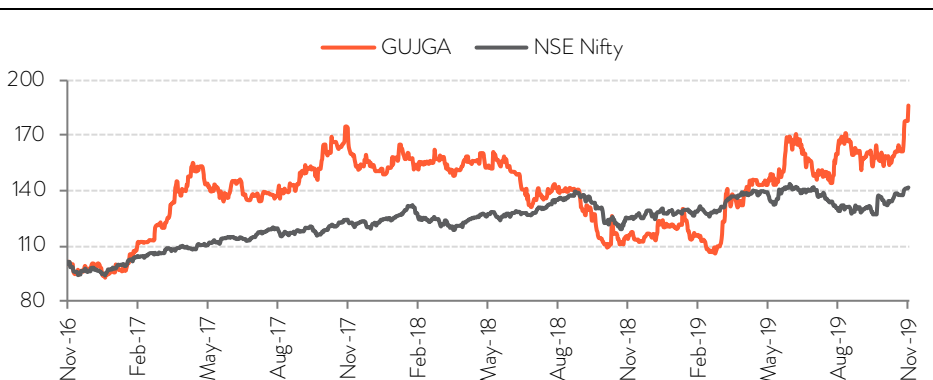
Source: BOBCAPS Research

### FIG 4 – FAIR VALUE SENSITIVITY TO TERMINAL GROWTH & COST OF EQUITY

		Cost of Equity (%)				
		(Rs)	9.4	10.4	11.4	12.4
Terminal growth (%)	3	315	266	229	200	176
	4	353	292	247	213	186
	5	409	327	<b>270</b>	229	198
	6	497	377	302	250	213
	7	661	459	349	280	232

Source: BOBCAPS Research

### FIG 5 – RELATIVE STOCK PERFORMANCE



Source: NSE

### Key risks

- Lower-than-expected margins over FY20-FY22 could change our valuation outlook for GUJGA
- Below-expected volume growth
- Change in the PNGRB regulations, or adverse court order (against NGT ruling for ceramic units), could alter volume growth outlook.

## FINANCIALS

### Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Total revenue</b>	<b>61,743</b>	<b>77,544</b>	<b>120,558</b>	<b>138,467</b>	<b>146,207</b>
EBITDA	8,951	9,836	15,593	18,407	19,326
Depreciation	(2,718)	(2,880)	(3,026)	(3,195)	(3,308)
EBIT	6,232	6,956	12,567	15,212	16,019
Net interest income/(expenses)	(1,961)	(1,962)	(1,448)	(1,353)	(1,264)
Other income/(expenses)	357	1,113	642	984	1,417
Exceptional items	0	(179)	0	0	0
EBT	4,628	6,107	11,760	14,843	16,172
Income taxes	(1,715)	(1,768)	(259)	(3,740)	(4,075)
<b>Reported net profit</b>	<b>2,914</b>	<b>4,160</b>	<b>11,502</b>	<b>11,103</b>	<b>12,097</b>
<b>Adjusted net profit</b>	<b>2,914</b>	<b>4,160</b>	<b>11,502</b>	<b>11,103</b>	<b>12,097</b>

### Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	2,931	3,523	6,246	7,169	7,551
Other current liabilities	11,957	13,129	12,983	14,901	15,694
Provisions	49	83	83	83	83
Debt funds	22,143	20,892	19,640	18,389	17,138
Other liabilities	10,789	11,808	9,103	10,588	12,205
Equity capital	1,377	1,377	1,377	1,377	1,377
Reserves & surplus	17,087	20,463	28,876	29,174	30,882
Shareholders' fund	18,464	21,840	30,253	30,551	32,259
<b>Total liabilities and equities</b>	<b>66,333</b>	<b>71,275</b>	<b>78,309</b>	<b>81,681</b>	<b>84,929</b>
Cash and cash eq.	1,363	3,092	5,090	7,617	10,827
Accounts receivables	3,917	5,103	7,217	8,289	8,752
Inventories	568	694	961	1,104	1,165
Other current assets	3,906	3,742	3,759	3,763	3,765
Investments	161	177	197	217	237
Net fixed assets	50,940	53,347	55,620	55,225	54,718
CWIP	4,783	4,885	4,783	4,783	4,783
Intangible assets	0	4	4	4	4
Other assets	695	678	678	678	678
<b>Total assets</b>	<b>66,333</b>	<b>71,722</b>	<b>78,309</b>	<b>81,681</b>	<b>84,930</b>

Source: Company, BOBCAPS Research

**Cash Flows**

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	5,632	7,040	14,528	14,298	15,405
Changes in working capital	66	1,262	180	1,622	647
Other operating cash flows	249	(752)	(3,347)	500	200
<b>Cash flow from operations</b>	<b>5,947</b>	<b>7,550</b>	<b>11,361</b>	<b>16,420</b>	<b>16,252</b>
Capital expenditures	(3,665)	(5,409)	(5,218)	(2,820)	(2,820)
Other investing cash flows	357	1,113	642	984	1,417
<b>Cash flow from investing</b>	<b>(3,308)</b>	<b>(4,296)</b>	<b>(4,577)</b>	<b>(1,836)</b>	<b>(1,403)</b>
Debt raised/repaid	(844)	(1,251)	(1,251)	(1,251)	(1,251)
Dividends paid	(664)	(806)	(4,039)	(3,899)	(4,248)
Other financing cash flows	(376)	532	503	(6,907)	(6,140)
<b>Cash flow from financing</b>	<b>(1,884)</b>	<b>(1,525)</b>	<b>(4,787)</b>	<b>(12,057)</b>	<b>(11,639)</b>
<b>Changes in cash and cash eq.</b>	<b>755</b>	<b>1,729</b>	<b>1,998</b>	<b>2,527</b>	<b>3,210</b>
<b>Closing cash and cash eq.</b>	<b>1,363</b>	<b>3,092</b>	<b>5,089</b>	<b>7,617</b>	<b>10,827</b>

**Per Share**

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	4.2	6.0	16.7	16.1	17.6
Adjusted EPS	4.2	6.0	16.7	16.1	17.6
Dividend per share	0.8	1.0	5.0	4.8	5.3
Book value per share	26.8	31.7	43.9	44.4	46.9

**Valuations Ratios**

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	2.6	2.1	1.3	1.1	1.0
EV/EBITDA	18.3	16.5	10.2	8.5	7.9
Adjusted P/E	48.5	34.0	12.3	12.7	11.7
P/BV	7.6	6.5	4.7	4.6	4.4

**DuPont Analysis**

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	63.0	70.2	97.8	74.8	74.8
Interest burden (PBT/EBIT)	74.3	85.2	93.6	97.6	101.0
EBIT margin (EBIT/Revenue)	10.1	9.0	10.4	11.0	11.0
Asset turnover (Revenue/Avg TA)	95.1	112.3	160.7	173.1	175.5
Leverage (Avg TA/Avg Equity)	3.7	3.4	2.9	2.6	2.7
Adjusted ROAE	16.7	20.6	44.2	36.5	38.5

Source: Company, BOBCAPS Research | Note: TA = Total Assets

**Ratio Analysis**

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
<b>YoY growth (%)</b>					
Revenue	21.2	25.6	55.5	14.9	5.6
EBITDA	20.4	9.9	58.5	18.0	5.0
Adjusted EPS	32.7	42.8	176.5	(3.5)	9.0
<b>Profitability &amp; Return ratios (%)</b>					
EBITDA margin	14.5	12.7	12.9	13.3	13.2
EBIT margin	10.1	9.0	10.4	11.0	11.0
Adjusted profit margin	4.7	5.4	9.5	8.0	8.3
Adjusted ROAE	16.7	20.6	44.2	36.5	38.5
ROCE	9.8	11.7	26.5	23.0	24.4
<b>Working capital days (days)</b>					
Receivables	22	21	19	20	21
Inventory	4	4	3	3	4
Payables	21	17	17	20	21
<b>Ratios (x)</b>					
Gross asset turnover	1.0	1.2	1.7	1.8	1.9
Current ratio	0.7	0.8	0.9	0.9	1.1
Net interest coverage ratio	3.2	3.5	8.7	11.2	12.7
Adjusted debt/equity	1.1	0.8	0.5	0.4	0.2

Source: Company, BOBCAPS Research

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### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

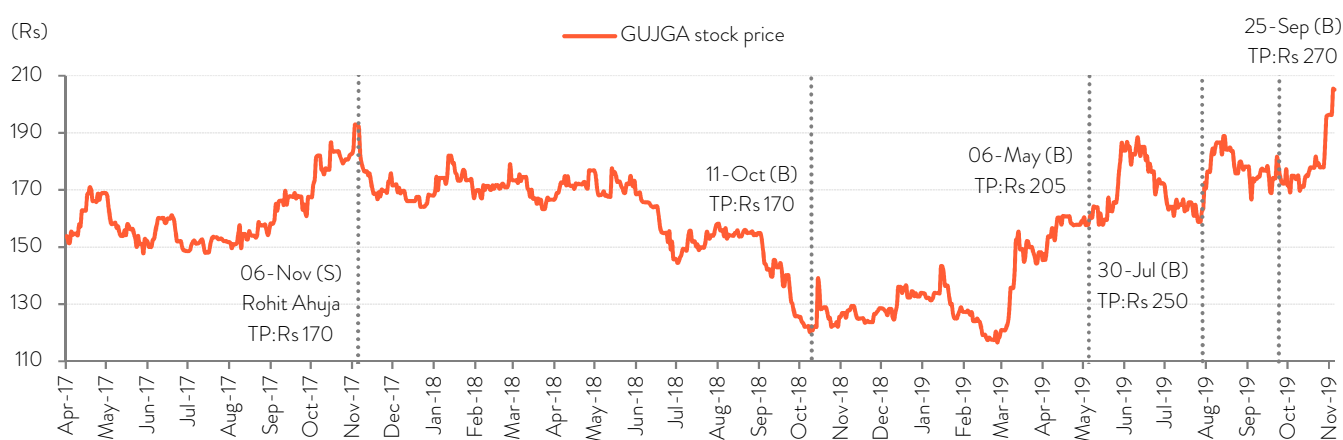
**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

### HISTORICAL RATINGS AND TARGET PRICE: GUJARAT GAS (GUJGA IN)



B – Buy, A – Add, R – Reduce, S – Sell

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