

BUY

TP: Rs 400 | ▲ 33%

GUJARAT GAS

Oil & Gas

05 November 2020

Strong beat on margins and volumes; upgrade to BUY

Gujarat Gas' (GUJGA) Q2FY21 earnings were above estimates, surging 8x QoQ to Rs 4.8bn. Q2 highlights: (a) volumes beat estimates at 9.8mmscmd (+5.5% YoY, +2.4x QoQ), returning to pre-Covid levels, and (b) EBITDA margin outperformed at Rs 8.1/scm (+88% YoY). We raise FY21/FY22/FY23 earnings by 33%/20%/20% to factor in higher margins and volumes. Our Sep'21 TP rises to Rs 400 (from Rs 335). The strong V-shaped recovery reinforces our investment rationale on B2B gas utilities; raise to BUY from ADD.

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Accelerated volume recovery: Volumes rebounded in Q2 driven by the industrial segment (7.9mmscmd, +1.8x QoQ), followed by CNG (1.3mmscmd, +2x QoQ). Strong recovery in consumption from ceramic units (primarily in Morbi) and the chemicals segment aided a return to normalcy for industrial volumes. Domestic PNG continued to grow (0.6mmscmd, +16% YoY). Management has guided for improvement in volumes to ~10.5mmscmd in H2FY21, well above our estimates.

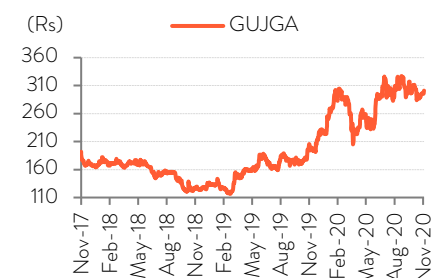
Margins hit near-historical highs: GUJGA outperformed our EBITDA margin estimate of Rs 5.1/scm, delivering Rs 8.1/scm in Q2, driven by a sharp reduction in gas costs. This kind of margin beat depicts strong pricing power besides benefits from the sharp increase in industrial volumes QoQ. Margins could retrace to ~Rs 5/scm in Q3 considering the recent surge in spot LNG prices (>US\$ 5/mmbtu). We expect the company to consistently average at Rs 6-7/scm EBITDA as incremental volumes bring in scale advantage.

Upgrade to BUY: The stock is trading at 12.7x FY22E EPS after considering our large earnings upgrade – in our view, valuations leave ample room for upsides given the surge in margins and accelerating volumes. Sustained low oil prices augur well for margins and represent an upside risk to earnings.

Ticker/Price	GUJGA IN/Rs 301
Market cap	US\$ 2.8bn
Shares o/s	688mn
3M ADV	US\$ 2.8mn
52wk high/low	Rs 334/Rs 189
Promoter/FPI/DII	61%/9%/30%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	77,544	103,003	80,419	96,998	106,288
EBITDA (Rs mn)	9,846	16,343	20,746	24,890	27,091
Adj. net profit (Rs mn)	4,170	9,058	13,005	16,349	18,285
Adj. EPS (Rs)	6.1	13.2	18.9	23.7	26.6
Adj. EPS growth (%)	43.1	117.2	43.6	25.7	11.8
Adj. ROAE (%)	20.7	33.1	35.1	36.7	36.2
Adj. P/E (x)	49.8	22.9	16.0	12.7	11.3
EV/EBITDA (x)	23.3	13.9	10.7	8.7	7.8

Source: Company, BOBCAPS Research

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FIG 1 – QUARTERLY PERFORMANCE

(Rs mn)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
Net sales	25,130	25,129	0.0	10,829	132.1	35,959	51,275	(29.9)
Gas Purchased	15,876	19,550	(18.8)	7,297	117.6	23,173	39,072	(40.7)
% of sales	63.2	77.8	-	67.4	-	64.4	76.2	-
Other expenditure	1,924	1,873	2.7	1,675	14.9	3,599	3,833	(6.1)
% of sales	7.7	7.5	-	15.5	-	10.0	7.5	-
EBITDA	7,330	3,706	97.8	1,857	294.6	9,188	8,371	9.8
EBITDA (Rs/scm)	8.1	4.3	87.5	4.9	64.2	7.2	4.9	44.7
EBITDA margin (%)	29.2	14.7	-	17.2	-	25.5	16.3	-
Depreciation and amortisation	856	802	6.8	823	4.1	1,679	1,580	6.2
Interest	339	528	(35.8)	401	(15.5)	740	1,037	(28.7)
Other income	208	237	(12.4)	149	39.4	356	462	(22.8)
PBT	6,343	2,614	142.7	783	710.3	7,126	6,215	14.6
Exceptional item (as reported)	-	-	-	-	-	-	-	-
Provision for tax	1,595	(2,559)	(162.3)	196	713.0	1,791	(1,294)	(238.4)
PAT (reported)	4,748	5,173	(8.2)	587	709.3	5,334	7,509	(29.0)
PAT (adjusted)	4,748	5,173	(8.2)	587	709.3	5,344	7,509	(28.8)
NPM (%)	18.9	20.6	-	5.4	-	14.8	14.6	-
EPS adj. (Rs)	6.9	7.5	(8.2)	0.9	709.3	7.8	10.9	(28.8)

Source: Company, BOBCAPS Research

FIG 2 – SEGMENTAL VOLUME BREAKUP

Volumes (mmscm)	Q2FY21	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	H1FY21	H1FY20	YoY (%)
CNG	118	136	(13.2)	62	90.3	180	271	(33.6)
PNG	788	723	9.0	315	150.2	1,103	1,421	(22.4)
Domestic	59	50	18.0	52	13.5	111	95	16.8
Industrial	723	663	9.0	260	178.1	983	1,307	(24.8)
Commercial	6	10	(40.0)	3	100.0	9	19	(52.6)
Total	906	859	5.5	377	140.3	1,283	1,692	(24.2)
Total (mmscmd)	9.8	9.3	5.5	4.1	137.7	7.0	9.2	(24.2)

Source: Company, BOBCAPS Research

Valuation methodology

GUJGA's unique positioning in the city gas distribution space makes it one of the best plays on gas volume growth potential, based on (a) its access to over 80% of CGD potential in Gujarat, and (b) strategic expansion into new areas (such as Dahej-Gujarat, Rajasthan, Western Maharashtra and Punjab) that are contiguous to its parent Gujarat State Petronet's pipeline networks.

We raise FY21/FY22/FY23 earnings estimates by 33%/20%/20% to factor in higher margins and volumes. Our Sep'21 target price thus rises to Rs 400 (from Rs 335). The strong V-shaped recovery reinforces our investment rationale on B2B gas utilities – upgrade to BUY from ADD.

FIG 3 – REVISED ESTIMATES

(Rs mn)	FY21E			FY22E			FY23E		
	Old	New	Var (%)	Old	New	Var (%)	Old	New	Var (%)
Gross Revenue	74,417	81,956	10.1	96,825.7	98,758	2.0	106,056.4	108,215	2.0
EBITDA	16,230	20,746	27.8	21,057.6	24,890	18.2	22,857.3	27,091	18.5
EBITDA margin (%)	21.8	25.3	-	21.7	25.2	-	21.6	25.0	-
PAT	9,753	13,005	33.3	13,597.2	16,349	20.2	15,221.5	18,285	20.1
PAT margin (%)	13.1	15.9	-	14.0	16.6	-	14.4	16.9	-
EPS (Rs)	14.2	18.9	33.3	19.8	23.7	20.2	22.1	26.6	20.1

Source: Company, BOBCAPS Research

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

- cost of equity of 11.8% and terminal growth of 5% (unchanged), and
- long-term average EBITDA margins of Rs 6.5/scm (raised from ~Rs 5.5/scm).

FIG 4 – VALUATION SUMMARY

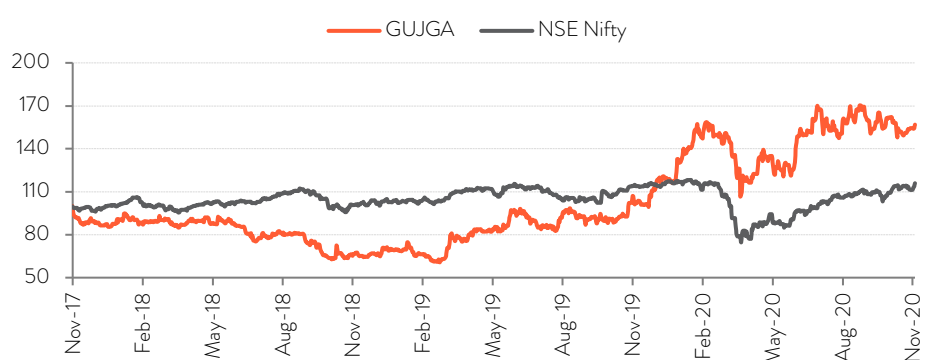
Valuation type	Value (Rs mn)
PV of FCFE	105,487
PV of terminal value	182,103
Less: Net Debt (FY19)	(11,689)
Equity value	275,901
Equity value (Rs/share)	400

Source: BOBCAPS Research

FIG 5 – FAIR VALUE SENSITIVITY TO TERMINAL GROWTH & COST OF EQUITY

		Cost of Equity (%)				
		(Rs)	9.8	10.8	11.8	12.8
Terminal growth (%)	3	454	390	341	301	269
	4	506	426	367	321	284
	5	580	475	400	345	302
	6	693	544	446	377	325
	7	887	650	511	420	355

Source: BOBCAPS Research

FIG 6 – RELATIVE STOCK PERFORMANCE

Source: NSE

Key risks

- Lower-than-expected margins over FY21-FY22 could change our valuation outlook for GUJGA.
- Below-expected volume growth.
- Change in PNGRB regulations or an unfavourable court ruling (against the NGT order for ceramic units) could alter our volume growth outlook.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue	77,544	103,003	80,419	96,998	106,288
EBITDA	9,846	16,343	20,746	24,890	27,091
Depreciation	(2,880)	(3,180)	(3,229)	(3,499)	(3,814)
EBIT	6,966	13,163	17,517	21,391	23,277
Net interest income/(expenses)	(1,962)	(1,922)	(1,388)	(1,224)	(1,060)
Other income/(expenses)	1,113	837	1,257	1,690	2,228
Exceptional items	(179)	0	0	0	0
EBT	6,117	12,078	17,386	21,857	24,445
Income taxes	(1,768)	(145)	(4,381)	(5,508)	(6,160)
Reported net profit	4,170	11,933	13,005	16,349	18,285
Adjustments	0	(2,875)	0	0	0
Adjusted net profit	4,170	9,058	13,005	16,349	18,285

Balance Sheet

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Accounts payables	3,523	3,790	2,384	2,865	3,128
Other current liabilities	13,129	14,259	8,928	10,730	11,716
Provisions	83	130	130	130	130
Debt funds	20,892	18,794	16,696	14,598	12,501
Other liabilities	11,808	9,094	10,833	13,019	15,463
Equity capital	1,377	1,377	1,377	1,377	1,377
Reserves & surplus	20,463	31,529	39,828	46,404	51,745
Shareholders' fund	21,840	32,906	41,204	47,781	53,122
Total liabilities and equities	71,275	78,973	80,175	89,122	96,060
Cash and cash eq.	3,092	6,919	9,447	12,656	16,574
Accounts receivables	5,103	5,101	3,984	4,805	5,265
Inventories	694	463	452	545	597
Other current assets	3,742	4,148	4,147	4,149	4,149
Investments	177	187	207	227	247
Net fixed assets	53,347	55,467	56,538	61,339	63,825
CWIP	4,885	5,686	4,783	4,783	4,783
Intangible assets	4	9	9	9	9
Other assets	678	610	610	610	610
Total assets	71,722	78,589	80,175	89,122	96,059

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income + Depreciation	7,050	15,113	16,234	19,848	22,099
Changes in working capital	1,262	1,380	(5,606)	1,367	736
Other operating cash flows	(752)	(3,648)	482	496	217
Cash flow from operations	7,560	12,845	11,109	21,710	23,052
Capital expenditures	(5,409)	(6,116)	(3,418)	(8,320)	(6,320)
Other investing cash flows	1,113	837	1,257	1,690	2,228
Cash flow from investing	(4,296)	(5,279)	(2,161)	(6,630)	(4,092)
Debt raised/repaid	(1,251)	(2,098)	(2,098)	(2,098)	(2,098)
Dividends paid	(806)	(4,190)	(4,567)	(5,741)	(6,421)
Other financing cash flows	521	2,549	244	(4,032)	(6,523)
Cash flow from financing	(1,536)	(3,739)	(6,420)	(11,871)	(15,041)
Changes in cash and cash eq.	1,728	3,827	2,528	3,210	3,918
Closing cash and cash eq.	3,091	6,919	9,447	12,656	16,574

Per Share

Y/E 31 Mar (Rs)	FY19A	FY20A	FY21E	FY22E	FY23E
Reported EPS	6.1	17.3	18.9	23.7	26.6
Adjusted EPS	6.1	13.2	18.9	23.7	26.6
Dividend per share	1.0	5.2	5.7	7.1	8.0
Book value per share	31.7	47.8	59.9	69.4	77.2

Valuations Ratios

Y/E 31 Mar (x)	FY19A	FY20A	FY21E	FY22E	FY23E
EV/Sales	3.0	2.2	2.8	2.2	2.0
EV/EBITDA	23.3	13.9	10.7	8.7	7.8
Adjusted P/E	49.8	22.9	16.0	12.7	11.3
P/BV	9.5	6.3	5.0	4.3	3.9

DuPont Analysis

Y/E 31 Mar (%)	FY19A	FY20A	FY21E	FY22E	FY23E
Tax burden (Net profit/PBT)	70.2	75.0	74.8	74.8	74.8
Interest burden (PBT/EBIT)	85.2	91.8	99.3	102.2	105.0
EBIT margin (EBIT/Revenue)	9.0	12.8	21.8	22.1	21.9
Asset turnover (Revenue/Avg TA)	112.3	137.1	101.3	114.6	114.8
Leverage (Avg TA/Avg Equity)	3.4	2.7	2.1	1.9	1.8
Adjusted ROAE	20.7	33.1	35.1	36.7	36.2

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

Ratio Analysis

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
YoY growth (%)					
Revenue	25.6	32.8	(21.9)	20.6	9.6
EBITDA	10.0	66.0	26.9	20.0	8.8
Adjusted EPS	43.1	117.2	43.6	25.7	11.8
Profitability & Return ratios (%)					
EBITDA margin	12.7	15.9	25.8	25.7	25.5
EBIT margin	9.0	12.8	21.8	22.1	21.9
Adjusted profit margin	5.4	8.8	16.2	16.9	17.2
Adjusted ROAE	20.7	33.1	35.1	36.7	36.2
ROCE	11.7	27.5	23.9	26.6	27.2
Working capital days (days)					
Receivables	21	18	21	17	17
Inventory	4	3	3	3	3
Payables	17	15	19	13	14
Ratios (x)					
Gross asset turnover	1.2	1.4	1.1	1.2	1.2
Current ratio	0.8	0.9	1.6	1.6	1.8
Net interest coverage ratio	3.6	6.8	12.6	17.5	22.0
Adjusted debt/equity	0.8	0.4	0.2	0.0	(0.1)

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

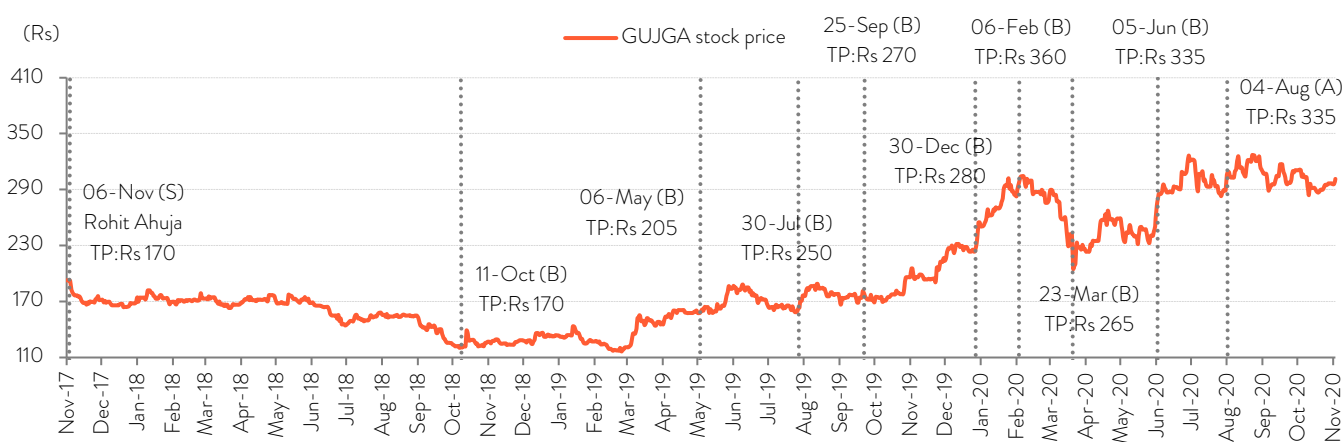
ADD – Expected return from >+5% to +15%

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)

RATINGS AND TARGET PRICE (3-YEAR HISTORY): GUJARAT GAS (GUJGA IN)



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

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