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DEMOCRATIZING WEALTH CREATION

VALUE PICK

CHASING VALUE, NOT PRICES

Company Name	:	**GUJARAT GAS LTD**
BSE Code	:	**539336**
Time Duration	:	**2 year**
CMP	:	**₹310.50 (as on 12 November, 2020)**
Target Price	:	**₹405**

Value Pick for the month of November 2020 is Gujarat Gas Limited (GGL). It is India's largest city gas distribution (CGD) player and has a presence in the states of Gujarat, Maharashtra, Punjab, Haryana, Madhya Pradesh & Rajasthan. Currently, GGL's primary revenue comes from Gujarat (>95 per cent). The state offers immense benefits like well-laid-out gas infrastructure with a network of pipelines and LNG terminals that account for close to 26 per cent of its energy needs. GGL currently caters to more than 1.4 million residential consumers and over 12,600 commercial customers. It dispenses CNG from over 400 stations for vehicular consumers and provides clean energy solutions to over 3,700 industrial units. The company is aggressively planning for penetration in PNG (domestic), PNG (commercial), and CNG (transport) sector. GGL has long-term plans to transform from a Gujarat-centric player to a pan-India player with 27 geographic areas (GAs), seven of which, were acquired in the latest CGD auction rounds 9 & 10.

A favourable demand outlook for CGD business

Natural gas is the cleanest and most efficient of all fossil fuels. It is the only fossil fuel, whose share of the primary energy mix, is expected to grow, as it has the potential to play an important role in the world's transition to a cleaner, more affordable, and secure energy future. With a focus on environmentally cleaner fuel, the Government of India (GOI) is actively promoting a shift towards cleaner energy sources, i.e. natural gas. There has been an increasing impetus coming in the form of environmental concerns over certain polluting fuels and various court directives. CGD projects have become a priority segment of the natural gas business. Realising the importance of natural gas, the government has set an aggressive target to increase the share of natural gas in the overall energy consumption mix to 15 per cent by 2030 from the current levels of 6 per cent. As a result, the expected growth in gas consumption is expected to grow by 10 per cent between FY18 and FY30. This can translate into a significant increase in the revenue for natural gas players such as GGL.

The CGD business in India contributes around 17.57 per cent of the total natural gas consumption in India and is leading the way with the highest CAGR amongst all the sectors in the coming decade. GGL is expected to benefit from the continued increase in natural gas demand (CNG and PNG) in Gujarat, which is amongst the highest natural gas consuming state in India. Further, there is an increase in the number of compressed natural gas (CNG) operated vehicles on account of the pricing of natural gas compared with other conventional fuels. Going forward, the number of CNG vehicles is expected to increase, which could support higher CNG demand.

Domestic gas consumption is also at a very nascent stage and offers healthy opportunities for further growth. A significant decline in US Henry Hub Natural Gas prices (from US$ 2.32/mmBtu to US$ 2.06/mmBtu) and domestic liquefied natural gas (LNG) prices (from US$ 3.69/mmBtu to US$ 2.39/mmBtu) during the past 12 months reduced the sourcing cost and resulted in gross margin expansion. Domestic natural gas prices have been further reduced to US$ 1.79/mmBtu for the period of October 2020 to March 2021. This is the lowest price since 2014, and it is expected to further boost the profitability of GGL.

Tightening environmental policy to benefit GGL volumes

Rising pollution is a major concern that has brought an increased judicial intervention, for example, the closure of coal gasifiers in Morbi (Gujarat) and the ban of pet coke & furnace oil in the National Capital Region (NCR) area. GGL's key markets of Tarapur, Rajkot, Vapi, Surat, etc. feature among the most polluted zones as per Environment Pollution Index 2017-18, and any judicial intervention may further lead to a steep jump in GGL's volumes. GGL's FY20 earnings got a boost from the closure of coal gasifiers in Morbi as volumes were up by 47 per cent YoY with the lower tax rate of 1.2 per cent. After a muted Q1FY21 (due to the widespread lockdown), volumes are now back to FY20 average due to a pickup in the industrial activity.

The state government is also encouraging industrial units to use natural gas as a fuel rather than coal due to environmental reasons. GGL is expecting the full implementation of NGT order in the year 2020, which is expected to improve industrial gas volumes by around 50 per cent in FY22 over FY20. GGL's industrial volumes remain relatively immune to competition, given the first-mover advantage to access large customers, along with its ability to match new players' pricing threats. GGL's current revenues accrue from geographical areas (GAs) of Surat, Anklesh-

Continued On PG 2...

war, Vapi & Rajkot, where the threat of new entrants is minimal despite the expiry of marketing exclusivity. Close proximity to multiple business zones like the dedicated freight corridor (DFC), Dholera industrial zone as part of Delhi Mumbai Industrial Corridor (DMIC) is also seen as the next big growth driver.

Financial performance

On a consolidated quarterly basis, Gujarat Gas reported net sales of Rs 2,559.91 crore in Q2FY21, down by marginally 0.36 per cent YoY but improving significantly sequentially by 131.17 per cent. The company's volumes grew by 5.5 per cent YoY to 9.85 metric standard cubic metre per day (mmscmd) and 140 per cent on a sequential basis. CNG volumes for Q2FY21 were at 1.28 mmscmd, which de-grew 13.3 per cent YoY along with a growth of 90 per cent QoQ as the economy has not fully opened up. However, in the CNG segment gas, the volume currently, is at 90 per cent of the pre-COVID levels. Gas sales volume has shown a robust recovery post lockdown. Gujarat Gas is flowing total volume close to 10.5 mmscmd as against FY20 average sales of 9.44 mmscmd. Realisations declined sequentially by 3.4 per cent to Rs 28.3/scm as price reduction were taken in the industrial segment to compete with alternate fuels.

Subdued gas prices during the quarter boosted operating profit for the company. GGL reported PBIDT (Ex OI) for the quarter at Rs 733.02 crore, growing by 97.79 per cent YoY as well as 294.65 per cent QoQ. The corresponding margins improved considerably to 28.63 per cent in Q2FY21 from 14.42 per cent in Q2FY20.

GGL reported a net tax of Rs 159.53 crore in Q2FY21 against the net tax gain of Rs 255.92 crore in Q2FY20, which impacted the bottom-line on a YoY basis. Net profit reported a YoY decline of 8.0 per cent to Rs 476.79 crore, while net margins deteriorated by 159 bps to 18.55 per cent. The company has adopted a new corporate tax regime of 25.17 per cent, which would prove to an effective tax rate in the future. The total debt declined at a YoY rate of 23.68 per cent to Rs 1,400 crore, which reduced the interest cost by 35.8 per cent to Rs 33.87 crore in Q2FY21.

On an annual basis, the company reported net sales of Rs 10,300.34 crore in FY20, expanding by 32.83 per cent from Rs 7,754.41 crore reported in the previous fiscal year. PBIDT came in at Rs 1,730.94 Cr., up by 56.25 per cent from the previous fiscal year. The corresponding margins improved to 16.80 per cent in FY20 from 14.28 per cent in FY19. The company reported its highest-ever net profit in FY20, which came in at Rs 1,198.85 crore, increasing by 187.52 per cent from Rs 416.96 crore in the previous fiscal year.

Valuation and outlook

The company has delivered good profit growth of 22 per cent CAGR over the last five years. In FY20, ROE stood at 43.42 per cent (vs 20.48 per cent last year). The company has a good return on equity (ROE) track record for 3 years, which stands at 26.8 per cent. ROCE improved to 29.03 per cent from 18.62 per cent, while, ROA has also shown a considerable improvement of 15.90 per cent from 6.03 per cent last year. The company's debt coverage indicators have also improved during FY20 marked by interest coverage of 6.89 times from 3.86 times in FY19. The stock is trading at a TTM PE of 21.63x as against its five-year median of 39.45x and the industrial average is 30.46x. Given the key positives such as the government's strong thrust on the usage of natural gas and the impending NGT order, it is likely that the gas volume off-take will improve. Further, a significant decline in the global natural gas prices has also improved the prospects of the industrial usage of gas. Moreover, the decline in debt and the rise in profitability should improve the balance sheet health, going forward. Considering all these factors, we expect the stock to reach the price of Rs 405, which represents a potential upside of 30 per cent.

Inc/Exp Statement (Consolidated)

Description	202003	201903	201803	201703	201603
Net Sales	10300.34	7754.41	6174.33	5092.61	6105.58
Total Income	10384.26	7866	6210.19	5118.95	6150.25
Total Expenditure	8653.32	6758.26	5269.15	4340.28	5375.87
PBIDT	1730.94	1107.74	941.04	778.67	774.38
PAT	1198.85	416.96	291.19	219.24	187.9
Dividend %	62.5	50	40	30	25
Adj. EPS(Rs)	17.41	6.08	4.25	3.2	2.76

Quarter On Quarter (Consolidated)

Particulars	202009	202006	Q on Q Var %	201909	Y on Y Var %
Net Sales	2559.91	1107.36	131.17	2569.25	-0.36
Total Expenditure	1826.89	921.62	98.23	2198.64	-16.91
PBIDT (Excl OI)	733.02	185.74	294.65	370.61	97.79
PAT	474.79	58.68	709.12	517.36	-8.23
PBIDTM% (Excl OI)	28.63	16.77	70.72	14.42	98.54
PBIDTM%	29.45	18.12	62.53	15.35	91.86
PATM%	18.55	5.3	250	20.14	-7.89
Adj. EPS(Rs)	6.91	0.86	703.49	7.51	-7.99

Continued On PG 3...

Stock vs. Index

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