

## Gujarat Gas

Rs1,270  
OUTPERFORMER

ANALYST MEET UPDATE

Mkt Cap: Rs16.3bn; US\$373m

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## Key Financials

As on 31 December	CY04	CY05	CY06P	CY07E	CY08E
Net profit (Rs m)	769	982	876	968	1,399
Shares in issue (m)	12.8	12.8	12.8	12.8	12.8
Adj. EPS (Rs)	60.0	76.6	68.3	75.5	109.2
% growth	8.8	27.6	(10.8)	10.5	44.6
PER (x)	20.9	16.4	18.4	16.6	11.5
Price/Book (x)	5.6	4.3	3.5	2.9	2.3
EV/EBITDA (x)	12.4	11.6	11.4	9.8	6.3
ROE (%)	29.8	29.7	21.0	18.9	22.2
ROCE (%)	35.6	28.6	22.2	21.3	25.4
EV/CE (x)	4.8	3.5	3.0	2.5	1.7

We attended the Gujarat gas analyst meet and came back convinced of GGCL's long term growth prospects in the natural gas space. However, CY07 operations could be hit due to changes in the gas sources. Contract with GSPC, ending in June 07, is unlikely to be renewed, while Cairn's supply is set to decline on account of ageing fields. While new supplies from PMT would more than compensate for the decline, there is a time lag of 3-4 months which would adversely impact volume growth as well as margins. This could impact stock performance in the near term. We have cut our CY07 EPS by 15.7% to Rs 75.5 to factor in the volume and margin impact. Maintain Buy with a revised 12-month target price of Rs1502/share.

## OTHER KEY TAKEAWAYS FROM THE MEET

**Demand growth continues to be robust:** GGCL is convinced of the long- term growth in the natural gas space across all verticals- CNG, CHP, Cogen and demand from industrial customers.

**CNG:** GGCL is eyeing the CNG business where margins are healthy and demand growth is predictable. Competitive pricing vis-à-vis competitive fuels is fuelling demand switch to natural gas. Incremental growth in CNG (besides the normal discretionary levels) will come from conversion of state transport buses where GGCL is working with state government agency- GSRTC. GSRTC's potential conversion is likely to be ~150 while another 250 local city bus would be converted to CNG over next one year. Even though the demand potential was not specified, high gas consumption by buses (average daily bus consumption of 65kgs) will mean a quantum jump in gas usage on a sustainable basis. During CY07, the company plans to open 8-10 CNG stations.

**Combined Heat and Power (CHP):** GGCL is eyeing the CHP segment where it provides industries with technical assistance to switch to cost-efficient captive power generation. From an installed base of 38MW in CY02, the total base has swelled to 189MW in CY06. With companies trying to save on energy costs, this market is expected to grow rapidly.

**Cogen business:** This SBU provides financial (if required), operational and maintenance support for developing power customer base. The potential target customer group is between 0.5-15mw; however, rising prices of natural gas could spook demand.

**Diversification into new geographies will keep long term growth momentum intact:** GGCL is investing aggressively in developing the industrial cities of Vapi, Jhagadia, Ankleshwar, etc for driving up gas volumes. That apart, the company has identified 12 new geographies that it will reveal once the regulator is in place. All this will keep the growth momentum in place.

**Supplies - short term tightness:** Natural gas supplies to GGCL will face a short- term supply crunch as the GSPC contract expires in June 2007 and supplies from Cairn gradually decline given the ageing fields. GSPC supplied 0.42mmscmd gas in CY06 while Cairn supplied 1.14 mmscmd. To compensate for supply contraction from Laxmi fields of Cairn, GGCL has entered into a contract with Cairn to supply gas from the Gauri fields and also Ambe field (expected from 2009). The supply crunch is expected to be a short term phenomenon as incremental PMT (Panna, Mukta and Tapti) gas supplies of 1.65 mmscmd are expected from September 2007, which will compensate for declining volumes from other sources. To tide over the interim supply crunch, GGCL may have to resort to high cost spot LNG, and cutting back on GGCL's low margin bulk volumes.

We believe this transition would have some impact on GGCL's volume growth as well as margins for CY07. We estimate retail margin impact of 11% from Rs2.7/scm to Rs2.4/scm for CY07, while weighted average margin is likely to drop to Rs1.95/scm. We also downgrade our YoY overall gas sales volume expectation from 15% to 8%, resulting in EPS cut by 15.7% to Rs 75.5 for CY07.

**British Gas setting up a JV for city gas distribution in southern states:** As regards British Gas setting up a JV in three southern states for city gas distribution, GGCL has clarified that it was just an enabling resolution that was signed with FIPB. British Gas is yet to decide whether GGCL would be a part of the new venture. We are not concerned on the same in the medium term even if GGCL is not part of the venture as it takes time to develop the gas market and British Gas will be better off catering to already well established GGCL.

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2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

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