

# Gujarat Gas

Rating: ◀▶

Target price: ▼

EPS: ▼

CMP

Rs. 439

Absolute

Reduce

Target

Rs. 385

Relative

Underperform

## Higher gas costs would continue to haunt spreads; Maintain Reduce-UPF

Gujarat Gas (GGAS) reported lower than expected results as gross spreads fell by 20% qoq to Rs. 4.7/scm from its peak of Rs. 5.9/scm in 2QCY11. Despite recent price hikes in Industrial segment (wef Sep), spreads plunged owing to sharp increase in material (gas) costs (3Q Rs.15/scm vs 2Q Rs.13.2/scm). This was due to rising proportion and prices of RLNG supplies coupled with surging USD. Average realisation grew by 3.4% qoq (25% yoy), due to the recent price hikes in Indl. Segment (wef from Sep'11). Volumes of 3.54mmcmd grew by 8% qoq after a lull of 3-4 quarters driven by Industrial segment. Overall PAT increased by 43% yoy but declined by 16% qoq to Rs. 802mn, as decline in spreads more than offset the positive impact of sequential volume growth.

Incorporating lower than expected 3QCY11 results and likely tepid 4QCY11, we have slightly lowered our volumes and spread estimates leading to 8%/2% drop in EPS estimates for CY11/CY12. In a scenario of tepid volume growth and rising input cost, operational performance is highly sensitive to price increases which is not going to be an easy task given the resistance shown by customers and state govt. **Maintain Reduce-UPF**

### Key takeaways from the post results management interaction

- **Volume growth:** Sequential volume growth of 8%, was led by growth in the Indl. segment, driven by pre-festival seasonality and new customer additions.
- **Cost pressures mount:** GGAS had to buy costly spot RLNG (at \$15-\$17/mmbtu) in 3QCY11 to meet qoq incremental sales of 0.22mmcmd and a shortfall of ~0.2mmcmd in the BG contracted LNG supplies (\$13-\$14) of 1.2mmcmd. Further sharp rally in USD escalated the gas purchase costs.
- **Spreads to further fall in 4QCY11:** The recent price hike in Industrial (wef Sep) would drive further 2%-3% increase in 4Q realisations. However, incessantly rising USD is likely to evade all the benefits of the last price hike. Mgmt. does not see rising USD pressure as a strong reason to justify another price hike at such a short interval. It prefers to adopt a wait and watch approach for the next couple of months, before considering any pricing decision
- **Authorisation:** GGAS expects authorisation of its existing network and outcome of its Bhavanagar bid to materialise soon

### 3QCY11 Update

Date: Nov 4, 2011

#### Market Data

SENSEX	17482
Nifty	5266
Bloomberg	GGAS IN
Shares o/s	128mn
Market Cap	Rs. 56bn
52-wk High-Low	Rs. 485-300
3m Avg. Daily Vol	Rs. 30mn
Index member	BSE 500

#### Latest shareholding (%)

Promoters	65.1
Institutions	23.5
Public	11.4

#### Stock performance (%)

	1m	3m	12m
GGAS	4%	7%	14%
Sensex	8%	-1%	-16%
BSEO&G	7%	3%	-19%

### Financial summary (Consolidated)

Year	Revenue (Rs. mn)	EBITDA (Rs. mn)	PAT (Rs. mn)	EPS (Rs.)	P/E(x)	EV/EBITDA
CY10	18,493	4,156	2,565	20.0	22.0	12.2
CY11E	24,277	4,748	3,178	24.8	17.7	10.5
CY12E	29,692	5,371	3,546	27.7	15.9	9.1

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## Quarterly Financial Results

<b>CMP</b>	Rs. 439	<b>Absolute</b>	Reduce
<b>Target</b>	Rs. 385	<b>Relative</b>	Underperform

Volumes & Realisation \ Period	30-Sep-11	30-Sep-10	yoy Growth	30-Jun-11	qoq Growth	CY10	CY11E	yoy Growth
Volumes (mmscm)	326	315	3.5%	302	7.9%	1,212	1,253	3.4%
Avg. Realisation (net) (Rs. /scm)	19.7	15.8	24.7%	19.1	3.4%	15.0	19.1	27.6%
Gross spread (Rs. /scm)	4.7	3.7	25.8%	5.9	-19.8%	4.3	4.9	12.7%
EBITDA (Rs. /scm)	3.6	2.9	26.1%	4.6	-22.2%	3.4	3.8	10.5%
Rs. mn\Period	30-Sep-11	30-Sep-10	yoy Growth	30-Jun-11	qoq Growth	CY10	CY11E	yoy Growth
<b>Revenues</b>	<b>6,533</b>	<b>5,071</b>	<b>28.8%</b>	<b>5,852</b>	<b>11.6%</b>	<b>18,493</b>	<b>24,277</b>	<b>31.3%</b>
Cost of Goods Sold	4,901	3,806	28.8%	3,995	22.7%	12,865	17,779	38.2%
<b>Gross Profit</b>	<b>1,632</b>	<b>1,265</b>	<b>29.1%</b>	<b>1,857</b>	<b>-12.1%</b>	<b>5,629</b>	<b>6,498</b>	<b>15.4%</b>
Employee Costs	139	130	7.4%	169	-17.6%	499	630	26.2%
Other expense	314	231	35.8%	284	10.5%	973	1,119	15.0%
Total operating expense	454	361	25.6%	453	0.0%	1,473	1,749	18.8%
<b>EBITDA</b>	<b>1,179</b>	<b>903</b>	<b>30.5%</b>	<b>1,403</b>	<b>-16.0%</b>	<b>4,156</b>	<b>4,748</b>	<b>14.3%</b>
<i>Margins</i>	18.0%	17.8%		24.0%		22.5%	19.6%	
Depreciation	153	138	11.3%	149	3.0%	542	605	11.6%
<b>EBIT</b>	<b>1,025</b>	<b>766</b>	<b>33.9%</b>	<b>1,255</b>	<b>-18.3%</b>	<b>3,614</b>	<b>4,143</b>	<b>14.6%</b>
Other income	112	50	124.7%	143	-21.6%	224	470	109.8%
Interest expense	0	0		0	5.9%	5	5	0.0%
<b>PBT</b>	<b>1,137</b>	<b>815</b>	<b>39.5%</b>	<b>1,397</b>	<b>-18.6%</b>	<b>3,833</b>	<b>4,609</b>	<b>20.2%</b>
Tax	328	250	31.2%	431	-23.9%	1,243	1,406	13.1%
Effective tax rate %	29%	31%		31%		32%	31%	
Minority & Pref Div.	7	5	63.7%	6	18.4%	25	25	0.0%
<b>PAT</b>	<b>802</b>	<b>561</b>	<b>43.0%</b>	<b>960</b>	<b>-16.5%</b>	<b>2,565</b>	<b>3,178</b>	<b>23.9%</b>
<i>Margins %</i>	12.3%	11.1%		16.4%		13.9%	13.1%	
<b>Adj. EPS (Rs.)</b>	<b>6.2</b>	<b>4.4</b>	<b>43.0%</b>	<b>7.5</b>	<b>-16.5%</b>	<b>20.0</b>	<b>24.8</b>	<b>23.9%</b>

# Gujarat Gas

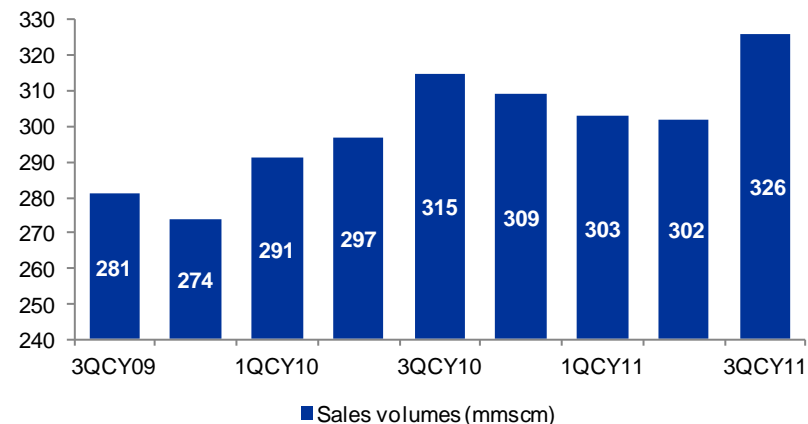
## Business Overview

<b>CMP</b>	Rs. 439	<b>Absolute</b>	Reduce
<b>Target</b>	Rs. 385	<b>Relative</b>	Underperform

	CY11E			CY12E		
	Old	New	Change	Old	New	Change
Volumes (mmscm)	1,281	1,253	-2%	1,390	1,372	-1%
Realisation (Rs. /scm)	19.5	19.09	-2%	21.1	21.4	1%
Gross spread (Rs. /scm)	5.2	4.9	-5%	5.2	5.1	-1%
Revenues (Rs. mn)	25,280	24,277	-4%	29,697	29,692	0%
EBITDA (Rs. mn)	5,249	4,748	-10%	5,566	5,371	-4%
PAT (Rs. mn)	3,448	3,178	-8%	3,608	3,546	-2%
EPS (Rs.)	26.88	24.78	-8%	28.1	27.7	-2%

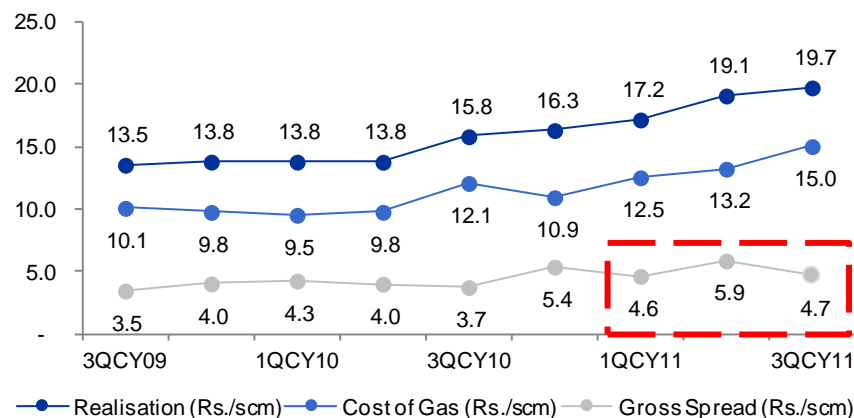
All figures in Rs. mn, except EPS, which is in Rs.

### Volumes grow 8% qoq and 3% yoy after 3 qtrs. of decline



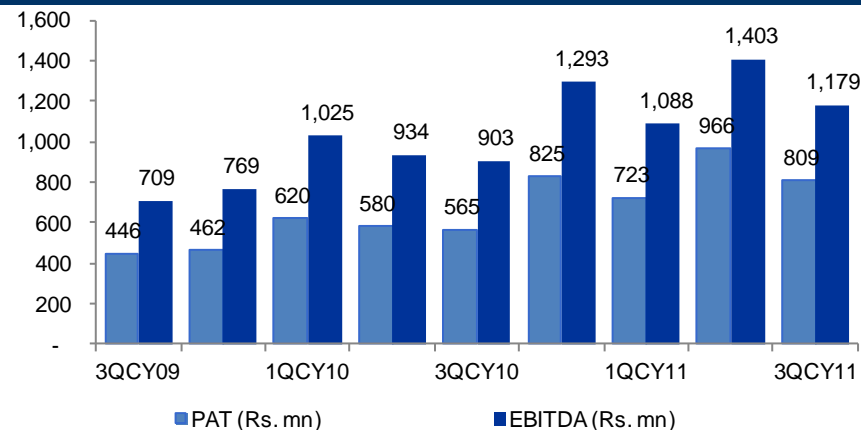
Source: Company, Spark Capital Research

### Gross spread decline on material cost jump



Source: Company, Spark Capital Research

### EBITDA & PAT decline on lower spreads despite volume growth



Source: Company, Spark Capital Research

DCF Valuation Estimates	CY11E	CY12E	CY13E	CY14E	CY15E	CY16E	CY17E	CY18E	CY19E	CY20E	CY21E
Volume (mmscmd)	3.4	3.8	4.1	4.4	4.6	4.9	5.1	5.3	5.5	5.8	6.0
Avg realisation (Rs. / scm)	19.1	21.4	22.3	23.4	23.4	23.4	23.4	23.4	23.4	23.4	23.4
Gross Spread (Rs. /scm)	4.9	5.1	5.2	5.4	5.0	5.0	5.0	5.0	5.0	5.0	5.0
EBITDA (Rs. /scm)	<b>3.8</b>	<b>3.9</b>	<b>3.9</b>	<b>3.9</b>	<b>3.4</b>	<b>3.5</b>	<b>3.5</b>	<b>3.5</b>	<b>3.5</b>	<b>3.5</b>	<b>3.5</b>
<b>NOPAT (Rs. mn)</b>	<b>2,776</b>	<b>3,131</b>	<b>3,355</b>	<b>3,623</b>	<b>3,203</b>	<b>3,590</b>	<b>3,722</b>	<b>3,860</b>	<b>4,005</b>	<b>4,157</b>	<b>4,317</b>
Depreciation (Rs. mn)	605	698	782	866	936	992	1,048	1,104	1,160	1,216	1,273
Capex +WC Chgs (Rs. mn)	1,912	1,918	1,936	1,444	964	964	975	973	972	971	970
FCFF (Rs. mn)	1,469	1,911	2,201	3,045	3,175	3,619	3,795	3,990	4,193	4,402	4,619
PV of CF as on Mar' 12 (Rs. mn)	0	1,776	1,856	2,328	2,202	2,276	2,165	2,065	1,968	1,874	1,784

Key DCF Estimates	Mar-12
WACC (%)	10.25%
Terminal Growth Rate (%)	3%
PV of Terminal Value (Rs. Mn)	25,342
<b>Total firm Value (Rs. Mn)</b>	<b>45,636</b>
Net debt / (cash) (Rs. Mn)	(6,622)
Pref. Sh. +Minority (Rs. Mn)	220
Other liabilities (Rs. Mn)	2,723
<b>Equity Value (Rs. Mn)</b>	<b>49,316</b>
Shares O/s (Nos. mn)	128
<b>Target Price (Rs. /Share)</b>	<b>385</b>

Terminal Growth	WACC					
		8%	9%	10%	11%	12%
	2.0%	474	409	359	320	289
	2.5%	499	425	371	329	296
	3.0%	529	445	<b>385</b>	339	303
	3.5%	565	468	400	350	311
	4.0%	610	496	418	362	320

	Current Trading Multiples			Implied target multiple		
	CY10	CY11E	CY12E	CY10	CY11E	CY12E
EPS (Rs.)	20.0	24.8	27.7	20.0	24.8	27.7
P/E (x)	22.0x	17.7x	15.9x	19.2x	15.5x	13.9x
P/B (x)	6.7x	5.7x	5.0x	5.8x	5.0x	4.4x
EV/EBITDA (x)	12.2x	10.7x	9.4x	10.5x	9.2x	8.1x

# Gujarat Gas

## Financial Summary

<b>CMP</b>	<b>Rs. 439</b>	<b>Absolute</b>	<b>Reduce</b>
<b>Target</b>	<b>Rs. 385</b>	<b>Relative</b>	<b>Underperform</b>

Abridged Financial Statements				
Rs. mn	CY09	CY10	CY11E	CY12E
<b>Profit &amp; Loss</b>				
Revenues	14,197	18,493	24,277	29,692
EBITDA	2,795	4,156	4,748	5,371
Depreciation	474	542	605	698
EBIT	2,321	3,614	4,143	4,673
Other Income/Exp	266	224	470	470
Interest	1	5	5	5
PBT	2,586	3,833	4,609	5,139
Net Profit	1,750	2,590	3,203	3,571
Adjusted Net Profit	1,729	2,565	3,178	3,546
<b>Balance Sheet</b>				
Shareholders Equity	7,653	8,447	9,830	11,282
Total debt	-	-	-	-
Total Networth & Liabilities	9,963	11,397	13,441	15,513
Net fixed assets	5,809	6,359	7,254	8,056
CWIP	1,356	1,298	1,798	2,298
Investments	4,238	5,488	5,488	5,488
Current assets	1,793	1,960	3,596	5,006
Current liabilities	3,476	4,051	5,038	5,677
Net current assets	(1,683)	(2,091)	(1,441)	(671)
Total Assets	9,963	11,397	13,441	15,513
<b>Cash Flows</b>				
Cash flows from Operations	1,782	2,874	3,734	3,886
Cash flows from Investing	(1,966)	(2,164)	(1,530)	(1,530)
Cash flows from Financing	39	(695)	(1,163)	(1,504)
Cash Generated	(146)	14	1,041	852
Opening Cash	225	79	94	1,135
Closing Cash	79	94	1,135	1,987

Key metrics				
	CY09	CY10	CY11E	CY12E
<b>Growth ratios (%)</b>				
Sales	9.1%	30.3%	31.3%	22.3%
EBITDA	18.8%	48.7%	14.3%	13.1%
Adj. Net Profit	8.5%	48.3%	23.9%	11.6%
<b>Margin ratios (%)</b>				
EBITDA	19.7%	22.5%	19.6%	18.1%
EBIT	16.4%	19.5%	17.1%	15.7%
Adj. Net Profit	12.2%	13.9%	13.1%	11.9%
<b>Performance ratios</b>				
RoIC (%)	29%	43%	46%	44%
RoE (%)	23%	32%	35%	34%
RoCE (%)	24%	32%	35%	34%
Sales / Total Assets (x)	1.5	1.7	2.0	2.1
Fixed Assets Turnover (x)	2.1	2.5	2.9	3.1
<b>Financial stability ratios</b>				
Total Debt to Equity (x)	-	-	-	-
Inventory & Debtor days	35.5	33.7	32.2	32.2
Creditor days	56.6	43.1	43.1	43.1
<b>Valuation metrics</b>				
Current Share Price (Rs.)	439			
Market Cap (Rs.mn)	56,302	56,302	56,302	56,302
Fully Diluted Shares (mn)	128.3	128.3	128.3	128.3
Adjusted EPS (Rs.)	13.5	20.0	24.8	27.7
P/E (x)	32.6	22.0	17.7	15.9
P/B (x)	7.4	6.7	5.7	5.0
EV (Rs.mn)	51,985	50,720	49,679	48,827
EV/ EBITDA (x)	18.6	12.2	10.5	9.1
Dividend Yield (%)	1.8%	2.7%	3.2%	3.2%

<b>CMP</b>	<b>Rs. 439</b>	<b>Absolute</b>	<b>Reduce</b>
<b>Target</b>	<b>Rs. 385</b>	<b>Relative</b>	<b>Underperform</b>

## Absolute Rating Interpretation

<b>BUY</b>	<b>Stock expected to provide positive returns of &gt; 15% over a 1-year horizon</b>
<b>ADD</b>	<b>Stock expected to provide positive returns of &lt;=15% over a 1-year horizon</b>
<b>REDUCE</b>	<b>Stock expected to fall &lt;=15% over a 1-year horizon</b>
<b>SELL</b>	<b>Stock expected to fall &gt;15% over a 1-year horizon</b>

## Relative Rating Interpretation

<b>OUTPERFORM</b>	<b>Stock expected to outperform sector index /sector peers in our coverage</b>
<b>UNDERPERFORM</b>	<b>Stock expected to underperform sector index/ sector peers in our coverage</b>

## Recommendation History

Date	CMP	Target price	Absolute Rating	Relative Rating
12-Oct-11	421	402	Reduce	UPF
28-Aug-11	440	402	Reduce	UPF
12-Aug-11	406	390	Reduce	UPF
12-July-11	404	358	Reduce	UPF

### Analyst Certification

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