

Gujarat Gas

ADD

Concerns overplayed; upgrade to Add

CMP: Rs370

Target Price: Rs372

- Rupee depreciation impact temporary; price increase to offset loss of profitability
- BG exit to not impact gas supply as 64% of volume tied up beyond 2018
- Lower CY11E volume by 5% on high winter LNG prices; increase margin estimate for CY12 and CY13 by 4% and 5% respectively

Rupee depreciation impact temporary: Gujarat Gas' (GGAS) gross margin will be impacted temporarily by rupee depreciation as the company does not hedge its gas purchases and only 22% of volume has exchange rate pass through clause. The impact on margin is likely to be temporary as management believes a price increase will likely be taken in the near future to compensate for rupee depreciation. Company strategy would be to maintain overall profitability and allow volume reduction as the marginal molecule in supply mix is high cost spot LNG.

No meaningful impact on supply mix from possible BG exit: We see minimal impact on GGAS' long term gas supply portfolio from BG's possible exit. This is because 64% of current volume is tied up beyond 2018 and it would be reasonable to assume the new management would have expertise and some kind of access to R-LNG.

Supply mix and tenure of contract

Supply source	Current volume (mmscmd)	Contract tenure
PMT	1.6	2018
APM	0.1	2020
Cairn	0.4	2020
Niko	0.16	2020
R-LNG	1.1	0.9mmscmd till December 2011, 0.2mmscmd till October 2013
Total	3.4	

Source: Company, BRICS Research

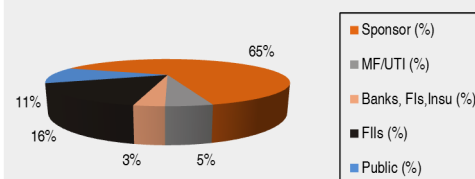
- Corporate development
- Earnings estimate change
- Target price change
- Rating change

KEY DATA

Bloomberg	GGAS IN
Reuters	GGAS.BO
52-wk H/L (Rs)	485.0/300.5
6-m avg trd value	US\$0.6mn
Market cap	Rs48.1bn/US\$0.9bn
Shares o/s	128.3mn
Face value	Rs2

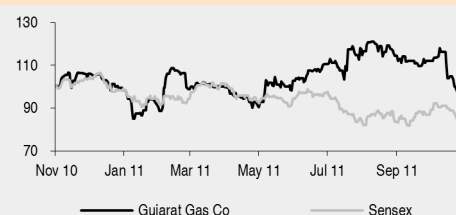
Source: Bloomberg

SHAREHOLDING (%)



Source: Ace Equity

PRICE PERFORMANCE



Source: Bloomberg

KEY FINANCIALS	(Rs mn)			
Y/E 31 Dec	2010	2011E	2012E	2013E
Revenue	18,493	21,528	25,921	28,138
EBITDA	4,156	4,862	5,375	5,330
EBITDA margin (%)	22.5	22.6	20.7	18.9
PAT	2,590	3,191	3,535	3,528
FDEPS (Rs)	20.1	24.9	27.6	27.5
% growth	48.0	23.8	10.8	(0.2)
P/E (x)	18.7	15.1	13.6	13.6
RoCE avg (%)	31.7	31.6	29.7	25.1

Source: Company, BRICS Research

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Reduce CY11E earnings by 5% on lower volume; increase CY12E, CY13E earnings by 4%, 5% on higher gross margin: We reduce CY11 EPS estimate downwards by 5% to Rs24.9 to factor in 5% reduction in our annual volume estimate to 3.4mmscmd. Q4CY11 volume is likely to be slightly lower qoq (3.54mmscmd in Q3CY11) due to post Diwali lull (no take or pay with some customers) and high R-LNG prices. We increase our gross margin estimate for CY12 and CY13 by Rs0.2/scm to Rs4.7/scm and Rs4.5/scm respectively, in line with the company's strategy of preserving these levels of gross margin, by price increases if necessary. This increases CY12E and CY13E EPS by 5% and 7% respectively. We are maintaining our CY12E volume estimate at 4mmscmd as we expect demand revival with likely moderation in R-LNG prices after winter.

Exhibit 1: Volume, gross margin assumptions

Particulars	CY11			CY12			CY13		
	New	Old	Change (%)	New	Old	Change (%)	New	Old	Change (%)
Volume (mmscmd)	3.4	3.6	-5%	4.0	4.0	0%	4.2	4.2	0%
Gross margin (Rs/scm)	4.9	4.9	0%	4.7	4.5	4%	4.5	4.3	5%
EPS (Rs)	24.9	26.2	-5%	27.6	26.2	5%	27.5	25.7	7%

Source: BRICS Research

Revise target price upwards by 1.6% to Rs372/share; upgrade to Add

Our DCF-based target price increases 1.6% to Rs372/share, implying upside of 0.5% to current market price. Current valuation at 13.3x CY12E and 13.4x CY13E is at a discount to IGL, which gives us comfort as IGL valuation could be a benchmark for transaction involving BG exit. We see little impact on fundamentals of Gujarat Gas from recent developments. Upgrade to Add as the stock has moved below our 12-month target price (TP).

Exhibit 2: Sensitivity of TP to cost of capital, terminal growth rate (Rs)

	Cost of capital			
	10.0%	12.5%	15.0%	
Terminal growth rate	2%	390	367	353
	3%	400	372	355
	4%	413	378	359

Source: BRICS Research

Exhibit 3: Sensitivity of TP to change in volume, gross margin assumption (Rs)

	Change in volume assumption (%)			
	-10%	0%	10%	
Change in gross margin assumption (Rs/scm)	(1.00)	286	286	285
	-	357	372	388
	1.00	427	457	490

Source: BRICS Research

Exhibit 4: Peer valuation**(Rs mn)**

Company	Net sales		EBITDA		Net profit		EPS (Rs)		P/E (x)	
	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Gujarat Gas*	25,921	28,138	5,375	5,330	3,535	3,528	27.6	27.5	13.3	13.4
Petronet LNG	222,205	348,672	16,941	19,813	9,154	10,255	12.2	13.7	12.7	11.4
Indraprastha Gas	21,884	24,487	6,846	7,514	3,555	3,693	25.4	26.4	15.4	14.8
GAIL India	456,813	501,423	64,859	71,305	39,219	48,028	30.9	37.9	12.1	9.8
Gujarat State Petronet	12,197	14,067	11,345	13,165	5,467	6,811	9.7	12.1	9.0	7.3

Source: Bloomberg, BRICS Research

*Calendar year

Financial summary

Income statement					Balance sheet				
(Rs mn)					(Rs mn)				
Y/E 31 Dec	2010	2011E	2012E	2013E	Y/E 31 Dec	2010	2011E	2012E	2013E
Revenue	18,493	21,528	25,921	28,138	Net fixed assets	7,657	7,844	8,252	8,768
Revenue growth (%)	30.3	16.4	20.4	8.6	Investments	5,488	5,321	5,321	5,321
Operating exp	14,337	16,666	20,546	22,809	Current assets	1,960	2,256	5,825	7,781
EBITDA	4,156	4,862	5,375	5,330	Inventories	189	260	313	340
EBITDA margin (%)	22.5	22.6	20.7	18.9	Sundry debtors	1,484	1,636	1,970	2,138
Depreciation	542	608	669	734	Cash & bank balance	94	190	3,372	5,133
EBIT	3,614	4,254	4,706	4,596	Loans & advances	193	170	170	170
MTM profit / (loss)	—	—	—	—	Other current assets	—	—	—	—
Other income	224	580	650	750	Total assets	15,448	15,762	19,397	21,869
Interest paid	5	—	—	—	Net worth	8,591	10,288	12,563	14,881
PBT	3,833	4,834	5,356	5,346	Share capital	257	257	257	257
Tax	(1,243)	(1,644)	(1,821)	(1,817)	Reserves & surplus	8,335	10,031	12,306	14,625
PAT	2,590	3,191	3,535	3,528	Minority interest	63	68	68	68
Minority interest	13	—	—	—	Total debt	—	—	—	—
EO income	—	—	—	—	Secured loans	—	—	—	—
APAT	2,577	3,191	3,535	3,528	Unsecured loans	—	—	—	—
PAT growth (%)	47.9	23.2	10.8	(0.2)	Current liabilities & prov	4,051	2,292	3,571	3,773
Shares o/s (mn)	128	128	128	128	Current liabilities	2,141	1,961	2,361	2,563
Fully diluted o/s shrs (mn)	128	128	128	128	Provisions	1,909	331	1,209	1,209
FDEPS (Rs) recurring	20.1	24.9	27.6	27.5	Net deferred tax liab	669	687	687	687
					Total liabilities	15,448	15,762	19,397	22,078
Cash flow statement					Key ratios				
(Rs mn)									
Y/E 31 Dec	2010	2011E	2012E	2013E	Y/E 31 Dec	2010	2011E	2012E	2013E
PBT	3,833	4,834	5,356	5,346	Valuation ratios				
Depreciation	542	608	669	734	PE (x)	18.7	15.1	13.6	13.6
Amortisation	—	—	—	—	CEPS (Rs)	23.9	29.6	32.8	33.2
Interest paid	5	—	—	—	PCE (x)	15.7	12.7	11.4	11.3
Tax paid	(1,176)	(1,644)	(1,821)	(1,817)	BVPS (Rs)	67	80	98	116
Chg in working capital	422	(1,959)	892	7	Price/Book (x)	5.6	4.7	3.8	3.2
Int/div in other income	—	—	—	—	EV/EBITDA (x)	11.3	9.7	8.1	7.9
Other operations	110	18	—	—	EV/Revenue (x)	2.5	2.2	1.7	1.5
CF from operations (a)	3,668	1,858	5,096	4,269	Dividend yield (%)	3.2	2.1	2.1	2.1
Capital expenditure	(994)	(766)	(1,076)	(1,250)	Cash flow yield (%)	2.9	2.6	8.4	6.3
Chg in investments	(1,250)	167	—	—	Performance ratios				
Other investing act	(41)	(29)	—	—	Raw material to sales (%)	69.6	70.1	72.7	74.5
Int/div in other income	—	—	—	—	SGA to sales (%)	2.6	2.4	2.1	2.0
CF from investments (b)	(2,285)	(629)	(1,076)	(1,250)	Effective tax rate (%)	(32.4)	(34.0)	(34.0)	(34.0)
Free cash flow (a+b)	1,384	1,229	4,020	3,019	PAT margin (%)	14.0	14.8	13.6	12.5
Equity raised/(repaid)	—	—	—	—	DPS (Rs)	12.0	8.0	8.0	8.0
Debt raised/(repaid)	—	—	—	—	Dividend payout ratio (%)	60	32	29	29
Interest paid	(5)	—	—	—	Return ratios				
Dividend (incl tax)	(1,802)	(1,209)	(1,209)	(1,209)	RoE avg (%)	31.5	33.8	30.9	25.7
Other fin activities	437	77	371	160	RoCE avg (%)	31.7	31.6	29.7	25.1
CF from financing (c)	(1,369)	(1,133)	(838)	(1,049)	Fixed asset turnover (x)	—	—	—	—
Net chg in cash (a+b+c)	14	96	3,182	1,970	Working capital ratios				
Opening balance	79	94	190	3,372	Inventory (days)	4	4	4	6
Closing balance	94	190	3,372	5,342	Payable (days)	61	47	46	37
					Receivable (days)	29	28	28	28
					Working capital (days)	(28)	(15)	(14)	(4)
					Leverage ratios				
					Interest cost (%)	—	—	—	—
					Net debt/equity (x)	—	—	(0.3)	(0.3)
					Interest coverage (x)	782.3	—	—	—

BRICS RECOMMENDATION SCALE

BUY:	More than 15% upside
ADD:	Upside up to 15% (between 0% and 15%)
REDUCE:	Downside up to 15% (between 0% and -15%)
SELL:	More than 15% downside

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