GUJARAT GAS COMPANY LTD. (GGCL) - "BUY"

3RD FEBRUARY, 2010

STOCK DETAILS

BSE Code	523477
CMP –	Rs. 240.95/-
Market Capitalisation (Rs. in mn)	Rs. 30,901 mn
Face Value (Rs.)	2/-
Book Value (Rs.)	53
52 Wk High (BSE)	Rs. 264/- (19th Jan, 2010)
52 Wk Low (BSE)	Rs. 104/- (24th Feb, 2009)

COMPANY PROFILE:

Gujarat Gas was incorporated in 1980 with the primary objective to procure, distribute and utilize natural gas and allied technology. In 1989, the company began its operations in the industrial hotspots of Ankleshwar and Bharuch in South Gujarat. In the year 1991, GGCL expanded its operations to Surat. Its CNG operations started in 1992. The 1st CNG station of India was setup in Gujarat.

It is India's largest private sector player in the natural gas transmission and distribution business.

It supplies gas to more than 2,65,000 domestic, commercial and industrial customers and serves over 100,000 Compressed Natural Gas (CNG) users. GGCL's pipeline network is spread over 3,000 kms.

ABOUT THE BUSINESS:

Transmission and Distribution of Natural Gas: In 1988, it pioneered the private distribution of Natural Gas in India, through the establishment of an independent network of pipelines in South Gujarat.

GGCL is sourcing gas from multiple suppliers. Some of the major suppliers include GAIL – GSPC – Gujarat State owned organisation, BG EPIL (from its PMT source – a JV of ONGC, Reliance and BG group), Cairn Energy.

Distribution operation is grouped into 2 lines of business:

1) **Piped Natural Gas (PNG):** PNG for residential, commercial and industrial customers for heating and other purpose
2) **CNG –** Compressed Natural Gas (as fuel for vehicles)

Gas is supplied to various categories of customers for multi – purpose usage such as:

1) **Residential** – for cooking and water heating
2) **Commercial** – for cooking, water heating, Jet dying, Yarn heating etc.
3) **Industrial**: customer for heating, boilers etc.
4) **CNG**: For running vehicles

Growth drivers:

Gujarat's state gas demand to double by 2012:

Gujarat's consumption of gas is expected to more than double in the next 3 years. Increasing base of domestic customers and expansion of industries will be the major drivers of demand for gas in the state. "The demand for gas in Gujarat will increase sharply due to demand from customers. It is expected to increase to more than 100 mmscmd by 2012. Currently, Gujarat consumes 35 - 40% of the gas available in India"

Ability to improve its margins: Gujarat Gas has been able to improve its Gross Gas spread (selling price – gas cost) on the back of shift in volume mix, aided by exchange rate. Gross Gas spread is likely to further improve on account of Gujarat gas providing gas to high margin industrial retail customers. Its ability to manage its margins is on account from the price hikes done in the various segments. In February and May 2009, the company had raised prices for the industrial units and PNG customers

Well placed against its peers: GGCL with its strong business model is well placed against its peer Indraprastha Gas Ltd. on the regulatory front, due to lower risks of potential margin erosion and pressure on account of competitive forces. It has also applied for Regulatory approval to operate in Kutch and Bhavnagar.

Industry overview:

The demand for natural gas continues to sustain and grow in India. However, availability of natural gas from local sources continues to fall significantly short of demand while RLNG (regasified liquefied natural gas) from the two LNG import terminals is not adequate to meet the shortfall.

The current demand is predominantly from the priority sectors of fertilizer and power, while the demand from the city gas distribution and petrochemicals sectors is comparatively lower. However in the long-term natural gas is expected to constitute 23% of the primary energy basket by the year 2020, up from its current share of 8%.

The projected production of crude oil during the 11th Five-Year Plan (2007-2012) is 206.76 MMT, while that of natural gas is 255.27 BCM.

Production of gas from Reliance Industries' eastern offshore KG D-6 fields, with a life of 11 years, started on April 1, 2009 and will increase to 80 million standard cubic metres per day (MSCMD) by the end of the year. Production will help save US$ 9 billion in oil import.

Consumption

India's domestic demand for oil and gas is on the rise. As per the Ministry of Petroleum, demand for oil and gas is likely to increase from 186.54 million tonnes of oil equivalent (mmtoe) in 2009-10 to 233.58 mmtoe in 2011-12.

Global Refining Hub

India is emerging as the global hub for oil refining with capital costs lower by 25 to 50 % over other Asian countries. Already, the 5th largest country in the world in terms of refining capacity, with a share of 3 % of the global capacity, India is likely to boost its refining capacity by 45 % or 65.3 mtpa (million tonne per annum) over the next 5 years, according to a Deutsche Bank report. Indian companies plan to increase their refining capacity to 242 mtpa by 2011-12 from about149 mtpa in 2007.

Risk and Concerns:

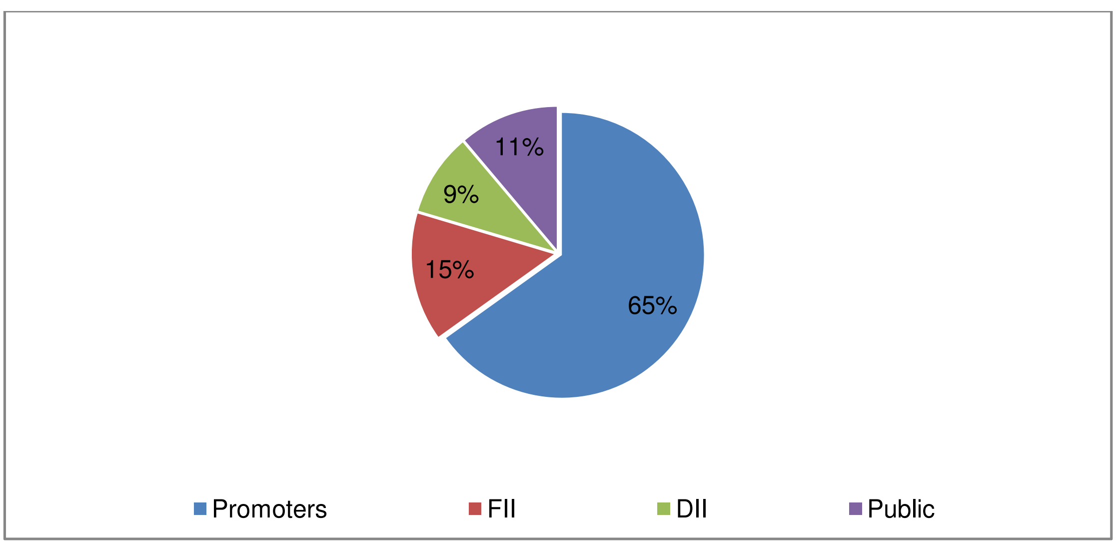
1) Depreciation of Indian Rupee & strengthening of US $ would be negative for the company since GGCL buys most of its gas at dollar denominated rates and hence the weakening of the rupee will push up the Company's gas cost
2) The growth of the Company, as of the entire industry, depends on the availability of additional gas.
3) Lower than expected allocation from KG D6 gas
4) Highly Competitive Oil & Gas Market
5) Government's interference in the oil and gas industry.

Financial highlights:

Particulars (Rs. In millions)	CY 08	CY 09E	CY 10E
Sales	13,012	14,208	18,044
EBITDA	2,367	2,682	3,456
EBITDA Margin	18%	19%	19%
Net Profit	1606	1,778	2,311
PAT Margin	12%	12%	12.5%
No. of Equity Shares (mn)	66	128	128
Diluted EPS (Rs.)	25	14	18
P/E (x)	9.6x	17x	13x

Note: CY – Calendar Year

Shareholding pattern as on December 2009



FINANCIALS - Income Statement – (Rs. in millions)

Particulars (Rs. in mn)	CY08	CY 09E	CY 10E
Net Sales	12,739	14,011	17,794
Other Operating Income	273	197	250
Total Income	**13,012**	**14,208**	**18,044**
Expenditure			
Material consumed/processed	9337	10263	13248
Personnel Expenses	412	418	440
Operating and Other Expenses	896	845	900
	10645	**11526**	**14588**
EBIDTA	**2,367**	**2,682**	**3,456**
Depreciation	418	450	455
EBIT	**1,949**	**2,232**	**3,001**
Less: Interest	1	1	2
Add: Other Income	412	350	375
Less: Deferred' Revenue Expenditure Written off	15	0	0
PBT	**2,345**	**2,581**	**3,374**
Tax	730	803	1063
PAT	**1,615**	**1,778**	**2,311**
Minority Shareholders Interest	9	0	0
PAT after Minority interest	**1,606**	**1,778**	**2,311**
No. of Equity Shares	66	128	128
EPS	**25**	**14**	**18**

Balance Sheet – (Rs. in millions)

Particulars	CY 08	CY 09E	CY 10E
LIABILITIES			
Equity Share Capital	131	256.5	256.5
Preference Share Capital	144	144	144
Reserves and Surplus	6,971	8,364	10,332
Minority Interest	44	44	44
Deferred Tax Liability (Net)	498	498	498
Deposits	1,273	1,396	1,498
Total	**9,061**	**10,702**	**12,772**
ASSETS			
Net Block	4,818	5,668	6,257
CWIP	1,344	1,600	1,850
Investments	3,545	3,600	3,700
Amt. recoverable from ESOP	10	-	**-**
Current Assets	2,032	2,834	4,165
Current Liabilities	2,692	3,000	3,200
Net Current Assets	**(660)**	(164)	**965**
Misc. Exp	**4**	-	**-**
Total	**9,061**	**10,702**	**12,772**

Cash Flow Statement – (Rs. in millions)

Particulars	CY 08	CY 09E	CY 10E
Net Profit before Tax	2345	2581	3374
Operating Cash Flow before Working Capital Changes	2559	2777	3831
Net Cash Flow from Operating Activities (A)	2059	1734	2192
Net Cash Flow from Investing Activities (B)	(1,924)	(1,345)	(1,394)
Net Cash Flow from Financing Activities (C)	(86)	(144)	(242)
Increase/(Decrease) in cash & cash equivalents during the year	49	245	556
Cash and Cash Equivalents at the beginning of the year	176	225	470
Cash and Cash Equivalents at the end of the year	225	470	1,026

Investment rationale:

1) **Availability of Gas to improve volumes:** Volume growth is expected on account of higher sourcing of RNLG due to availability at reasonable prices and 0.50 mmscmd of RIL's KG – D6 gas expected to flow from 2QCY 2010 E.

2) **Improving Volume Mix to drive growth:** An improving volumes mix and appreciating rupee will also propel company's growth as it will improve its Gross Gas Spread. Gujarat Gas has shifted to high margin retail business from low margin bulk volumes.

3) **Capex plans to drive growth:** In CY 2009, the company incurred capex of ~ Rs. 1,400 mn towards pipeline up gradation and expansion, setting up CNG stations. Going ahead, the company plans to spend ~Rs. 1,400 – Rs. 1,500 mn each in CY 2010 and CY 2011. As the company has increased the pipeline length from 3,000 – 3,300 km, the company has enough capacity to increase its current volume off – take of ~ 3 mmscmd.

4) **Sourcing Gas from Multiple Suppliers:** GGCL is sourcing gas from multiple suppliers. Some of the major suppliers include GAIL - A Central Government Organization, GSPC – Gujarat State owned organization, BG EPIL (from its PMT source - a JV organization of ONGC, Reliance and BG Group), Cairn Energy... The gas is received at various receiving stations of GGCL. The same is subjected to the process of filtration, addition of odorant as well as change of pressure before being supplied into the network for distribution.

5) **Strong fundamentals:** It is a virtually debt free company, enjoys positive cashflow at the operating level. It has been generating RoE in the range of 20 – 22% (in line with the regulated returns).

6) **Proposed deregulation of Petrol prices as per Kirit Parikh report to drive CNG growth:** Proposed deregulation of Petrol prices would lead to hike in prices of petrol resulting into high fuel cost. This will induce vehicle owners to switch to cheaper alternative i.e Compressed Natural Gas (CNG). Proposed hike in prices of LPG would compel retail households to opt for Piped Natural Gas. Gujarat having one of the best City Gas Distribution in the country would prove to be boon for the company. Currently Piped Natural Gas is available at Rs. 12.52 per kg whereas LPG is available at Rs. 22.04 per kg. Post proposed hike, LPG would be available at Rs. 29.08 per kg resulting into parity from Rs.10 to Rs.17/- per kg.

Valuation

At the CMP of Rs. 240/- the stock trades at a P/E of 17x its CY 09E earnings, 13 x CY 10E earnings. With due consideration to better margins, improved gas supplies, lower regulatory risks, proposed hike in traditional auto fuel and LPG cylinder prices, we recommend a **"Buy"** at the current market price with a price target of Rs. 285/- (PE of 15.8x CY 10E EPS) on 6 months horizon.

Disclaimer: