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DEALMONEY MONTHLY MAG

August 2018

- ✓ Sector of the month
- ✓ Picks of the month

Sector of the Month (GAS Distribution):

India remained as the third largest energy consumer in 2017. India had 1.2 trillion cubic meters of proven gas reserves at the end of 2017 and produced 31.83 bcm of gas in FY 18 which is expected to rise and reach 36 bcm ^ by 2021.

The country is undergoing a rapid transformation, with official data suggesting GDP growth around 7 percent per annum.2Forecasts predict India's urban population will expand from the current level of about 400 million to more than 600 million by 2030.3Given the anticipated growth of urban as well as rural populations, manufacturing output, and the overall size of the economy, it is evident that India's energy use patterns will change dramatically in the years to come. It is estimated that more than half of the commercial infrastructure India will need in 2030 has yet to be built. Energy demand is expected to triple over the same period.

The primary energy mix of India is also set to alter on account of the substitution of oil by natural gas. The share of natural gas in the energy mix is expected to increase to 20% in 2025 and beyond as compared to 11% in 2010. Based on the plans for expansion in natural gas supply in the country with the help of additional RLNG terminals, nationwide transmission pipeline network and transnational pipelines expected to materialize in next 5 to 10 years, it is envisaged that the share of natural gas in the primary energy mix would reach 20% till 2030. However to achieve a 20% share of natural gas in the primary energy it is required to attract and sustain investments in the gas infrastructure including the cross country pipelines.

Primary energy mix for India

Source	2010	2025
Coal	53%	50%
Oil	30%	25%
Gas	11%	20%
Hydro	5%	2%
Nuclear	1%	3%
	100%	**100%**

Historically, natural gas was significantly cheaper than alternate fuels like motor spirit, naphtha, diesel and LSHS/FO. Although the price of natural gas is steadily increasing (especially of imported gas), newer technology and larger plants have now made it possible to ensure efficiency and economies of scale enabling increase in usage of natural gas. Therefore natural gas has now become the preferred fuel for fertilizers, petrochemicals and has made inroads into power generation segment. Further, planned investments in the power, fertilizer, petrochemical and other areas including City Gas Distribution suggest a sustained increase in the level of natural gas consumption in the country.

Source: Dealmoney research, pngrp.gov.in

Increasing Demand for Gas

Natural Gas demand has increased significantly in recent years due to the increase in the availability of gas, development of transmission and distribution infrastructure, the savings from the usage of natural gas in place of alternate fuels and the overall favourable economics of supplying gas at reasonable prices to end consumers. It has become easier for the power, fertilizer and CGD sectors, as well as industrial and commercial establishments, to switch over to natural gas for their energy requirements. In the near future power and fertilizer sectors are expected to remain the anchor segments for natural gas demand in India. Going forward though, with the additional supply of gas significant demand for natural gas is also expected to come from the industrial (usage both in process and power generation - cogeneration) and CGD segments.

The total consumption of natural gas was 127 mmscmd (January 2013) with power and fertilizer sectors consuming 36 and 39 mmscmd of gas respectively. While power sector consumption accounted for 28% of the total natural gas consumption in India, the fertilizer sector consumption accounted for 31% of the total consumption.

Sector wise natural gas consumption in India (January 2013)

Sector	Domestic Gas	RLNG	Total Consumption	% of total supply
Power	30.36	5.8	36.2	28%
Fertilizers	31.02	8.37	39.4	31%
CGD/CNG	6.69	7.28	14	11%
Court Mandated Customers	0.98	2.89	3.9	3%
Shrinkage for liquid extraction - LPG etc.	6.02	0.37	6.4	5%
Refineries	2.07	8.62	10.7	8%
Petrochemicals	3.5	1.37	4.9	4%
Sponge Iron/Steel	1.11	3.49	4.6	4%
Small consumers <50,000 scmd)	2.38	0.01	2.4	2%
Other users	0.75	3.29	4	3%
Internal Consumption in pipelines	1.45	0	1.5	1%
Total	**86.33**	**41.49**	**127.8**	**100.00%**

Source: Dealmoney research, pngrp.gov.in

India can be divided into six major regional natural gas markets namely Northern, Western, Central, Southern, Eastern and North-Eastern market. Out of these, the Western market accounts for the highest consumption of natural gas with more than 50% of the total gas consumption in the country. This is followed by the Northern market that consumes ~25% of the overall consumption. The Eastern market accounts for the lowest consumption in the country among all the gas markets.

Regional gas markets in India

Region	% of consumption	States with infrastructure and consuming gas	States lacking pipeline infrastructure
Western	53%	Gujarat, Maharashtra	Goa
Northern	26%	Delhi, UP, Haryana, Rajasthan	Punjab, J&K, Himachal Pradesh, Uttarakhand
Central	3%	Madhya Pradesh	Chattisgarh
Southern	14%	Tamil Nadu, Andhra Pradesh	Kerala, Karnataka
Eastern	NIL	-	Bihar, West Bengal, Jharkhand, Orissa
North - Eastern	4%	Assam, Tripura	Meghalaya, Sikkim, Arunachal Pradesh, Mizoram, Manipur, Nagaland

At present, natural gas markets remain mostly limited to the states where gas sources have been found. States closer to the gas source or having pipeline infrastructure (HVJ pipeline) have had the benefits of higher availability of gas and local development of gas market e.g. Gujarat, Maharashtra, Northern markets, Andhra Pradesh, etc. Other states like Punjab, Haryana, Jharkhand, Uttarakhand, Karnataka, Kerala, Bihar, Chattishgarh, etc. have not been able to utilize benefits of gas due to lower gas availability and inadequate pipeline infrastructure.

LNG terminal capacity to grow at CAGR of 10% over FY18-25E

To meet the growing demand of natural gas, substantial investments are being made to increase the LNG terminal capacity and infrastructure related to import and transportation of LNG. The capacity of LNG terminals in India is expected to increase to ~60MMTPA by FY25E at CAGR of ~10%. Currently, India has the infrastructure to annually import and re-gasify ~30mmtpa of LNG through the four terminals – Dahej (15 mmtpa), Hazira (5 mmtpa), Dabhol (5 mmtpa) and Kochi (5 mmtpa). Further, Dahej terminal is undergoing capacity expansion by FY19E to 17.5mmtpa. Moreover, a 5mmtpa LNG

Source: Dealmoney research, pngrp.gov.in

import terminal at Mundra on the west coast of India, partly owned by the Adani Group, is expected to be commissioned by Q2FY19E.

India negotiated better terms for a long-term LNG deal with Qatar (Rasgas) in FY16 reducing LNG import cost by ~50% to $6-7mmbtu from $12-13mmbtu. This was followed by renegotiation with Exxon (Gorgon project) in FY18.These renegotiated prices linked with Brent crude has made RLNG (Regasified LNG) more attractive.

Gas pipelines of 13,489km under construction

India has built ~16,470km (as of FY18) gas pipeline network with a design capacity of ~387mmscmd with GAIL contributing ~67% of the total pipeline network. Gas pipelines are currently running at an average capacity utilization of ~43% and with the subsequent rise in demand, we expect improvement in the utilization. The pipeline network has been developed mostly in the northern and western regions. We expect southern market to pick up pace with GAIL's Kochi – Mangalore pipeline nearing completion. Currently, ~13,489km of gas pipeline is under construction nationwide with design capacity of ~548mmscmd.

Government reforms to boost gas consumption

Government is undertaking reforms in upstream to make investments more attractive leading to growth in domestic gas production. The decline in production during FY13-16 was due to the lack of investment in upstream sector. The new Hydrocarbon Exploration Licensing Policy (HELP) in FY16 aimed at enhancing transparency and having key features such as revenue sharing model, have positively modified the dynamics of upstream sector. Revenue sharing model will not be subject to cost recovery like the previous profit sharing model, where the contractor first claimed its costs before splitting leftover profits, causing delays in process.

Demand Drivers

The Power, Fertilizer, Industrial and CGD segments are expected to contribute to the bulk of future growth of natural gas demand in India. Natural gas demand from the power sector is expected to be driven, not only by the shortage of domestic coal supply and the rising cost of its substitute i.e. imported coal but also by increased domestic gas supply and power sector reforms. Fertilizer industry is the only industry that uses chemical and thermal heat of gas for its production and remains a major contributor to the natural gas demand in the country. A higher emphasis on food security in India and increasing import

price of urea are expected to drive the demand from the fertilizer sector. Rising price of crude oil/Naptha was one of the drivers for the rising gas demand from Fertilizer units and is also expected to remain one of the drivers from Industrial users as the price of the alternate fuels (Naphtha/FO) used by them is linked to crude oil.

The process of addressing environmental concerns is expected to drive the demand of natural gas from the industrial users as well as Compressed Natural Gas (CNG) users in the CGD segment. Factors like availability of domestic gas, import of LNG and development of requisite infrastructure are also expected to push the growth of natural gas demand from the CGD user segment.

Source: Dealmoney research, pngrp.gov.in

Demand drivers for various end user segments

Sector	**Demand Drivers**
Power Sector	Rising cost of imported coal
	Constrained domestic coal supply
	Supply of domestic gas
	Power sector reforms
	Fast-growing economy
Fertilizer Sector	Greater emphasis on Food Security
	Increase in import price of Urea
	Rising price of crude oil
	Subsidy burden
	Conducive Govt. Policy for new investment in urea manufacturing units
Industrial User Segment	Rising price of crude oil
	Environmental concerns
City Gas Distribution	Environmental concerns
	Subsidy burden
	Enabling policy framework
	Supply of domestic gas
	Availability of affordable RLNG
	Requisite infrastructure
	GDP / Household income

Source: Dealmoney research, pngrp.gov.in

The demand for Natural gas will be driven by Power, Fertilizer, City Gas, Industrial, Petchem/ Refineries/ Internal Cons. The consolidated Realistic Demand for natural gas from 2012-13 to 2029-30 has been provided below.

Total Realistic Demand - 12th and 13th five year plan

	12th Plan					13th Plan				
MMSCMD	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**	**2020-21**	**2021-22**
Power	86.5	104.59	122.69	140.78	158.88	173.88	188.9	203.88	218.88	233.88
Fertilizer	59.86	59.96	60.39	72.09	96.85	103.45	105.7	105.65	105.65	107.85
City Gas	15.3	16.22	17.19	18.22	22.32	26.62	31.16	35.94	40.96	46.25
Industrial	20	20	22	25	27	28	32	35	37	37
Petchem/Refineries/Internal Cons.	54	56.57	59.25	62.07	65.01	68.1	71.34	74.73	78.28	81.99
Sponge Iron/Steel	7	8	8	8	8	9	9	10	10	10
Total Realistic Demand	242.66	265.33	289.52	326.16	378.06	409.05	438	465.19	490.76	516.97

Source: Dealmoney research, pngrp.gov.in

Total Realistic Demand - 2023 to 2030

MMSCMD	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29	2029-30
Power	248.88	263.88	278.88	293.88	308.88	323.88	338.9	353.88
Fertilizer	110.05	110.05	110.05	110.05	110.05	110.05	110.1	110.05
City Gas	49.96	53.95	58.27	62.93	67.96	73.4	79.27	85.61
Industrial	39.62	42.42	45.42	48.63	52.06	55.75	59.69	63.91
Petchem/Refineries/Internal Cons.	85.89	89.97	94.24	98.72	103.41	108.32	113.5	118.85
Sponge Iron/Steel	10.4	10.82	11.26	11.72	12.19	12.68	13.19	13.73
Total Realistic Demand	**544.79**	**571.09**	**598.11**	**625.92**	**654.55**	**684.07**	**714.5**	**746.03**

The total realistic natural gas demand is likely to grow from 242.66 MMSCMD in 2012-13 to 746 MMSCMD in 2029-30 (CAGR of 6.83%) over the projection period.

Source: Dealmoney research, pngrp.gov.in

Pick of the Month (Petronet LNG Ltd.): CMP: 231 Target: 300

Petronet LNG Limited, one of the fastest growing world-class companies in the Indian energy sector, has set up the country's first LNG receiving and regasification terminal at Dahej, Gujarat, and another terminal at Kochi, Kerala. While the Dahej terminal has a nominal capacity of 15 MMTPA, the Kochi terminal has a capacity of 5 MMTPA. The company is in the process to build a third terminal at Gangavaram, Andhra Pradesh.

Petronet LNG is at the forefront of India's all-out national drive to ensure the country's energy security in the years to come. Formed as a Joint Venture by the Government of India to import LNG and set up LNG terminals in the country, it involves India's leading oil and natural gas industry players.

Looking out for investment opportunities: There are minimal investment opportunities in R-LNG terminal which makes it difficult for the company to evaluate relative investments both in upstream LNG and downstream gas sectors. The company is planning to buy small stake in the upcoming Qatar LNG expansion (77mt to 100mt). Gujarat Gas which has a large customer base has submitted bids for 7 CGD (City Gas Distribution) areas.

Solid Volume at Dahej plant and much-awaited Kochi-Mangalore Pipeline: Dahej has clocked a highest volume of 212 TBTUs in crossing its capacity utilization at 111%. This strong volume is near term till the competitor Mundra plant is ready. Further, incremental volume could be aided from Kochi-Mangalore pipeline on the back of higher take-off at BPCL’s refinery, MRPL refinery, OMPL and connectivity new customer in the vicinity regions.

Financial performance: PLNG’s topline rose by solid 42.5% YoY to Rs. 9,169.15 crs from Rs. 6435.1 crs in Q1FY18. EBITDA rose by 14% QoQ and 24% YoY to Rs. 934.41 bn in 1QFY19, mainly on the back of ramp up in volumes at 220 tn BTUs and blended tariffs at Rs. 49.3/mn BTU (+6% qoq and yoy), bolstered by seasonal efficiency gains. On the profit front, it reported a growth of 34% YoY to Rs. 586.97 in Q1FY19 from Rs. 437.58 in Q1FY18. The company’s RoE and RoCE stands 21% and 22.5%, respectively. It’s EBITDA and PAT margins stands 10.8% and 6.8% respectively. At the CMP of Rs. 234 the stock is trading at the EPS of 16.5x FY18. We expect the stock to achieve **the target of Rs. 300** in near medium term.

NSE / BSE Code	Inds. Gases & Fuels
Sector	Industrial Gases & Fuels
Industry	Tyres & Allied
Face value / Book Value (` per share)	10 / 68.7
Dividend yield (%)	1.9
52 H/L (Rs.)	275 / 198
Market Cap. (Rs. Cr)	351,000
Shares Outstanding (Cr)	1,500.0
NSE / BSE Code	1,808,240

	17-Jun	17-Sep	17-Dec	18-Mar
Promoters	50.0%	50.0%	50.0%	50.0%
Institutions	0.0%	0.0%	0.0%	0.0%
Non-Institutions	34.7%	34.9%	35.3%	34.6%
Others	3.2%	0.0%	3.2%	4.0%
Total	12.1%	15.1%	11.5%	11.4%

(In Rs. Cr)	FY14	FY15	FY16	FY17
Net Sales	377,476	396,270	271,334	246,160
Sales Growth	20.0%	5.0%	-31.5%	-9.3%
EBITDA	14,985	15,177	15,863	25,923
EBITDA Margin	4.0%	3.8%	5.8%	10.5%
PAT	7,119	9,048	9,133	17,057
NPM%	1.9%	2.3%	3.4%	6.9%
Adj. EPS (Rs.`)	4.7	6.0	6.2	11.5

	FY14	FY15	FY16	FY17
P/E (x)	49.3	38.8	38.4	20.6
P/B (x)	7.0	6.2	5.3	4.3
EV/Sales(x)	0.9	0.9	1.3	1.4
EV/EBITDA(x)	23.7	23.4	22.3	13.7
ROCE(x)	16.2%	15.4%	16.4%	26.1%
ROE(x)	15.1%	16.5%	14.8%	23.0%

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Pick of the Month (Gujarat Gas Ltd.): CMP: 771 Target: 900

Gujarat Gas is India's largest city gas distribution player with presence spread across 22 Districts in the State of Gujarat and Union Territory of Dadra Nagar Haveli and Thane which includes Palghar district of Maharashtra. The company has India's largest customer base in major user segments. The company has ~20,000 km of gas pipeline network. It has 291 CNG stations and provides close to 6.0 mmscmd of Natural Gas to over 12.5 Lakh households, ~6 lakh vehicles and to 3295 industrial customers.

Strong volume growth ahead: Gujarat Gas is growing well and is likely to ramp up sales owing to increasing its reach and connecting new consumers, faster shift of users from liquid to gas and aggressive focus on the sticky & profit making CNG and domestic PNG segments. A few triggers to boost Gujarat Gas are verdict on disputed areas and inclusion of gas under GST can fast-track volume growth. The company can sustain the sales growth of 12% annually.

Margins improving amid volatility: The Company's CNG segment continues to be a profitable segment, given undisturbed supply of cheap domestic gas, it is focusing on signing new consumers and retaining them on network rather than maximizing margins effectively. This would directly help the company in soaking the term take-or-pay contracts more efficiently, and skillfully source and blend the inexpensive spot LNG.

Solid earnings growth: Gujarat Gas can sustain the growth of 24% which is remarkably higher than its domestic peers. With the high cash level, the company is expected should suffice for the same. The stock trades at the premium valuations to domestic and regional peers, possibly primarily owing to option value of higher earnings growth arising from likely inclusion of gas under GST, favorable regulatory orders and higher execution level, so no requirement for aggressively bidding and winning new areas.

Financial performance: Gujarat Gas's topline has reported a growth of 20% YoY to Rs. 1813.5 crs in Q1FY19 from Rs. 1516.9 crs in Q1FY18. EBITDA fell 8% YoY to Rs. 248.6 crs owing to increase in operating expenses. The company posted exceptional gain in other income to Rs. 58.4 crs in Q1FY19 from Rs. 7.8 crs in Q1FY18. At PAT level, the company posted 16% growth on YoY basis to Rs. 121.4 crs in Q1FY19 which was bolstered by marginally decrease in finance cost (down 2% YoY), significant gain in other income and strong topline growth. At CMP of Rs. 790 the stock is trading at the PE multiple of 24.1x FY18 which is slightly at premium due to large customer base and above rationale. We expect the stock to **touch target of Rs. 900** in mid-term.

NSE / BSE Code	Inds. Gases & Fuels
Sector	Industrial Gases & Fuels
Industry	Tyres & Allied
Face value / Book Value (` per share)	10 / 142.9
Dividend yield (%)	0.5
52 H/L (Rs.)	974 / 715
Market Cap. (Rs. Cr)	108,903
Shares Outstanding (Cr)	137.7
NSE / BSE Code	1,808,240

	17-Jun	17-Sep	17-Dec	18-Mar
Promoters	60.9%	50.4%	60.9%	60.9%
Institutions	0.0%	0.0%	0.0%	0.0%
Non-Institutions	16.8%	16.9%	16.9%	17.3%
Others	15.8%	15.8%	15.8%	15.7%
Total	6.6%	16.9%	6.5%	6.1%

(In Rs. Cr)	FY14	FY15	FY16	FY17
Net Sales	77,974	90,063	61,056	50,926
Sales Growth	NA	15.5%	-32.2%	-16.6%
EBITDA	5,857	11,072	7,299	7,523
EBITDA Margin	7.5%	12.3%	12.0%	14.8%
PAT	284	4,436	1,883	2,195
NPM%	0.4%	4.9%	3.1%	4.3%
Adj. EPS (Rs.`)	2.1	33.6	13.7	15.9

	FY14	FY15	FY16	FY17
P/E (x)	383.1	24.6	57.8	49.6
P/B (x)	6.7	5.5	7.2	6.5
EV/Sales(x)	1.7	1.4	2.1	2.6
EV/EBITDA(x)	22.3	11.8	17.9	17.4
ROCE(x)	12.0%	19.2%	11.1%	13.2%
ROE(x)	3.5%	24.5%	10.8%	13.8%

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