

14 May 2009 | 7 pages

Gujarat State Petronet (GSPT.BO)

Buy: Better Visibility Buoy Stock... What Could Take It Higher?

- Sharp run-up in stock** — GSPL has seen a sharp run in its stock price of late, outperforming the Sensex by 19% in the last 2 weeks, on the back of improved visibility of transmission volumes. In this note, we seek to examine different scenarios where further upside could come from. While higher than estimated volumes could be positive at the margin, our current assumption of a worst-case outcome on the social tax issue (i.e., 30% PBT contribution with no tax benefit till perpetuity) could offer upside to our fair value.
- Possible upside to volumes, but social tax more material** — While our volume estimates (28-35mmscmd over FY10-11E) are likely conservative in light of how much GSPL is currently transporting, driven by spot LNG and KG gas (c25 mmscmd, likely to increase to c30-35 mmscmd by end-FY10), increase in our volume estimates will not have a material impact on our DCF value (increase in volumes by 1 mmscmd per year increases our DCF value by ~3%). Bigger upsides can come only from a change in our social tax assumptions, which could see our DCF value increasing to Rs58-78 based on various scenarios.
- Scenario #1: Social contribution retained but made tax deductible – DCF value of Rs58** — In a scenario where the social contribution continues till perpetuity but is made tax deductible (our current TP factors in no tax deduction), our DCF value could increase to Rs58. This is the more likely of the three scenarios as mgmt has stated that it will not provide for the social contribution unless it is made tax deductible and until specific projects are identified for the deployment of the funds (the key reason behind not providing for this in FY09).
- Scenario #2: Social contribution retained but reduced from 30% to 10-20% – value of Rs59-68** — In a scenario where the social contribution is reduced from 30% of PBT to 10-20%, our fair value could increase to Rs59-68. This could further increase to Rs64-71 if the contribution is also made tax deductible.
- Scenario #3: Social contribution revoked – value of Rs78** — In a best possible scenario of the social contribution being completely revoked by the government of Gujarat, our DCF value could increase to Rs78.

Buy/Medium Risk	1M
Price (14 May 09)	Rs49.70
Target price	Rs50.00
Expected share price return	0.6%
Expected dividend yield	0.7%
Expected total return	1.3%
Market Cap	Rs27,937M US\$563M

Price Performance (RIC: GSPT.BO, BB: GUJS IN)



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See Appendix A-1 for Analyst Certification and important disclosures.

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Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	30.2	28.0	42.1	29.6	22.9
EV/EBITDA adjusted (x)	12.5	9.7	9.1	6.4	5.6
P/BV (x)	2.8	2.4	2.4	2.2	2.1
Dividend yield (%)	1.0	1.0	0.7	1.0	1.3
Per Share Data (Rs)					
EPS adjusted	1.65	1.78	1.18	1.68	2.17
EPS reported	1.65	1.78	1.18	1.68	2.17
BVPS	17.79	20.30	21.07	22.16	23.57
DPS	0.50	0.50	0.35	0.50	0.65
Profit & Loss (RsM)					
Net sales	3,176	4,179	4,721	7,280	8,925
Operating expenses	-1,521	-2,166	-2,266	-3,437	-4,121
EBIT	1,655	2,013	2,455	3,843	4,804
Net interest expense	-457	-815	-893	-1,393	-1,559
Non-operating/exceptionals	175	294	280	170	146
Pre-tax profit	1,373	1,491	1,842	2,621	3,391
Tax	-479	-492	-626	-891	-1,153
Extraord./Min.Int./Pref.div.	0	0	-553	-786	-1,017
Reported net income	894	999	663	943	1,221
Adjusted earnings	894	999	663	943	1,221
Adjusted EBITDA	2,681	3,645	4,163	6,396	7,791
Growth Rates (%)					
Sales	20.5	31.6	13.0	54.2	22.6
EBIT adjusted	43.6	21.6	22.0	56.5	25.0
EBITDA adjusted	38.0	36.0	14.2	53.6	21.8
EPS adjusted	58.4	7.9	-33.6	42.3	29.4
Cash Flow (RsM)					
Operating cash flow	862	5,091	-972	3,056	4,008
Depreciation/amortization	1,026	1,632	1,708	2,553	2,987
Net working capital	-1,058	2,460	-3,343	-440	-200
Investing cash flow	-4,401	-6,177	-2,936	-5,000	-5,700
Capital expenditure	-4,401	-5,821	-3,292	-5,000	-5,700
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	2,540	885	2,767	3,669	-928
Borrowings	2,852	1,022	3,000	4,000	-500
Dividends paid	-318	-329	-233	-331	-428
Change in cash	-999	-201	-1,141	1,725	-2,621
Balance Sheet (RsM)					
Total assets	21,059	27,175	27,893	33,066	33,954
Cash & cash equivalent	1,811	2,569	1,514	3,347	830
Accounts receivable	349	416	388	598	734
Net fixed assets	17,029	21,259	22,843	25,291	28,004
Total liabilities	11,400	15,766	16,053	20,614	20,710
Accounts payable	1,295	4,094	1,425	1,567	1,724
Total Debt	8,638	9,660	12,660	16,660	16,160
Shareholders' funds	9,659	11,410	11,840	12,452	13,245
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	84.4	87.2	88.2	87.9	87.3
ROE adjusted	9.5	9.5	5.7	7.8	9.5
ROIC adjusted	7.6	8.0	8.1	11.2	12.3
Net debt to equity	70.7	62.2	94.1	106.9	115.7
Total debt to capital	47.2	45.8	51.7	57.2	55.0

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Figure 1. GSPL – Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	Adj P/E	P/B	Adj P/B	P/CEPS	EV/EBITDA	ROE	Adj ROE
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(x)	(x)	(x)	(x)	(%)	(%)
2007A	894	1.6	58.4	30.2	22.7	2.8	2.3	14.1	11.7	9.5%	13.7%
2008A	999	1.8	7.9	28.0	17.8	2.4	2.0	10.6	9.5	9.5%	15.3%
2009E	663	1.2	(33.6)	42.1	22.7	2.4	1.8	11.8	8.4	5.7%	11.2%
2010E	943	1.7	42.3	29.6	14.5	2.2	1.6	8.0	6.1	7.8%	14.7%
2011E	1,221	2.2	29.4	22.9	12.1	2.1	1.4	6.6	5.3	9.5%	15.7%

Source: Powered by dataCentral, CIRA estimates

Gujarat State Petronet

Company description

GSPL is a gas transmission company with a network of pipelines in the western Indian state of Gujarat. It has a gas transmission network of over 1,100 kms of pipeline connecting Hazira, Vadodara, Ahmedabad, Kalol, Himmatnagar, Mehsana, Rajkot, and Vapi. GSPL's network connects all major supply sources in Gujarat to important consumption centres in the state and transports c18-19 mmscmd of gas.

Investment strategy

We rate Gujarat State Petronet Buy/Medium Risk (1M). GSPL has set up an "open access" pipeline network in India's most vibrant gas market, Gujarat. Gujarat is the landfall of gas from India's western offshore fields (India's largest source of gas) with two LNG receiving terminals. The state is also among the most industrialized regions in India with a large presence of energy-intensive industries in addition to traditional gas-using industries. GSPL's parent, Gujarat State Petroleum Corporation, continues to play an important role as an aggregator of gas demand and supplies. GSPL is highly levered to increasing supplies of gas in India, and gas production from Reliance's KG block, which will boost its transmission volumes, is a key positive.

Valuation

Our target price of Rs50 is based on our DCF fair value for March-2010E. Our DCF assumptions are based on gas volumes tied up with Reliance (11 mmscmd), expected incremental volumes of c10 mmscmd to be consumed in Gujarat, and announced capex plans. We use DCF given the utility nature of the business, with steady cash flows, and to capture the value of the business over the longer term. Our valuation is based on explicit forecasts until FY12E, 38% CAGR of volumes over FY09-12E, FY12E transported volumes of 41 mmscmd, and a terminal growth of 3.0%. We use a WACC of 11.3% (risk free 8.0%, risk premium 6.0%, beta of 1.0, cost of equity 14.1%, cost of debt 12.5%, target D/E of 1.0x). Also, on an adjusted P/B basis, GSPL would trade at 1.6x FY10E and 1.4x FY11E on our target price, which we believe is reasonable given adjusted ROEs increasing to 15-17% over the next few years as utilisations increase.

Risks

We assign a Medium Risk rating to GSPL. Key downside risks to our target price are: 1) worsening of economics of spot LNG, which could impact our volume estimates; 2) political risk - the directive by the state government for the company to contribute 30% of pre-tax profits towards socio-economic projects is an adverse step; any move to increase this would be negative; 3) adverse impact, if any, of regulation of gas pipeline tariffs by the Petroleum and Natural Gas Regulatory Board; 4) project risk - GSPL is implementing expansion of its pipeline network that is subject to time and cost over-runs that could impact earnings. If any of these factors has a greater impact than we expect, the stock could have difficulty achieving our target price.

Appendix A-1

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Gujarat State Petronet (GSPT.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Saurabh Handa

Covered since June 5 2007



Chart current as of 9 May 2009

	Date	Rating	Target Price	Closing Price
1	31-Aug-06	*1M	*49.00	35.55
2	28-Sep-06	1M	*55.00	38.35
3	23-Jan-07	1M	*60.00	46.50
4	13-Jun-07	1M	*72.00	54.80

	Date	Rating	Target Price	Closing Price
5	26-Oct-07	1M	*74.00	57.75
6	21-Jan-08	*1L	*104.00	73.50
7	8-Apr-08	1L	*84.00	59.60
8	28-Jul-08	1L	*79.00	59.65

	Date	Rating	Target Price	Closing Price
9	28-Oct-08	*2M	*36.00	32.25
10	4-Feb-09	*1M	*42.00	30.10
11	22-Apr-09	1M	*50.00	39.05

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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