

Company Flash

2 April 2007 | 5 pages

Gujarat State Petronet (GSPT.BO)

Buy: Further Clarity on KG Gas Transportation

- What's new** — Reliance Industries over the weekend confirmed that 11-14mmscmd of gas from its KG basin fields would flow through GSPL's network from 2Q08. Importantly, RIL also quantified that 3.5-11mmscmd of gas from GSPC's KG fields would also be transported to Gujarat through Reliance's pipeline. This gas will likely flow through the GSPL net work.
- Significant upside potential** — While it is as yet unclear on the timeline for the GSPC gas, the additional gas will likely have a significant impact on GSPL's network utilization and could lead to potential upside to our DCF-based fair value.
- Reiterate Buy** — With greater visibility of gas supplies ensuring better utilization of GSPL's network, we remain positive on the stock. We reiterate our Buy/Medium Risk (1M) rating with a target price of Rs60.

Buy/Medium Risk	1M
Price (30 Mar 07)	Rs46.75
Target price	Rs60.00
Expected share price return	28.3%
Expected dividend yield	1.1%
Expected total return	29.4%
Market Cap	Rs25,376M US\$588M

Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2005A	160	0.53	na	87.7	4.1	4.8	0.4
2006A	467	1.04	95.1	44.9	2.8	7.1	0.5
2007E	840	1.55	48.9	30.2	2.6	9.0	1.1
2008E	678	1.25	-19.2	37.4	2.5	6.9	1.1
2009E	1,516	2.80	123.6	16.7	2.3	14.6	2.4

Source: Powered by dataCentral

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

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Gujarat State Petronet

Company description

GSPL is a gas transmission company with a network of pipelines in the western Indian state of Gujarat. The company has a gas transmission network comprising 496km of pipelines (includes the recently commissioned 63km long Kalol-Himmatnagar pipeline) connecting Hazira-Vadodara-Ahmedabad-Kalol-Himmatnagar and is in the process of expanding the network by 679km by July 2007. GSPL's network connects all the major supply sources in Gujarat to important consumption centres in the state and currently transports 13mmscmd of gas.

Investment thesis

We rate Gujarat State Petronet as Buy/Medium Risk (1M). GSPL has seized the opportunity for setting up an "open access" pipeline network in India's most vibrant gas market, Gujarat. Gujarat has the advantage of being the landfall point of gas from India's western offshore fields (the largest source of gas for India) as well as having 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, has played and continues to play an important role as an aggregator of gas demand and supplies.

Valuation

Our target price of Rs60 is based on our DCF fair value for Dec 2007E. Our DCF is based on higher gas volumes tied up with Reliance (11-14mmscmd) and the higher capex associated with the deal (Rs7bn). We use DCF to value the company given the utility nature of the business, which ensures steady cash flows. Discounted cash flows also capture the value of the business over a longer term. Our DCF valuation is based on conservative assumptions for volume growth – with FY11E committed volumes assumed at 38mmscmd (existing GTAs + Reliance GTA = 36mmscmd) – and terminal growth of 3%. We use a WACC of 10.8% (risk free ~ 8.0%, risk premium ~ 6.0%, beta of 0.9, target D/V~ 35%). Also, on a price/cash earnings basis, we think GSPL is at a justifiable premium to other gas utilities (10.4x FY08E) given our high growth expectations of its gas transmission business. We prefer P/CEPS to the more traditional P/E multiple as a valuation tool given GSPL's aggressive depreciation policy.

Risks

We assign a Medium Risk rating to GSPL – rather than a default Speculative Risk for stocks with a trading history of less than 12 months – in view of the utility nature of the business. The key downside risks to our target price include: 1) Government regulation of gas pipeline tariffs. With the setting up of the Petroleum and Natural Gas Regulatory Authority, pipeline tariffs across India could come under scrutiny. 2) Gas supplies – We assume an 11% CAGR in gas supplies for GSPL. If supplies are lower than our expectations, this could impact earnings and valuations. 3) Project risk – GSPL is implementing a Rs14.5bn 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: Pradeep Mirchandani, CFA (covered since September 1 2006)



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