Company Focus

26 October 2007 | 7 pages

Gujarat State Petronet (GSPT.BO)

Target price change ☑
Estimate change ☑

Buy: 2Q FY08 – Another Steady Operating Performance

- **Steady operating performance** — GSPL reported net income of Rs163m, in line with our estimate and down 27% yoy. As expected, operating profits remained strong at Rs810m (up 23% yoy, operating margin 85%). As was the case in 1Q, the reported PAT was down primarily because of higher capital costs (reduction of interest capitalized, commissioning of new pipelines). Cash profits, a better measure of profitability in our view, were Rs570m during the quarter, relatively flat qoq, up 26% yoy, and in line with our estimates.
- **Seasonally low volumes** — Gas transmission volumes of 15.1mmscmd (16.9mmscmd in 1Q) were seasonally lower (power plants typically plan shutdowns during the rains). The impact on revenues was, however, mitigated due to (1) take-or-pay clauses in contracts and (2) increased demand from new demand centres at longer distances (implying longer tariffs).
- **Reducing FY08-10E earnings by 5-6%** — This is to factor in details from the FY07 annual report and higher capex of Rs15bn over the next 2 years than earlier assumed by us. Our target price increases to Rs74 (Rs72 earlier) as we roll forward our DCF value to Sep-08E (Jun-08E earlier).
- **Maintain Buy/Medium Risk** — GSPL is a pure-play gas transmission company that is highly levered to increasing consumption of gas in Gujarat, India's most vibrant gas market, without being exposed to the vagaries of gas pricing. This, combined with a 28% 3-year EPS CAGR (significantly higher than peers) and highest leverage to KG gas, makes it one of our top Indian gas utilities picks.

Buy/Medium Risk	1M
Price (26 Oct 07)	Rs58.40
Target price	Rs74.00
from Rs72.00	
Expected share price return	26.7%
Expected dividend yield	0.7%
Expected total return	**27.4%**
Market Cap	Rs32,802M
	US$833M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	P/CEPS (x)	ROE (%)	Div. Yield (%)
2006A	467	1.04	95.1%	56.1	3.5	20.8	7.1%	0.4%
2007A	894	1.65	58.4%	35.5	3.3	16.5	9.5%	0.9%
2008E	737	1.33	-19.0%	43.8	2.9	13.0	7.1%	0.7%
2009E	1,113	1.98	48.5%	29.5	2.7	9.6	9.6%	1.0%
2010E	1,885	3.35	69.4%	17.4	2.5	7.7	15.0%	1.7%

Source: Powered by dataCentral

Saurabh Handa[1]
+91-22-6631-9858
saurabh.handa@citi.com

Rahul Singh[1]
+91-22-6631-9863
rahul.r.singh@citi.com

Garima Mishra[1]
garima.mishra@citi.com

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

[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	56.1	35.5	43.8	29.5	17.4
EV/EBITDA adjusted (x)	18.9	14.3	12.1	9.2	7.5
P/BV (x)	3.5	3.3	2.9	2.7	2.5
Dividend yield (%)	0.4	0.9	0.7	1.0	1.7
Per Share Data (Rs)					
EPS adjusted	1.04	1.65	1.33	1.98	3.35
EPS reported	1.04	1.65	1.33	1.98	3.35
BVPS	16.74	17.79	19.96	21.24	23.42
DPS	0.25	0.50	0.39	0.59	1.01
Profit & Loss (RsM)					
Net sales	2,635	3,176	4,005	5,748	7,061
Operating expenses	-1,483	-1,521	-2,226	-2,972	-3,158
EBIT	**1,152**	**1,655**	**1,779**	**2,777**	**3,903**
Net interest expense	-413	-457	-866	-1,160	-1,140
Non-operating/exceptionals	45	175	220	69	51
Pre-tax profit	**784**	**1,373**	**1,133**	**1,686**	**2,813**
Tax	-317	-479	-396	-573	-928
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**467**	**894**	**737**	**1,113**	**1,885**
Adjusted earnings	467	894	737	1,113	1,885
Adjusted EBITDA	1,943	2,681	3,531	5,087	6,271
Growth Rates (%)					
Sales	29.5	20.5	26.1	43.5	22.8
EBIT adjusted	81.0	43.6	7.5	56.1	40.6
EBITDA adjusted	50.2	38.0	31.7	44.0	23.3
EPS adjusted	95.1	58.4	-19.0	48.5	69.4
Cash Flow (RsM)					
Operating cash flow	**1,871**	**862**	**2,102**	**3,810**	**4,955**
Depreciation/amortization	791	1,026	1,753	2,310	2,369
Net working capital	613	-1,058	-387	387	702
Investing cash flow	**-6,047**	**-4,401**	**-8,572**	**-7,000**	**-2,000**
Capital expenditure	-6,047	-4,401	-8,572	-7,000	-2,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**3,065**	**2,540**	**4,294**	**2,609**	**-4,162**
Borrowings	1,350	2,852	4,362	3,000	-3,500
Dividends paid	-155	-318	-259	-391	-662
Change in cash	**-1,111**	**-999**	**-2,176**	**-580**	**-1,206**
Balance Sheet (RsM)					
Total assets	**17,140**	**21,059**	**27,750**	**32,610**	**31,584**
Cash & cash equivalent	2,372	1,811	900	837	431
Accounts receivable	137	349	440	632	776
Net fixed assets	13,650	17,029	23,848	28,538	28,169
Total liabilities	**8,065**	**11,400**	**16,536**	**20,674**	**18,425**
Accounts payable	1,261	1,295	1,908	2,388	2,526
Total Debt	5,786	8,638	13,000	16,000	12,500
Shareholders' funds	**9,075**	**9,659**	**11,214**	**11,936**	**13,159**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	73.7	84.4	88.2	88.5	88.8
ROE adjusted	7.1	9.5	7.1	9.6	15.0
ROIC adjusted	7.8	7.6	6.5	8.1	10.3
Net debt to equity	37.6	70.7	107.9	127.0	91.7
Total debt to capital	38.9	47.2	53.7	57.3	48.7

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Figure 1. GSPL — 2Q FY08 Results (Rupees in Millions)

Year to 31-Mar	2QFY07	1QFY08	2QFY08	% yoy	Comments
Net sales	**758**	**958**	**954**	**25.7%**	YoY increase driven by strong volume growth
Employee costs	8	13	15	89.9%	
Gas transportation charges	25	8	6	-74.5%	
Connectivity charges	21	32	29	37.6%	
O&M expense of pipelines and compressors	20	35	52	164.5%	Increase driven by higher maintenance expenses on the newly commissioned pipelines
Admin & others	27	37	42	55.8%	
Total expenditure	100	124	144	43.4%	
EBITDA	**658**	**834**	**810**	**23.0%**	
EBITDA margin	*86.8%*	*87.1%*	*84.9%*	*-186 bps*	Robust margins driven by high operating leverage, as higher volumes imply better utilization of the network
Depreciation	230	398	407	77.0%	Sequentially flat; yoy growth driven by commissioning of new pipelines in 4QFY07
Interest	100	198	207	105.7%	Sequentially flat; yoy growth driven by reduction of interest capitalized following commissioning of new pipelines
Non-operating income	44	53	56	27.0%	
Profit before tax	372	291	253	-32.1%	
Tax	148	113	90	-39.4%	
- Current tax	1	74	52	7271.4%	
- Deferred tax	147	39	38	-74.2%	
Tax rate	*39.8%*	*38.7%*	*35.5%*	*-429 bps*	
Profit after tax	**224**	**179**	**163**	**-27.3%**	
Cash profits	454	577	570	25.5%	Stable on a sequential basis
Operational parameters					
Gas transported (mmscm)	1,160	1,536	1,372	18.3%	Sequential decline due to seasonality (power plants typically plan shutdowns during the rains, a lean demand season)
Gas transported (mmscmd)	12.6	16.9	15.1	19.6%	
Avg. transportation charge (Rs/tcm)	654	624	695	6.3%	Increase due to (1) take-or-pay clauses in existing contracts and (2) better realizations from new distant demand centres

Source: Company Reports and Citi Investment Research

We are modestly adjusting our earnings estimates downwards by 5-6% over FY08-10E as we factor in details from the FY07 annual report as well as higher capital costs driven by higher capex of Rs15bn that the company plans to incur over the next 2 years. This includes Rs6bn towards the Reliance agreement, with the balance being incurred primarily towards creating pipeline connectivity to Mundra and Pipavav. Our EPS estimates reduce by 7-10% because of the increase in share count following the placement of shares to IFC in September.

Figure 2. GSPL – Earnings Revisions

Year to	Net Profit (Rs Mils.)			Diluted EPS (Rs)			Div. Per Share (Rs)	
31-Mar	Old	New	% Chg	Old	New	% Chg	Old	New
2008E	780	737	-5.5%	1.44	1.33	-7.2%	0.4	0.4
2009E	1,189	1,113	-6.4%	2.19	1.98	-9.7%	0.7	0.6
2010E	1,978	1,885	-4.7%	3.65	3.35	-8.0%	1.1	1.0

Source: Citi Investment Research estimates

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 over 1,100km of pipelines connecting Hazira, Vadodara, Ahmedabad, Kalol, Himmatnagar, Mehsana, Rajkot, and Vapi. GSPL's network connects all the major supply sources in Gujarat to important consumption centres in the state and currently transports c.16mmscmd of gas.

Investment strategy

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 Rs74 is based on our DCF fair value for Sep-08E. Our DCF is based on gas volumes tied up with Reliance (11-20mmscmd) and the capex associated with the deal (Rs6bn). 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 five years of explicit forecasts, 23% CAGR of committed volumes over FY07-12E, FY12E volumes of 45mmscmd, and terminal growth of 3%. We use a WACC of 10.5% (risk free 8.0%, risk premium 6.0%, beta of 0.75, target D/E ~40%). Also, on a price/cash earnings basis, we think GSPL is at a justifiable premium to other gas utilities (9.6x FY09E) given our high growth expectations of its gas transmission business (EPS CAGR of 28% over FY07-10E). We prefer P/CEPS to the more traditional P/E multiple as a valuation benchmark given GSPL's aggressive depreciation policy.

Risks

We assign a Medium Risk rating to GSPL based on our quantitative risk-rating system. 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 a 23% CAGR in gas volumes for GSPL. If supplies are lower than our expectations, this could impact earnings and valuations. 3) 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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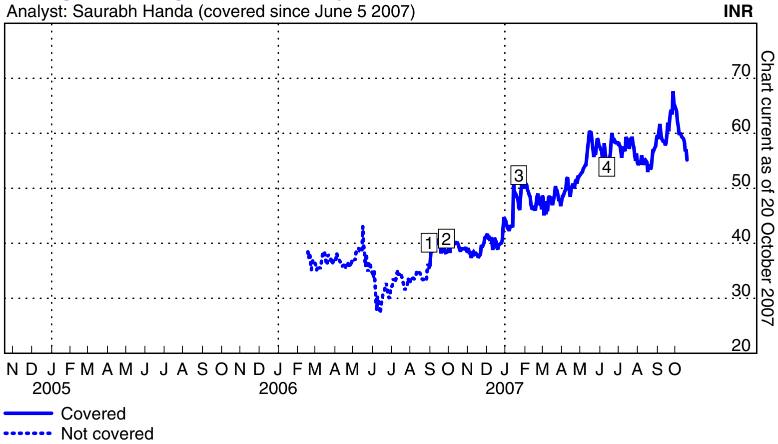
Gujarat State Petronet (GSPT.BO)
Ratings and Target Price History - Fundamental Research
Analyst: Saurabh Handa (covered since June 5 2007)



#	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
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