

# Finally set to take off; 1Q earnings up 147% YoY

## On the threshold of strong growth phase; Retain Buy

Gujarat State Petronet Ltd (GSPL) has had a spectacular 1Q FY10 with earnings rising 147% YoY. We expect GSPL's FY10E earnings to jump 123% YoY driven by 108% YoY volume growth. We expect its 3 year EPS CAGR in FY09-FY12E to be 53%, driven by transmission volume CAGR of 45%, rising pipeline utilization rate and stable tariff. GSPL is thus finally on the threshold of a strong growth phase. The main driver of this growth is the gas production from the KG D6 block of Reliance Industries (RIL), which is expected to double Indian gas output. Our revised PO of Rs79 (down 7%) implies 25% potential upside. Our PO factors impact of only existing and under-implementation pipeline. We retain our Buy.

## FY10E EPS growth at 123% YoY; 3-year EPS CAGR: 53%

GSPL's 1Q FY10 earnings jumped by 147% YoY driven by 41% YoY rise in gas transmission volumes and 25% YoY rise in tariff. The main driver of GSPL's volume growth is start of KG D6 gas production from April 2009. GSPL has a contract with RIL to transport 11mmscmd (may scale up to 14-20mmscmd) of gas to Jamnagar. It currently transports only 5mmscmd. It also transports D6 gas to other consumers. GSPL's volumes have already doubled from FY09 levels to 30mmscmd now and should be 40mmscmd by 4Q. FY10E EPS is set to jump 123% YoY driven by 108% YoY rise in volumes to 31mmscmd and despite 16% YoY lower tariff. Upside to tariff assumption cannot be ruled out. We expect FY11-FY12E EPS growth at 26-28% YoY driven by 13-29% YoY volume growth.

## Several future growth opportunities; not factored in PO

We see strong growth opportunities for GSPL as gas supply in India surges and government encourages a national gas grid. GSPL has filed expression of interest with the regulator for the Rs45bn Mehsana-Bhatinda-Srinagar pipeline. Clarity on whether GSPL gets this project is likely by end-FY10E

## Estimates (Mar)

(Rs)	2007A	2008A	2009E	2010E	2011E
Net Income (Adjusted - mn)	894	999	1,234	2,755	3,464
EPS	1.65	1.81	2.20	4.90	6.16
EPS Change (YoY)	91.3%	9.9%	21.4%	123.2%	25.8%
Dividend / Share	0.500	0.500	0.750	1.00	1.00
Free Cash Flow / Share	(5.77)	(1.17)	(5.92)	(8.80)	9.35

## Valuation (Mar)

	2007A	2008A	2009E	2010E	2011E
P/E	38.32x	34.88x	28.73x	12.87x	10.24x
Dividend Yield	0.792%	0.792%	1.19%	1.58%	1.58%
EV / EBITDA*	15.78x	11.60x	9.96x	5.52x	4.42x
Free Cash Flow Yield*	-8.83%	-1.83%	-9.39%	-13.95%	14.82%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 13.

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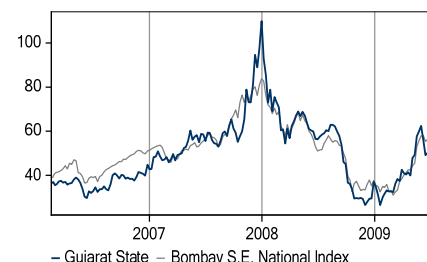
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## Stock Data

Price	Rs63.10
Price Objective	Rs85.00 to Rs79.00
Date Established	23-Jul-2009
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs25.25-Rs67.30
Mrkt Val / Shares Out (mn)	US\$732 / 562.0
Average Daily Volume	5,766,593
ML Symbol / Exchange	GJRSF / BSE
Bloomberg / Reuters	GUJS IN / GSPT.BO
ROE (2009E)	10.5%
Net Dbt to Eqty (Mar-2008A)	62.4%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	60.9%



— Gujarat State — Bombay S.E. National Index

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24 July 2009

# iQprofile<sup>SM</sup> Gujarat State

## Key Income Statement Data (Mar)

	2007A	2008A	2009E	2010E	2011E
<b>(Rs Millions)</b>					
Sales	3,176	4,179	4,875	8,486	10,565
Gross Profit	2,681	3,645	4,245	7,660	9,567
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	1,655	2,013	2,540	5,151	6,365
Net Interest & Other Income	(282)	(521)	(627)	(977)	(1,116)
Associates	NA	NA	NA	NA	NA
Pretax Income	1,373	1,491	1,914	4,174	5,249
Tax (expense) / Benefit	(479)	(492)	(679)	(1,419)	(1,785)
Net Income (Adjusted)	894	999	1,234	2,755	3,464
Average Fully Diluted Shares Outstanding	543	552	562	562	562

## Key Cash Flow Statement Data

Net Income	894	999	1,234	2,755	3,464
Depreciation & Amortization	1,026	1,632	1,705	2,509	3,202
Change in Working Capital	1,058	(2,460)	1,991	3,419	(898)
Deferred Taxation Charge	409	82	145	710	892
Other Adjustments, Net	(2,115)	4,920	(3,982)	(6,838)	1,797
Cash Flow from Operations	1,271	5,173	1,093	2,554	8,457
Capital Expenditure	(4,401)	(5,821)	(4,422)	(7,500)	(3,200)
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	0	(356)	356	0	0
Cash Flow from Investing	(4,401)	(6,177)	(4,066)	(7,500)	(3,200)
Shares Issue / (Repurchase)	8	1,080	0	0	0
Cost of Dividends Paid	(306)	(324)	(475)	(634)	(634)
Cash Flow from Financing	2,554	1,768	1,374	4,866	(5,634)
Free Cash Flow	(3,130)	(648)	(3,329)	(4,946)	5,257
Net Debt	6,827	7,081	10,530	16,109	11,486
Change in Net Debt	3,429	248	3,449	5,579	(4,623)

## Key Balance Sheet Data

Property, Plant & Equipment	17,029	21,259	23,976	28,968	28,966
Other Non-Current Assets	0	356	0	0	0
Trade Receivables	349	416	481	1,163	1,158
Cash & Equivalents	1,811	2,569	970	891	514
Other Current Assets	1,777	2,511	2,810	4,750	4,229
Total Assets	20,966	27,112	28,237	35,771	34,867
Long-Term Debt	8,638	9,650	11,200	16,700	11,700
Other Non-Current Liabilities	917	999	1,144	1,853	2,746
Short-Term Debt	0	0	300	300	300
Other Current Liabilities	1,845	5,106	3,478	2,681	3,054
Total Liabilities	11,400	15,756	16,122	21,534	17,800
Total Equity	9,566	11,356	12,115	14,236	17,067
Total Equity & Liabilities	20,966	27,112	28,237	35,771	34,867

## iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	6.9%	7.4%	7.7%	12.2%	13.5%
Return On Equity	9.7%	9.5%	10.5%	20.9%	22.1%
Operating Margin	52.1%	48.2%	52.1%	60.7%	60.3%
EBITDA Margin	84.4%	87.2%	87.1%	90.3%	90.6%

## iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	1.4x	5.2x	0.9x	0.9x	2.4x
Asset Replacement Ratio	4.3x	3.6x	2.6x	3.0x	1.0x
Tax Rate (Reported)	34.9%	33.0%	35.5%	34.0%	34.0%
Net Debt-to-Equity Ratio	71.4%	62.4%	86.9%	113.2%	67.3%
Interest Cover	3.6x	2.5x	2.9x	4.4x	4.6x

## Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 13.

## Company Description

Gujarat State Petronet (GSPL) was promoted in 1998 by Gujarat government-owned companies led by Gujarat State Petroleum Corp (38% stake). It has a 1,283km pipeline network in Gujarat. It transmitted 15mmscmd of gas in FY09. Volumes are set surge sharply in FY10E. It has agreement with Reliance to transmit 11mmscmd (may rise to 14-20mmscmd) of gas from Bharuch to Jamnagar. Its volumes are mainly from KG D6 gas, Dahej and Hazira LNG terminals. Its main customers are Reliance, Torrent and Essar

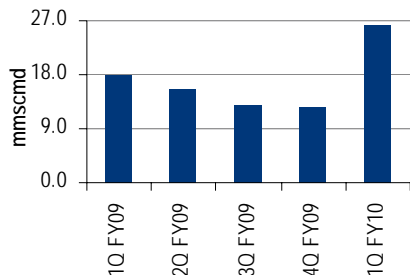
## Investment Thesis

GSPL offers the strongest volume and earnings growth among gas utilities. Uncertainty in GSPL is also relatively less than for peers. GSPL offers the best pipeline connectivity in Gujarat, which is and will remain the largest gas consuming state in India. Most of the incremental gas in India will be from RIL. Only GSPL has a firm transportation agreement with RIL, which will mean 65-118pct rise in volumes over FY08 levels. Another volume driver may be gas discovery by GSPC, its parent. Buy

## Stock Data

Price to Book Value	2.9x
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Chart 1: Trend in GSPL's gas transmission volumes since 1Q FY09



Source: Company

## Finally set to take off in FY10E 1Q FY10 earnings up 147% YoY

### Volume up 41% YoY and tariff up 25% YoY

GSPL's 1Q FY10 earnings jumped by 147% YoY to Rs805m. The jump in earnings was driven by

- 41% YoY rise in gas transmission volumes to 25.3mmscmd.
- 25% YoY rise in pipeline tariff to Rs915/tcm

### Start of KG D6 gas main driver of 1Q transmission volumes

#### 1Q volumes 97% QoQ higher and 41% YoY higher

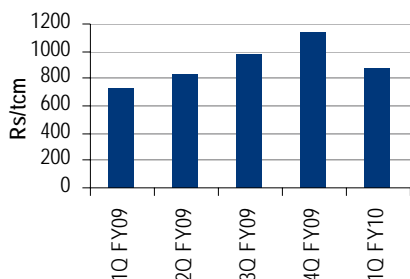
Gas production from KG D6 block was expected to start in FY09 but did not. D6 gas production finally started in April 2009 and was the main driver of 1Q volume growth. 1Q FY10 volumes are 41% YoY and 97% QoQ higher. Volumes had declined in 2H FY09 due to some existing consumers shifting from gas to liquid fuels. Spot LNG was more expensive than liquid fuels in 2H and hence the shift.

Table 1: 1Q FY10 results

Rsmn	1Q FY10	1Q FY09	Change
Net sales	2,108	1,195	76%
Total expenditure	128	119	7%
EBDITA	1,980	1,076	84%
EBDITA margin	93.9%	90.0%	4%
Interest	245	218	12%
Depreciation	550	415	33%
Other Income	35	68	-48%
Extra-ordinary items	0	0	
PBT	1,220	511	139%
Tax	415	185	125%
PAT	805	326	147%
EPS	1.4	0.6	137%
<b>Operational details</b>			
Volumes (mmscmd)	25.3	18.0	41%
Tariff (Rs/tcm)	915	729	25%

Source: Company, DSP Merrill Lynch

Chart 2: Trend in GSPL's average pipeline tariff since 1Q FY09



Source: Company

### Pipeline tariff sustain despite surge in volumes

#### 1Q tariff 2% higher than FY09 average; volumes 70% higher than FY09

In 1Q FY10 GSPL's tariff has declined by 20% QoQ to Rs915/tcm from Rs1,143/tcm in 4Q FY09. 4Q FY09 tariff of Rs1,143/tcm includes amounts related to take or pay obligation from customers as volumes declined to 13mmscmd from 16-18mmscmd in 1H. 1Q FY10 tariff of Rs915/tcm, which does not include any take or pay amounts, is 2% higher than FY09 average tariff of Rs898/tcm. 1Q FY10 volume of 25.3mmscmd is 70% higher than average FY09 volume of 14.9mmscmd. Thus tariff has sustained despite the sharp ramp up in volumes.

### Renewal of contracts at higher tariff in Jan'09 has kept tariffs healthy

The high tariff in 1Q FY10 despite no take or pay related amounts is due to

- Renewal of several existing contracts at higher tariffs from January 1, 2009
- Start of new high tariff contracts

## Volume & earnings set to take off from FY10E

### GSPL's gas transmission volumes already at 30mmscmd

FY09 average transmission volumes were 14.9mmscmd

GSPL's gas volumes have ramped up to 30mmscmd now and volumes are expected to rise to 40mmscmd by 4Q FY10E. The rise in gas transmission volumes is due to

- Start of KG D6 gas supply from April 2009
- Consumers switching back to spot LNG or KG D6 gas from liquid fuels as now gas is far cheaper than liquid fuels
- Transmission of spot LNG volumes to RIL's Jamnagar refinery from mid-May 2009 with volumes now at 5mmscmd

Table 2: Source-wise break-up of gas transmission by GSPL

mmscmd	Current	End-FY10E
LNG from Dahej and Hazira import terminals	16.0	15.0
KG D6	10.0	21.0
PMT	2.0	2.0
GSPC-Niko	1.0	1.0
Cairn India	1.0	1.0
<b>Total</b>	<b>30.0</b>	<b>40.0</b>

Source: Company

### KG D6 gas to be main driver of further volume growth

#### RIL-GSPL contract for 11mmscmd; may be scaled up to 14-20mmscmd

GSPL has an agreement with RIL to transport at least 11mmscmd of gas to its Jamnagar refineries. KG D6 gas is expected to drive more volume growth for RIL besides this specific gas transportation contract RIL has as a consumer with GSPL. Currently 5mmscmd of spot LNG is being used by RIL at its refineries but it is expected to start using KG D6 gas from 3Q FY10. As per the contract between GSPL and RIL volumes transmitted to Jamnagar may be scaled up to 14mmscmd and even 20mmscmd.

### Gas volumes expected to ramp up to 40mmscmd by 4Q

#### KG D6 gas to ramp up from 30mmscmd now to 80mmscmd by end-2009E

GSPL's gas volumes are expected to further rise to 40mmscmd by 4Q FY10E.

The ramp up in RIL's KG D6 volumes from the prevailing 30mmscmd to 80mmscmd is expected by 4Q. It would be the main driver of further growth in GSPL's volumes in FY10E. Of GSPL's current volumes of 30mmscmd, only 10mmscmd are KG D6 gas volumes. By 4Q when KG D6 gas volumes ramp up to an estimated 80mmscmd, KG D6 gas volumes transmitted by GSPL in Gujarat are expected to rise to 21mmscmd (see Table 2).

### Incremental supply to RIL & Torrent Power to drive growth

#### Some gas supply also to IOC and IPCL from 3Q FY10E

The expected rise in GSPL's gas transmission volume to 40mmscmd will come mainly from 6mmscmd additional volumes to RIL and 2-3mmscmd to Torrent Power. As against 11mmscmd to be transported to Jamnagar refineries of RIL only 5mmscmd is currently being transported. Currently regassified LNG is being used by RIL but when KG D6 volume ramps up fully 11mmscmd of D6 gas would be used by the Jamnagar refineries. Torrent Power volumes currently are 2-3mmscmd as against the eventual 5mmscmd. GSPL is also likely to transmit gas to IPCL and IOC's Gujarat refinery from 3Q FY10E.

Table 3: Main consumers of gas transmitted by GSPL

mmscmd	Current	End-FY10E
RIL	5.0	11.0
Essar Steel	6.0	6.0
GPEC	3.0	3.0
Torrent	3.0	5.0
GSPC Gas	2.4	2.4
Essar Power	1.4	1.4
Kribhco	1.4	1.4
IFFCO	1.2	1.2
GSEG	0.7	0.7
GSFC	0.7	0.7
GSEC	0.7	0.7
Adani	0.6	0.6
Others	3.9	5.9
<b>Total</b>	<b>30.0</b>	<b>40.0</b>

Source: Company

### RIL, Essar and Torrent Power main customers of GSPL

These consumers to account for 60% of volumes when at 40mmscmd

When GSPL's volumes ramp up to 40mmscmd its main customers are likely to be

- Reliance Industries. GSPL has an agreement to transport 11mmscmd of gas to RIL's Jamnagar refinery, which is expected to be achieved by 4Q FY10E when KG D6 gas fully ramps up. We estimate volumes transmitted to RIL's Jamnagar refineries could eventually rise to 14-20mmscmd.
- Essar group. GSPL transports 7.4mmscmd of gas to Essar Steel (6mmscmd) and Essar Power (1.4mmscmd). RIL may get an opportunity to transport 4-5mmscmd of gas to Essar Oil's refinery located close to RIL's refineries
- Torrent Power. GSPL will transmit 5mmscmd of gas to Torrent Power when it fully ramps up

These three consumers are likely to account for 60% of GSPL's volume when it ramps up to 40mmscmd, in our view. Table 3 gives some of GSPL's other main consumers.

### FY10E gas volumes assumed 108% YoY higher at 31mmscmd

We expect gas transmission volumes of GSPL to rise to 31mmscmd. This would imply 108% YoY rise in FY10E volumes over FY09 levels of 14.9mmscmd. We expect volumes to average 26mmscmd in 1H and 36mmscmd in 2H.

### FY10E tariff assumed to be 16% YoY lower at Rs750/tcm

Tariff to decline later in FY10E as volumes ramp up

1Q FY10 tariff of GSPL is Rs915/tcm. Tariff is likely to fall later in FY10E as volumes ramp up. The decline in tariff would be due to

- Lower tariff on transmission to RIL and Torrent Power
- Changes in tariff as per new regulations.

### Application of new regulations may also reduce tariff

The process for GSPL being granted authorization has begun. Once authorization is granted, the process for GSPL's tariffs being approved by the regulator should begin. GSPL's revised tariff as per regulations notified in November 2008 is likely to be available by end of FY10E. The application of the new regulation may also reduce tariff later in FY10E from 1Q levels.

### Upside risk to FY10E tariff assumption of Rs750/tcm 1Q tariff 22% higher than that assumed for FY10E

We are assuming GSPL's FY10E tariff to be 16% YoY lower at Rs750/tcm. There may be upside risk to FY10E tariff given that

- 1Q tariff of Rs915/tcm is 22% higher than tariff assumed for FY10E of Rs750/tcm
- Tariff even after corrections later in FY10E is expected to settle at Rs750/tcm only by 4Q FY10E. Thus average FY10E tariff is likely to be higher than Rs750/tcm though it would be lower than 1Q tariff
- Tariff for large gas consumers like RIL and Torrent Power under the new regulations may be higher than the prevailing tariff, which was negotiated earlier.

### FY10E earnings expected to rise by 123% YoY Earnings growth driven by 108% YoY volume rise

We expect GSPL's FY10E earnings to jump by 123% YoY driven by 108% YoY rise in gas transmission volumes. The strong earnings growth is despite assuming 16% YoY lower pipeline tariff.

- FY10E revenue is likely to be 74% YoY higher at Rs8.5bn. GSPL has already achieved revenue of Rs2.1bn in 1Q. 1Q volume at 25.3mmscmd is 18% lower than 31mmscmd expected in FY10E
- FY10E EBITDA is expected to be 80% YoY higher at Rs7.7bn (Rs2bn achieved in 1Q)
- FY10E pre-tax profit is expected to be 118% YoY higher at Rs4.2bn (Rs1.22bn in 1Q)
- FY10E net profit is expected to be 123% YoY higher at Rs2.8bn (Rs805m achieved in 1Q)
- FY10E EPS is expected to be Rs4.9/share (Rs1.4/share already in 1Q)

Table 4: Upside to GSPL's FY10E earnings if tariff is higher than assumed

Tariff Rs/tcm	FY10E net profit Rs-m	FY10E EPS Rs/share	FY10E ROCE	Cumulative ROCE FY03- FY10E
750	2,755	4.9	13%	7.4%
800	3,128	5.6	14%	7.7%
850	3,502	6.2	15%	7.9%
900	3,875	6.9	16%	8.2%
<b>Upside vis-à-vis base case if FY10E tariff (Rs/tcm)</b>	<b>FY10E net profit</b>	<b>FY10E EPS</b>		
800	14%	14%		
850	27%	27%		
900	41%	41%		

Source: Banc of America Securities - Merrill Lynch

### Upside risk to FY10E EPS from higher than assumed tariff 16% YoY decline in tariff assumed

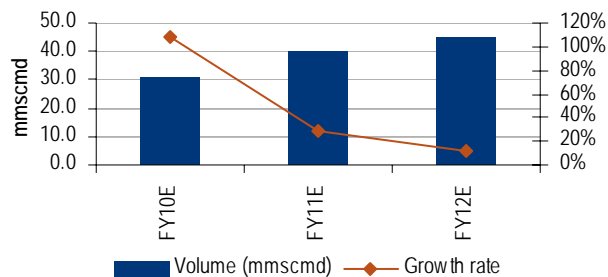
As discussed FY10E tariff could be higher than the assumed Rs750/tcm. It is unlikely to be Rs900/tcm or higher but could be over Rs800/tcm. As can be seen from Table 4, if average tariff is Rs50/tcm higher than assumed we estimate FY10E net profit and EPS would be 13.6% higher than base case.

## Volume & earnings outlook for FY11-FY12E

### FY11E volumes growth of 29% and FY12E of 13% assumed

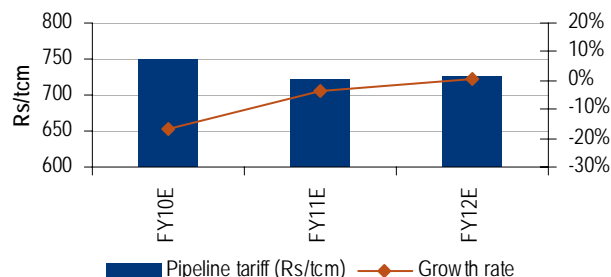
We expect GSPL's transmission volumes to grow 29% YoY to 40mmscmd in FY11E. Given that transmission volumes are expected to be 40mmscmd in 4Q FY10E itself, FY11E average volumes should be 40mmscmd or higher, in our view. Transmission volumes for FY12E are assumed to rise by 13% YoY to 45mmscmd.

Chart 3: Growth in GSPL's transmission volume from FY10 – FY12E



Source: Banc of America Securities – Merrill Lynch

Chart 4: GSPL's pipeline tariff forecast for FY10 – FY12E



Source: Banc of America Securities – Merrill Lynch

### FY11-FY12E pipeline tariff assumed to be flat

#### FY11E tariff 3% YoY lower at Rs725/tcm

GSPL's FY11E pipeline tariff is assumed to be 3% YoY lower at Rs725/tcm. FY12E tariff is expected to flat at Rs725/tcm.

### FY11-FY12E earnings growth to 26-28% YoY

We expect GSPL's FY11E earnings to be 26% YoY higher. While net profit is expected at Rs3.5bn, EPS is expected to be Rs6.2/share. FY12E earnings growth is expected to be 28% YoY. While net profit is expected to be Rs4.4bn, EPS is expected to be Rs7.9/share.

Table 5: GSPL - set to take off from FY10E

	FY10E	FY11E	FY12E
Net Profit (Rsmn)	2,755	3,464	4,430
EPS (Rs/share)	4.9	6.2	7.9
YoY growth	123%	26%	28%
Volume (mmscmd)	31	40	45
YoY growth	108%	29%	13%
Tariff (Rs/tcm)	750	725	725
YoY growth	-16%	-4%	0%

Source: Banc of America Securities - Merrill Lynch

### 3-year EPS CAGR of 53% in FY09-FY12E

We expect GSPL's 3-year EPS CAGR from FY09 to FY12E to be 53%. Thus we believe GSPL is now on the threshold of a strong growth phase driven by higher volumes and stable tariff. GSPL even in the past has seen strong earnings growth driven by volumes and stable tariff (see Appendix).

### GSPL assumed at MAT rate of tax in FY10-FY12E

#### Book profit still after maximum marginal corporate tax rate of 34%

We have assumed current tax rate to be at MAT rate of 17% due to pipeline capex being allowed as deductible expenditure under Section 35AD. However given deferred tax liability book profit is after tax rate of 34%.



**Table 6: GSPL's pipeline network**

Pipeline	Length (kms)
<b>South to North Gujarat (A)</b>	
Baroda-Ahmedabad-Kalol	143
Paguthan-Baroda	84
Kalol-Himmatnagar	63
Mora-Sajod	58
Kalol-Mehsana	47
Amboli-Dahej	45
Padamla-Halol	37
Bhadbut-Paguthan	26
Mora-Utran	25
Kalol-Santej	15
Hazira-Mora	14
<b>Total</b>	<b>557</b>
<b>South to Maharashtra border (B)</b>	
Mora-Vapi	138
<b>To Western Gujarat (C)</b>	
Anand-Rajkot	294
Rajkot-Jamnagar	110
<b>Total</b>	<b>404</b>
<b>Others including spur lines (D)</b>	<b>181</b>
<b>Grant total (A)+(B)+(C)+(D)</b>	<b>1,280</b>

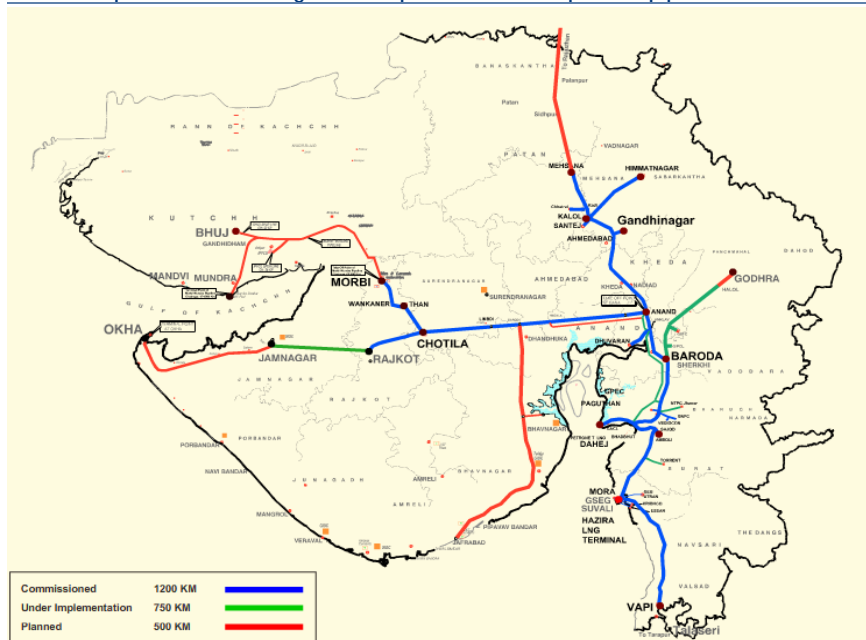
Source: Company, BSE

## Future growth plans

### 1,280km pipeline network with 52mmscmd capacity

Offers better gas pipeline connectivity than any other player in Gujarat  
 GSPL has 1,280km pipeline network in the state of Gujarat (see Table 6 and Chart 5). GSPL offers better pipeline connectivity than any other player in Gujarat including GAIL, which had presence in Gujarat much before GSPL was formed. Gujarat consumes 35-40% of India's gas consumption and thus is the state consuming more gas than any other state.

**Chart 5: Map of GSPL's existing, under implementation and planned pipelines**



Source: Company

**Table 7: GSPL's under implementation and proposed pipeline network**

Pipeline	Length (kms)
<b>Under implementation</b>	
Morbi-Mundra	225
Darod-Jafrabad/Pipavav	225
Baroda-Godhra	40
<b>Total</b>	<b>490</b>
<b>Proposed</b>	
Jamnagar-Okha	140
Mehsana - Bhatinda	960
Bhatinda-Srinagar	440
<b>Total</b>	<b>1,540</b>

Source: Company, Banc of America Securities - Merrill Lynch

## GSPL implementing Rs10bn pipeline projects

### Rajkot-Jamnagar and Bhadbhut-Gana pipelines completed since Mar'09

GSPL commissioned the Rajkot-Jamnagar pipeline in March 2009 while the Bhadbhut-Gana was commissioned in April 2009 at a cost of Rs3.5bn. GSPL is currently implementing the following pipelines

- Morbi-Mundra pipeline at a cost of Rs2.5bn to be completed in 3Q FY10E
- Loop line along the Anand-Rajkot pipeline at a cost of Rs2bn
- Darud-Pipavav pipeline at a cost of Rs5.2bn to be completed in 1Q FY11E

### EOI filed for Mehsana-Bhatinda-Srinagar pipeline

#### 1,400km Rs45bn 20mmscmd capacity pipeline; doubled to 40mmscmd

GSPL has filed expression of interest with the regulator for a new pipeline. The route, capacity and cost of the proposed pipeline are

- 960km long Mehsana-Bhatinda pipeline via Rajasthan (different route compared to HVJ). The pipeline is proposed to be later extended by 440 km from Bhatinda to Srinagar
- Initial gas transmission capacity of the pipeline is proposed to be 20mmscmd to be later expanded to 40mmscmd



- The cost of the Mehsana-Bhatinda pipeline is estimated at Rs35bn with the proposed extension to Srinagar costing another Rs10bn

If all goes well bids may be called by the regulator in September 2009 and the process of choosing a bidder may be completed in March 2010. Under new regulations bids are to be called with award being made to the bidder with the lowest tariff.

## FY10-FY12E earnings and PO cut

### FY10-FY12E earnings cut by 24-28%

We have cut GSPL's FY10-FY12E earnings by 24-31% to Rs4.9-7.9/share. The old earnings forecast had been made on more optimistic volume growth assumptions with KG D6 gas assumed to start in 1H FY09. The capex assumed, too, was lower.

Table 8: GSPL's revised earnings

Rs/share	Revised EPS	Old EPS	Change
FY10E	4.9	6.8	-28%
FY11E	6.2	9.0	-31%
FY12E	7.9	10.4	-24%

Source: Banc of America Securities - Merrill Lynch

### PO cut by 7% to Rs79/share from Rs85/share earlier

#### PO based only on existing and pipelines under implementation

We have also cut GSPL's DCF-based PO by 7% to Rs79/share from Rs85/share earlier. This is the PO based on the new volume, tariff and capex assumptions. The PO is based on assumption of no new pipelines other than those under implementation

## Retain Buy

### On the threshold of a strong growth phase

#### 123% YoY earnings growth in FY10E and 3-year EPS CAGR to FY12E 53%

We believe GSPL is on threshold of strong earnings growth phase drive by strong volume growth, high pipeline utilization rate and stable tariff. We expect FY10E earnings to be 123% YoY higher. FY10-FY12E EPS CAGR is expected to be 53%.

### Big future growth opportunities not factoring in PO

#### Rs35bn Mehsana-Bhatinda could be next growth driver

Our earnings and fair value estimates factor in only existing pipelines and those under implementation. Future growth opportunities are not factored in due to lack of clarity. One such opportunity is the Rs35bn Mehsana-Bhatinda pipeline. GSPL has filed EOI with regulator for this pipeline.

Gas supply in India set to increase sharply. The government has indicated it would like to encourage a comprehensive network of pipelines. The finance minister in the July 2009 budget said "Government proposes to develop a blueprint for long distance gas highways leading to a National Gas Grid. This would facilitate transportation of gas across the length and breadth of the country." Thus there would be several growth opportunities for an aggressive company like GSPL with strong presence in Gujarat. Gujarat is the largest gas consuming state. Most of the main gas pipelines in India start from or end in Gujarat.

### PO offers 25% potential upside

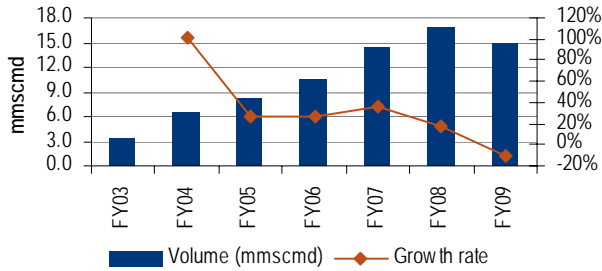
GSPL's revised PO of Rs79/share offers 25% potential upside. There could be more upside as clarity on more growth opportunities emerges. We retain our Buy rating on GSPL.

## Appendix

**6-year volume CAGR of 29% since FY03; 5-year CAGR 39%  
Volumes declined by 11% YoY in FY09**

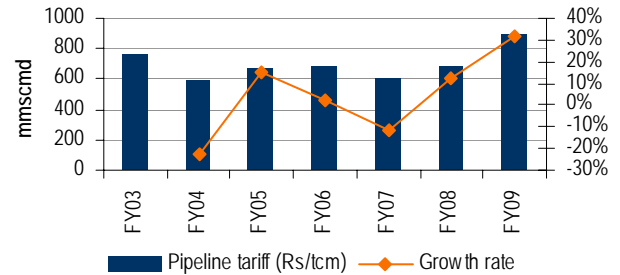
GSPL's gas transmission volumes have increased at a 5-year CAGR of 39% from 3.3mmscmd in FY03 to 16.8mmscmd in FY08. GSPL's gas transmission volumes declined by 11% YoY to 14.9mmscmd in FY09. 6-year volume CAGR from FY03 to FY09 is still a robust 29%.

Chart 6: GSPL's transmission volume from FY03 to FY09



Source: Company, Banc of America Securities – Merrill Lynch

Chart 7: GSPL's pipeline tariff from FY03 to FY09



Source: Company, Banc of America Securities – Merrill Lynch

### Pipeline tariff has sustained despite rising volumes

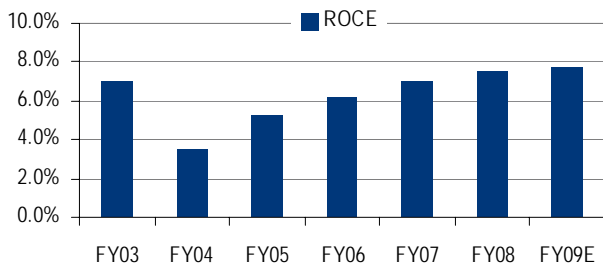
**FY08 tariff just 10% lower than FY03; FY09 tariff 18% higher than FY03**

GSPL's pipeline tariff has sustained at reasonable levels despite strong volume growth. GSPL's average tariff was Rs760/tcm in FY03 when its average volume was just 3.3mmscmd. While its gas transmission volumes jumped 5x to 16.8mmscmd in FY08, its average tariff at Rs682/tcm was just 10% lower than FY03 average tariff. In FY09 GSPL's volumes declined YoY. Thus FY09 average volumes are 4.6x FY03 volumes while average FY09 tariff is 18% higher than average FY03 tariff.

### 6-year profit CAGR 41% and 6-yr EPS CAGR 17%

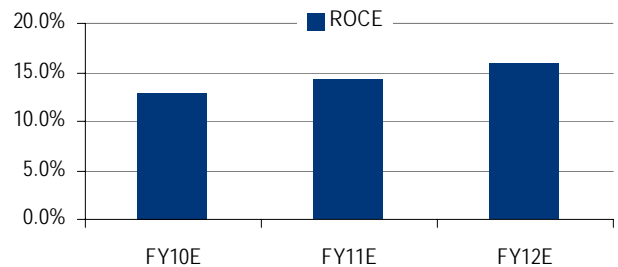
GSPL's profit has increased at CAGR of 41% from Rs160m in FY03 to Rs1.2bn in FY09. 6-year EPS CAGR during FY03 to FY09 is 17%. Outstanding shares have increased from 185m in FY03 to 562m in FY09.

Chart 8: GSPL's ROCE for FY03-FY09E



Source: Company, Banc of America Securities – Merrill Lynch

Chart 9: GSPL's ROCE set to rise from FY10E onwards



Source: Company, Banc of America Securities – Merrill Lynch

### **6-8% ROCE from FY03-FY09**

GSPL's ROCE was in a band of 6-8% in FY03 to FY09. During this period GSPL's ROCE was well below the return permitted by regulation of 12% as

- Tariff was market determined
- GSPL aggressively incurred capex to expand its pipeline network

### **ROCE set to rise to 13-16% in FY10-FY12E**

#### **Regulations and sharp volume growth to help**

We expect GSPL's ROCE to be 13-16% in FY10-FY12E. Strong volume growth is expected to be the main driver of rise in ROCE. Regulation has also helped GSPL to the extent that it realized its tariff gave ROCE of less than 12%. Therefore GSPL revised tariff upwards under several contracts in January 2009.

### **Cumulative ROCE in FY03-FY09 6.2%; 9.9% in FY03-FY12E**

GSPL's ROCE in FY10-FY12E may be higher than regulated return of 12%. However its cumulative ROCE from FY03-FY09 is 6.2%. Cumulative ROCE from FY03-FY12E would be 9.9% on our assumptions. Cumulative ROCE would be 12% only after 16% ROCE sustains for four more years up to FY16E.

## Price objective basis & risk

### Gujarat State (GJRSF)

DCF-based PO of GSPL works out to Rs79. WACC is 10pct based on 11.5pct cost of equity, 9.5pct cost of debt, 17pct tax and debt-equity of 67pct. We have assumed gas transmission volume CAGR of 45pct in FY09-FY12E. Gas transmission tariff is assumed to decline at a CAGR of 7% in FY09-FY12E. In our view P/E is not suitable to value GSPL for two reasons 1) GSPL depreciates its pipeline over 12 years vis-à-vis 30 years by peers like GAIL, thereby making earnings multiple unsuitable. 2) GSPL is in a takeoff stage. So, valuation based on one-year earnings or EBITDA is not suitable. We prefer DCF to value GSPL. Neither depreciation policy nor GSPL being at a take-off stage is an issue while using DCF valuation. Downside risks: 1) Regulatory risk in the form of regulator requiring GSPL to cut tariff. ROCE for GSPL is actually lower than the regulated rate and management expects tariff upside from regulation. 2) Lower than expected gas transmission volumes.

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Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY	Bharat Heavy	BHHEF	BHEL IN	Bharat Parekh
	Gujarat State	GJRSF	GUJS IN	Vidyadhar Ginde
	IVRCL Infrastruc	IIFRF	IVRC IN	Bharat Parekh
	Jaiprakash	JPRKF	JPA IN	Bharat Parekh

24 July 2009

India - Engineering/Construction/Utilities Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
	Jaiprakash Hydro	XJSHF	JHPL IN	Bharat Parekh
	Larsen & Toub -G	LTORF	LTOD LI	Bharat Parekh
	Larsen & Toubro	LTOUF	LT IN	Bharat Parekh
	Mundra Port SEZ	XMANF	MSEZ IN	Bharat Parekh
	Nagarjuna Const	NGRJF	NJCC IN	Bharat Parekh
	NCC-GDR	XAKUF	NJGR LX	Bharat Parekh
	Reliance Infrastructure	RCTDF	RELI IN	Bharat Parekh
<b>NEUTRAL</b>				
	Gail India	XGLAF	GAIL IN	Vidyadhar Ginde
	Gail Limited - G	GAILF	GAID LI	Vidyadhar Ginde
	Gujarat Inds	GUJIF	GIP IN	Bharat Parekh
	Neyveli Lignite	NEYVF	NLC IN	Bharat Parekh
	Sun TV LTD	SUTVF	SUNTV IN	Bharat Parekh
	Tata Pwr. Co.	XTAWF	TPWR IN	Bharat Parekh
<b>UNDERPERFORM</b>				
	ABB	ABVFF	ABB IN	Bharat Parekh
	Balaji Tele	BLJIF	BLJT IN	Bharat Parekh
	NTPC Ltd	NTHPF	NATP IN	Bharat Parekh
	Suzlon Energy	SZEYF	SUEL IN	Bharat Parekh
	Zee Entertainmen	XZETF	Z IN	Bharat Parekh
<b>RVW</b>				
	GMR Infra	GMRLF	GMRI IN	Bharat Parekh
	Indraprastha Gas	IAGSF	IGL IN	Vidyadhar Ginde

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Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Amortization	Amortization
Operating Margin	Net Income	Shareholders' Equity
Earnings Growth	Operating Profit	Sales
Free Cash Flow	Expected 5-Year CAGR From Latest Actual	N/A
	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

\*Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of June 30, 2009 or such later date as indicated. BAS-ML price charts do not reflect analysts' coverage of the stock at prior firms. Historical price charts relating to companies covered as of June 30, 2009 by former Banc of America Securities LLC (BAS) analysts are available to BAS clients on the BAS website."

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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	68	40.24%	Buy	38	61.29%
Neutral	44	26.04%	Neutral	23	57.50%
Sell	57	33.73%	Sell	17	34.00%

### Investment Rating Distribution: Global Group (as of 01 Jun 2009)

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Neutral	807	25.29%	Neutral	362	51.49%
Sell	1081	33.88%	Sell	394	39.96%

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Underperform	N/A	≥ 20%

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