

Company Focus

28 July 2008 | 9 pages

Gujarat State Petronet (GSPT.BO)

 Target price change
 Estimate change

Buy: 1Q – Another Strong Quarter; Remains Top Gas Utility Pick

- 1Q beats estimates; margins expand further** — GSPL's 1Q PAT of Rs326m was again ahead of expectations buoyed by better volumes, higher blended tariffs, and operating margin expansion. EBITDA margin of 90% was up ~300bps from avg FY08 margins (87.2%). Key reasons: 1) higher average tariffs, as sales to locations at farther distances improved, 2) opex decline (-4% YoY, -9% QoQ). Avg tariffs of Rs729/tcm (Rs719 in 4Q, Rs680 in FY08) were also lifted by capacity charges for Torrent Power, where volumes are yet to commence.
- Volumes to pick up from Q4** — Mgmt reiterated that KG gas should start flowing through their network once production commences (take-or-pay for 11 mmscmd starts from Nov), as many existing units, even those higher in priority, may not be in a position to accept more gas either due to lack of readiness or lack of spare pipeline capacity. Coupled with Shell LNG expansion by Q2 (2.9 to 3.7 MMTPA), mgmt guided towards volumes exceeding 25 mmscmd by Q4.
- Increasing earnings 8-10%** — We are raising our FY09-10E earnings by 8-10%, factoring in higher than earlier assumed tariffs and higher interest costs while leaving volume assumptions largely unchanged; also introducing FY11E.
- Reiterate Buy; top gas pick; Rs79 TP** — We maintain Buy (1L) with a new Rs79 TP, which incorporates higher WACC (10.8%). GSPL stands out as a structural growth story with relatively lower exposure to macroeconomic challenges. Recent newsflow on further discoveries on the east coast by its parent, the latter's aggressive plans in Gujarat on the back of this, and imminent production of KG gas lend visibility to our 27% 3-year EPS CAGR.

Buy/Low Risk	1L
Price (28 Jul 08)	Rs59.65
Target price	Rs79.00
	<i>from Rs84.00</i>
Expected share price return	32.4%
Expected dividend yield	1.0%
Expected total return	33.4%
Market Cap	Rs33,525M
	US\$795M

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



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	EV/EBITDA	P/E	P/B	P/CEPS	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)
2006A	467	1.0	na	19.3	57.3	3.6	21.3	na	0.4
2007A	894	1.6	58.4	13.8	36.2	3.4	16.9	9.5	0.8
2008A	999	1.8	9.8	11.1	33.0	2.9	12.5	9.5	0.9
2009E	1,102	2.0	8.5	9.7	30.4	2.8	11.5	9.4	1.0
2010E	1,564	2.8	41.9	7.9	21.4	2.6	8.3	12.4	1.4
2011E	2,050	3.6	31.1	7.0	16.3	2.3	6.5	14.9	1.8

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	36.2	33.0	30.4	21.4	16.3
EV/EBITDA adjusted (x)	14.5	11.7	10.7	8.6	7.0
P/BV (x)	3.4	2.9	2.8	2.6	2.3
Dividend yield (%)	0.8	0.9	1.0	1.4	1.8
Per Share Data (Rs)					
EPS adjusted	1.65	1.81	1.96	2.78	3.65
EPS reported	1.65	1.81	1.96	2.78	3.65
BVPS	17.79	20.26	21.54	23.34	25.71
DPS	0.50	0.53	0.59	0.84	1.09
Profit & Loss (RsM)					
Net sales	3,176	4,179	5,096	7,290	9,254
Operating expenses	-1,521	-2,166	-2,368	-3,287	-4,119
EBIT	1,655	2,013	2,728	4,003	5,135
Net interest expense	-457	-815	-1,360	-1,849	-2,271
Non-operating/exceptionals	175	294	302	215	242
Pre-tax profit	1,373	1,492	1,670	2,369	3,106
Tax	-479	-492	-568	-806	-1,056
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	894	999	1,102	1,564	2,050
Adjusted earnings	894	999	1,102	1,564	2,050
Adjusted EBITDA	2,681	3,645	4,536	6,461	8,230
Growth Rates (%)					
Sales	20.5	31.6	22.0	43.0	26.9
EBIT adjusted	43.6	21.7	35.5	46.7	28.3
EBITDA adjusted	38.0	36.0	24.4	42.4	27.4
EPS adjusted	58.4	9.8	8.5	41.9	31.1
Cash Flow (RsM)					
Operating cash flow	862	2,047	2,782	3,758	4,955
Depreciation/amortization	1,026	1,632	1,808	2,458	3,095
Net working capital	-1,058	-585	-128	-264	-190
Investing cash flow	-4,401	-6,500	-9,800	-9,700	-1,636
Capital expenditure	-4,401	-6,500	-9,800	-9,700	-1,636
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	2,540	4,202	5,613	4,951	-1,919
Borrowings	2,852	4,362	6,000	5,500	-1,200
Dividends paid	-318	-351	-387	-549	-719
Change in cash	-999	-252	-1,405	-991	1,400
Balance Sheet (RsM)					
Total assets	21,059	27,625	34,677	41,816	42,635
Cash & cash equivalent	1,811	2,557	1,250	384	1,909
Accounts receivable	349	458	419	599	761
Net fixed assets	17,029	21,896	29,888	37,130	35,671
Total liabilities	11,400	16,241	22,577	28,701	28,189
Accounts payable	1,295	1,425	1,567	1,724	1,897
Total Debt	8,638	13,000	19,000	24,500	23,300
Shareholders' funds	9,659	11,384	12,100	13,115	14,445
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	84.4	87.2	89.0	88.6	88.9
ROE adjusted	9.5	9.5	9.4	12.4	14.9
ROIC adjusted	7.6	7.3	7.8	8.9	10.4
Net debt to equity	70.7	91.7	146.7	183.9	148.1
Total debt to capital	47.2	53.3	61.1	65.1	61.7

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Figure 1. GSPL – 1QFY09 Results (Rupees in Millions)

Year to 31-Mar	1Q08	4Q08	1Q09	%YoY	Comments
Net sales	958	1,161	1,195	24.7%	Includes cRs32m capacity charge booked towards Torrent Power's take-or-pay contract
Employee costs	13	34	19	44.5%	
Gas transportation charges	8	0	0	nm	
Connectivity charges	32	24	32	1.4%	
O&M expense of pipelines and compressors	35	36	32	-7.3%	
Admin & others	37	38	36	-1.2%	
Total expenditure	124	131	119	-3.8%	
EBITDA	834	1,030	1,076	29.0%	
<i>EBITDA margin</i>	<i>87.1%</i>	<i>88.7%</i>	<i>90.0%</i>	<i>296 bps</i>	Margin improvement driven by higher revenues, cost decline, and improvement in blended tariffs
Depreciation	398	413	415	4.2%	
Interest	198	203	218	10.1%	
Non-operating income	53	88	68	27.6%	
Profit before tax	291	502	511	75.4%	
Tax	113	96	185	63.9%	
- Current tax	74	134	164	121.6%	
- Deferred tax	39	-38	20	-47.2%	
<i>Tax rate</i>	<i>38.7%</i>	<i>19.2%</i>	<i>36.1%</i>	<i>-254 bps</i>	Recovered to normalised levels
Profit after tax	179	406	326	82.7%	
Cash profits	577	819	741	28.5%	
Operational parameters					
Gas transported (mmscm)	1,536	1,614	1,639	6.7%	Vols remained steady on a sequential basis despite a decline in PLNG vols as Dabhol offtake also declined
Gas transported (mmscmd)	16.9	17.7	18.0	6.7%	
Avg. transportation charge (Rs/tcm)	624	719	729	16.9%	Higher sales to consumers located at higher distances implying higher tariffs

Source: Company Reports and Citi Investment Research estimates

Figure 2. GSPL – Earnings Revision

Year to 31-Mar	Net Profit (Rs Mils.)		Diluted EPS (Rs)			Dividend Per Share (Rs)	
	Old	New	Old	New	% Chg	Old	New
2009E	1,005	1,102	1.79	1.96	9.7%	0.5	0.6
2010E	1,453	1,564	2.59	2.78	7.6%	0.8	0.8

Source: Citi Investment Research estimates

Figure 3. GSPL – DCF Valuation

	March-09	March-10	March-11	March-12	Terminal
EBIT	2,728	4,003	5,135	4,962	5,210
Less: Tax	(501)	(711)	(932)	(966)	(1,014)
Add: Depreciation	1,808	2,458	3,095	3,973	4,171
Add: Decrease in net WC	(128)	(264)	(190)	(215)	(250)
Less: Capex	(9,800)	(9,700)	(1,636)	(1,706)	(2,000)
Free Cash Flow to Firm	(5,893)	(4,213)	5,472	6,048	6,117
NPV of cash flows	(5,893)	(3,803)	4,457	4,444	
Terminal Value					55,543
Total Firm value	60,641				
Less: Net Debt	17,750				
Total Equity value	42,891				
Value per share (Rs)	79				
Terminal growth rate	3.5%				
WACC	10.8%				
Target D/V	55%				
Cost of Debt	10.50%				
Cost of Equity	15.5%				
Equity Beta	1.0				
Risk Free Rate	9.50%				
Market Risk Premium	6.00%				

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. It has a gas transmission network comprising 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/Low Risk (1L). 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) and has 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.

Valuation

Our target price of Rs79 is based on our DCF fair value for Mar-09E. Our DCF is based on gas volumes tied up with Reliance (11-20mmscmd) and announced capex plans (Rs26bn over FY08-10E). 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 DCF valuation is based on explicit forecasts till FY12E, 30% CAGR of committed volumes over FY09-12E, FY12E committed volumes of 50 mmscmd, and terminal growth of 3.5%. We use a WACC of 10.8% (risk free 9.5%, risk premium 6.0%, beta of 1.0, cost of equity 15.5%, cost of debt 10.5%, target D/E of 1.1x). Also, on an adjusted P/B basis, GSPL would trade at 2.4x FY10E on our target price, which we believe is reasonable given adjusted post-tax ROCEs increasing to 11-14% over the next few years as volumes increase. On a price/cash earnings basis, GSPL trades at 8.3x FY10E, a slight premium to other gas utilities, which seems justified given our high growth expectations of its gas transmission business (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 Low Risk rating to GSPL as improved visibility of gas supplies will likely ensure high utilization of the company's pipelines even after its ongoing expansions. Key downside risks to our target price are: 1) adverse impact, if any, of regulation of gas pipeline tariffs by the Petroleum and Natural Gas Regulatory Board; 2) gas supplies – we assume a 30% CAGR in gas volumes for GSPL. If supplies are lower than our expectations or KG gas production commencement gets delayed, 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

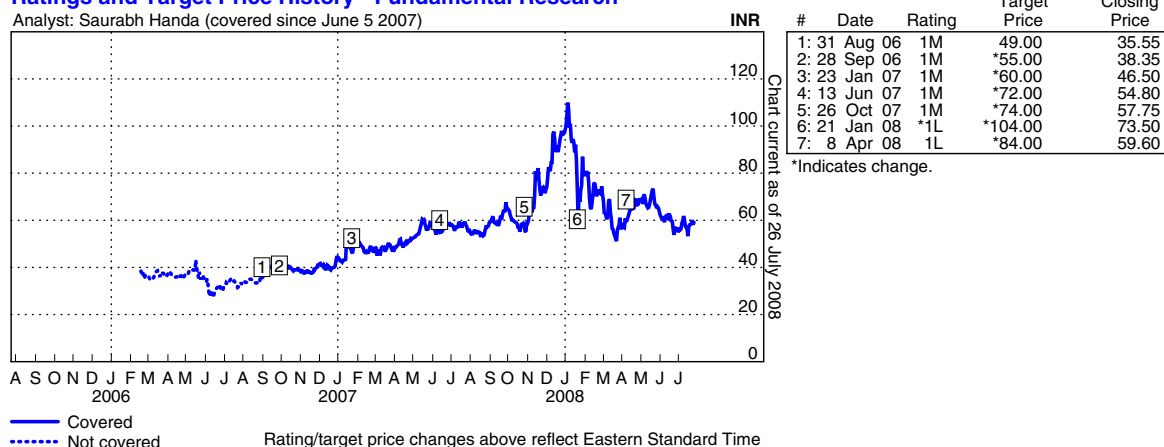
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Analyst: Saurabh Handa (covered since June 5 2007)



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