

## Company Flash

2 January 2009 | 8 pages

# Gujarat State Petronet (GSPT.BO)

## Hold: Shareholder Vote will be Key on Social Contribution Issue

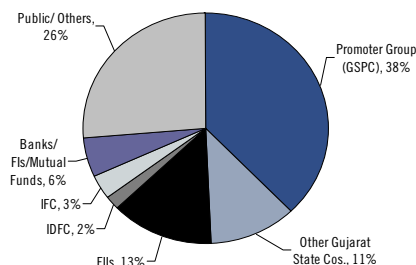
- GACL rejects government's social contribution proposal** — As per press reports (*Economic Times*), shareholders of Gujarat Alkalies & Chemicals Ltd (GACL) rejected a directive for the company to contribute 30% of pre-tax profits to Gujarat state government socio-economic projects. Key to note, however, is the lower share of gov't/gov't-owned companies of ~40% in the company that probably made this possible (vs. c49.3% for GSPL).
- Positive read-off for GSPL, but higher gov't holding a key risk** — The news has a positive read-off for GSPL, which de-rated significantly since the directive was announced. However, given that Gujarat gov't-owned companies (GSPC, GNFC, GIDC, Gujarat Maritime Board, etc.) together have combined shareholding of c49.3% in GSPL, the proposal has a possibility of still going through, if all non-gov't shareholders do not exercise their vote. What obviously ruled in GACL's favour was the higher shareholding of non-gov't minorities.
- Target price increases to Rs52 assuming no social contribution** — Our Rs36 target price assumes the forced contribution of 30% of pre-tax profits from FY09 till perpetuity, with no tax deduction for this provision. If shareholders dismiss this resolution or if the Gujarat government revokes this directive due to a negative response, our target price could rise to Rs52.
- Maintain Hold** — Given strong 15% outperformance in the past week that leaves little upside to our target price, uncertainty surrounding the gov't directive, and an expected weak 3Q due to lower spot volumes, we maintain our Hold (2M) rating.

<b>Hold/Medium Risk</b>	<b>2M</b>
Price (02 Jan 09)	Rs34.75
Target price	Rs36.00
Expected share price return	3.6%
Expected dividend yield	0.7%
<b>Expected total return</b>	<b>4.3%</b>
Market Cap	Rs19,532M US\$401M

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



Figure 1. GSPL – Shareholding Pattern



Source: BSE, Citi Investment Research

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

**Saurabh Handa<sup>1</sup>**  
 +91-22-6631-9858  
 saurabh.handa@citi.com

**Rahul Singh<sup>1</sup>**  
 +91-22-6631-9863  
 rahul.r.singh@citi.com

**Garima Mishra<sup>1</sup>**  
 garima.mishra@citi.com

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<sup>1</sup>Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
<b>Valuation Ratios</b>					
P/E adjusted (x)	21.1	19.2	41.7	30.7	20.9
EV/EBITDA adjusted (x)	9.3	7.4	8.3	7.0	5.8
P/BV (x)	2.0	1.7	1.7	1.6	1.5
Dividend yield (%)	1.4	1.4	0.7	1.0	1.4
<b>Per Share Data (Rs)</b>					
EPS adjusted	1.65	1.81	0.83	1.13	1.66
EPS reported	1.65	1.81	0.83	1.13	1.66
BVPS	17.79	20.30	20.84	21.58	22.66
DPS	0.50	0.50	0.25	0.34	0.50
<b>Profit &amp; Loss (RsM)</b>					
Net sales	3,176	4,179	4,426	6,679	8,596
Operating expenses	-1,521	-2,166	-2,334	-3,177	-4,009
<b>EBIT</b>	<b>1,655</b>	<b>2,013</b>	<b>2,092</b>	<b>3,502</b>	<b>4,587</b>
Net interest expense	-457	-815	-1,093	-2,010	-2,286
Non-operating/exceptionals	175	294	303	278	291
<b>Pre-tax profit</b>	<b>1,373</b>	<b>1,491</b>	<b>1,302</b>	<b>1,770</b>	<b>2,592</b>
Tax	-479	-492	-443	-602	-881
Extraord./Min.Int./Pref.div.	0	0	-391	-531	-777
<b>Reported net income</b>	<b>894</b>	<b>999</b>	<b>469</b>	<b>637</b>	<b>933</b>
Adjusted earnings	894	999	469	637	933
Adjusted EBITDA	2,681	3,645	3,883	5,853	7,573
<b>Growth Rates (%)</b>					
Sales	20.5	31.6	5.9	50.9	28.7
EBIT adjusted	43.6	21.6	4.0	67.4	31.0
EBITDA adjusted	38.0	36.0	6.5	50.7	29.4
EPS adjusted	58.4	9.8	-53.9	35.9	46.5
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>862</b>	<b>5,091</b>	<b>-1,238</b>	<b>2,496</b>	<b>3,668</b>
Depreciation/amortization	1,026	1,632	1,791	2,350	2,987
Net working capital	-1,058	2,460	-3,498	-492	-252
<b>Investing cash flow</b>	<b>-4,401</b>	<b>-6,177</b>	<b>-8,756</b>	<b>-9,700</b>	<b>-1,588</b>
Capital expenditure	-4,401	-5,821	-9,112	-9,700	-1,588
Acquisitions/disposals	0	0	0	0	0
<b>Financing cash flow</b>	<b>2,540</b>	<b>885</b>	<b>7,835</b>	<b>6,776</b>	<b>-1,527</b>
Borrowings	2,852	1,022	8,000	7,000	-1,200
Dividends paid	-318	-329	-165	-224	-327
<b>Change in cash</b>	<b>-999</b>	<b>-201</b>	<b>-2,159</b>	<b>-428</b>	<b>552</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>21,059</b>	<b>27,175</b>	<b>32,515</b>	<b>40,328</b>	<b>40,328</b>
Cash & cash equivalent	1,811	2,569	480	135	767
Accounts receivable	349	416	364	549	707
Net fixed assets	17,029	21,259	28,580	35,930	34,531
<b>Total liabilities</b>	<b>11,400</b>	<b>15,766</b>	<b>20,801</b>	<b>28,201</b>	<b>27,595</b>
Accounts payable	1,295	4,094	1,425	1,567	1,724
Total Debt	8,638	9,660	17,660	24,660	23,460
<b>Shareholders' funds</b>	<b>9,659</b>	<b>11,410</b>	<b>11,714</b>	<b>12,127</b>	<b>12,733</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	84.4	87.2	87.7	87.6	88.1
ROE adjusted	9.5	9.5	4.1	5.3	7.5
ROIC adjusted	7.6	8.0	6.5	8.4	9.7
Net debt to equity	70.7	62.2	146.7	202.2	178.2
Total debt to capital	47.2	45.8	60.1	67.0	64.8

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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. 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 Hold/Medium Risk. 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. While the long-term thesis remains intact given the economics of gas and increasing supplies from the discoveries on the east coast, near-term headwinds exist as (i) economic viability of spot LNG has reduced with falling naphtha prices and (ii) the Gujarat government has directed the company to contribute 30% of its pre-tax profits towards social projects, which will serve as a dampener on investor sentiment.

### Valuation

Our target price of Rs36 is based on our DCF fair value for Mar-09E. Our DCF is based on gas volumes tied up with Reliance (11-14 mmscmd) 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, 21% CAGR of committed volumes over FY08-12E, FY12E committed volumes of 44 mmscmd, and terminal growth of 2.5%. We use a WACC of 11.3% (risk free 9.0%, risk premium 6.0%, beta of 1.0, cost of equity 15.1%, cost of debt 11.5%, target D/E of 1.0x). Also, on an adjusted P/B basis, GSPL would trade at 1.2x FY10E on our target price, which we believe is reasonable given adjusted post-tax ROCEs increasing to 10-14% over the next few years as volumes increase.

## **Risks**

We assign a Medium Risk rating to GSPL. Key downside risks to our target price are: 1) worsened economics of spot LNG, which could impact our volume estimates in the near-term more than assumed by us; 2) political risk - the directive by the state govt. 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. Key upside risks to our target price are: 1) higher than assumed spot LNG volumes if international prices decline; 2) removal of the requirement by the state govt. to contribute 30% of pre-tax profits towards socio-economic projects; 3) higher than expected gas supplies which could positively impact earnings and valuations.

# Appendix A-1

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#### 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
4 13-Jun-07	1M	*72.00	54.80
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
9 28-Oct-08	*2M	*36.00	32.25

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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2 January 2009

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