

Oil&Gas and Petrochemicals

Target price Rs110

Earnings revision

(%)	FY12E	FY13E
Sales	↓ 12.7	↓ 15.2
EBITDA	↓ 13.3	↓ 15.5
EPS	↓ 15.9	↓ 19.9

Shareholding pattern

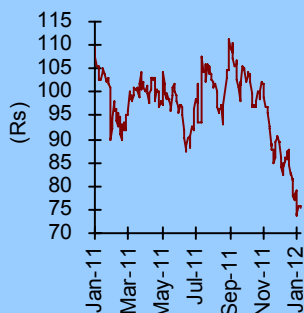
	Mar '11	June '11	Sept '11
Promoters	37.7	37.7	37.7
Institutional investors	42.0	40.4	42.4
MFs and UTI	11.4	10.7	15.0
FIs/ Banks	6.8	9.1	8.9
FII	11.3	8.2	7.5
Others	20.3	21.9	19.9

Source: www.nseindia.com

Target price revision

Rs110 from Rs132

Price chart



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INDIA

Gujarat State Petronet

BUY

Maintained

Rs76

Concerns priced in

Reason for report: Company update

Post our interaction with Gujarat State Petronet's (GSPL) management, our concerns about dropping volumes stand largely mitigated as most of the supply agreements entered into by the company are take or pay contracts. We have revised downwards our volumes estimates by 13-15% over FY12-14, which translates into a revised fair value of Rs110/share, down by 17%. However, the recent correction in the stock fully factors in the concerns on volumes and tariffs. Additional LNG capacities from GSPL's Dahej terminal and Shell's Hazira expansion provide volume visibility in the near term. As for its 4,000km cross-country pipeline, ample sourcing options exist, with ~60mmscmd LNG capacities under commissioning over the next three-four years and additional LNG capacities planned on the east coast. Reiterate Buy.

- Drop in volumes – impact muted due to take or pay clause:** Gas transmission volumes have dropped to ~33mmscmd, as volume offtake from Essar OIL and Torrent Power has declined by ~3mmscmd. Though GSPL's supply mix is dominated by LNG, in wake of dwindling supply from RIL's KG D6 due to production fall there, its revenue hit would be marginal as most of the supply agreements are take or pay contracts. Offtake from Torrent Power is expected to resume in February. Further, drop in spot LNG prices is expected push up volumes as it would bring in customers who cut back due to high LNG prices. We trim our volume estimates for FY12, FY13 and FY14 to 35mmscmd, 37mmscmd and 42.6mmscmd factoring in further decline in RIL volumes.
- Concerns on tariffs in the price:** With PNGRB expected to approve GSPL's tariffs in few months' time, it is being speculated that the tariffs could be lower than the current levels. Though it is challenging to estimate GSPL's regulated tariffs, we believe that the current price of GSPL already captures in the tariffs at Rs0.6/scm, we below our worst case scenario of Rs0.7/scm levels. Our valuations factor in a sharp decline in tariffs, based on which we reiterate that the stock offers favourable risk-reward at the current levels.
- Investments in new pipelines, GSPC Gas add value:** We continue to see positive value in GSPL's investment in the 4,000km cross-country pipeline, as upcoming LNG capacities provide enough volume cushion to make these investments viable. GSPL's stakes in GSPC Gas and Sabarmati Gas provides upsides as well (Rs15/share), as GSPC Gas Company continues to expand its volume base (>4mmscmd currently).

Market Cap	Rs42.5bn/US\$0.8bn	Year to Mar			
Reuters/Bloomberg	GSPT.BO/GUJS IN	2011	2012E	2013E	2014E
Revenue (Rs bn)		10,470	9,995	9,998	10,687
Net Income (Rs bn)		5,064	4,957	4,865	5,211
EPS (Rs)		9.0	8.8	9.0	9.6
% Chg YoY		23.2	(2.1)	1.8	7.1
P/E (x)		8.4	8.6	8.5	7.9
CEPS (Rs)		11.3	11.5	12.0	13.0
EV/E (x)		5.7	5.8	5.6	5.1
Dividend Yield (%)		1.3	1.3	1.4	1.4
RoCE (%)		17.2	14.7	13.3	13.2
RoE (%)		29.3	24.1	20.5	19.3
Shares Outstanding (mn)	562.58				
52-week Range (Rs)	111/74				
Free Float (%)	62.3				
FII (%)	7.5				
Daily Volume (US\$/'000)	3,279				
Absolute Return 3m (%)	(28.8)				
Absolute Return 12m (%)	(29.2)				
Sensex Return 3m (%)	(5.0)				
Sensex Return 12m (%)	(16.4)				

LNG to dominate supply mix – until domestic volumes ramp up

With volume offtake from Essar Oil and Torrent Power declining by ~3mmscmd, overall gas transmission volumes have come down to ~33 mmscmd at present. Though GSPL's supply mix is dominated by LNG, in wake of dwindling supply from RIL's KG D6 due to production fall, its revenues would be marginally hit as most of the supply agreements are take or pay contracts.

Offtake from Torrent Power is expected to resume in February '12. Spot LNG prices have dropped to US\$12-14/mmbtu at present from US\$16-17/mmbtu in October-November. This is expected to help bring back customers who cut back due to high LNG prices. Besides, the gas prices were significantly propped up by the depreciation in the rupee. But, with the rupee gaining strength, gas prices have begun to ease.

We trim our volume estimates for FY12, FY13 and FY14 to 35mmscmd, 37mmscmd and 42.6mmscmd factoring in further decline in RIL volumes. We continue to maintain tariff decline to Rs0.7/scm by FY14. According, we revise down our earnings estimates by 16% to 19% over the next three years (Table 1). We believe this to be the worst case scenario for the company considering that ~20mmscmd additional capacities are coming up on the west coast over the next 2-3 years.

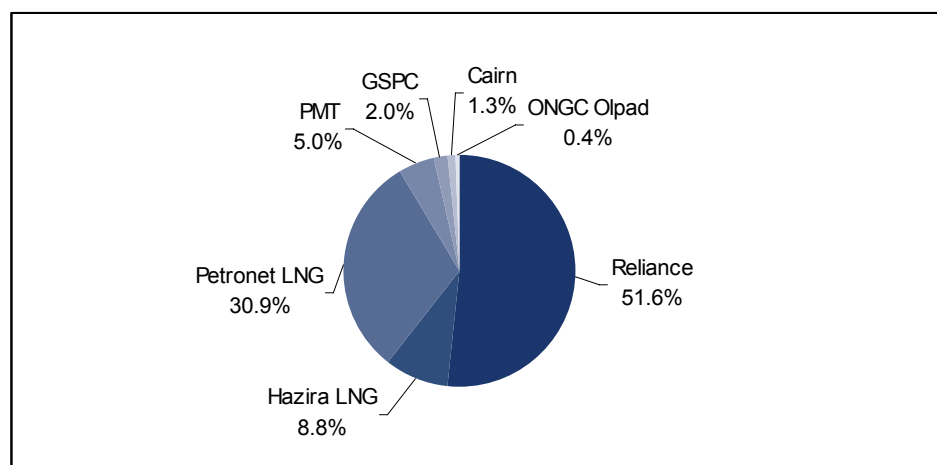
Table 1: Change in assumptions and earnings

(Rs mn)

	New			Old			% change		
	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E	FY12E	FY13E	FY14E
Volumes (mmscmd)	35.09	37.26	42.64	37.66	43.82	49.23	(6.8)	(15.0)	(13.4)
Average Tariffs (Rs/mmscm)	0.80	0.76	0.71	0.86	0.76	0.71	(6.7)	(0.5)	(0.6)
Revenue	9,995	9,998	10,687	11,454	11,786	12,408	(12.7)	(15.2)	(13.9)
EBITDA	9,255	9,196	9,768	10,673	10,879	11,384	(13.3)	(15.5)	(14.2)
PAT (adjusted)	4,957	4,865	5,211	5,893	6,076	6,464	(15.9)	(19.9)	(19.4)

Source: I-Sec research

Chart 1: Supply mix for GSPL (current)



Source: I-Sec research

Concerns on tariffs in the price

The Petroleum & Natural Gas Regulatory Board (PNGRB) is expected to approve GSPL's tariffs in few months' times. And it is being speculated that the tariffs could be lower than the current levels. The PNGRB is awaiting clarification on the following two issues with regards to calculation of tariffs:

- **Depreciation:** The regulator has considered using the actual depreciation rate as used by GSPL – 8% till FY10 and 3.17% thereafter. However, GSPL has asked for 3.17% depreciation rate for the entire period under consideration, which results in a higher net block (hence higher tariffs).
- **Pipeline start up date:** The regulator has assumed a common start up date for pipelines to arrive at the net block, while GSPL has assumed actual start up dates to calculate the net block.

The PNGRB is expected to arrive at the final decision on GSPL's tariffs after the appointment of its Director (Commercial) and Director (Technical). Though it is difficult to precisely estimate GSPL's regulated tariffs, we believe that the current price of GSPL already captures in the tariff fall below Rs0.7/scm levels. Our valuations factor in a sharp decline in tariffs, on the basis of which we reiterate that the stock offers favourable risk-reward at the current levels.

Upsides from new pipelines and CGD business

We continue to see positive value in GSPL's investment in the 4,000km cross-country pipeline, as upcoming LNG capacities provide enough volume cushion to make these investments viable. For the valuation of this pipeline, we have tried to capture most of the risks associated with execution and sourcing availability. We have assumed a conservative scenario for valuation – 10% cost escalations, lower utilisation levels and delays in commissioning. The DCF value for this pipeline works out to Rs15/share, which we believe is conservative considering that GSPC has ~5mmtpa LNG contracts in place. Around 80mmscmd LNG capacities under commissioning provide strong visibility to the company's valuation outlook. Shell/Total have recently indicated that they are expanding their Hazira LNG capacity to 10 mmtpa over the next few years,

As the Mehsana-Bhatinda Gas Pipeline (MBPL) and the Bhatinda-Jammu-Srinagar Gas Pipeline (BJSPL) are in a series, the volumes are envisaged to flow through the MBPL system first and then through the BJSPL. As such, the consortium has decided to treat the combined network of MBPL and BJSPL as one composite network and consider it as one project. This prompted the Steering Committee of the consortium to set up two separate JV companies, one for MBPL and BJSPL (MBJSPL) & other for MBBVPL (Mallavaram-Bhopal-Bhilwara-Vijaipur).

GSPL plans to achieve financial closure for the Mehsana-Bhatinda JV in January. The project, estimated to cost Rs35 bn, is being implemented by a special purpose vehicle, with 52% majority holding of GSPL.

Table 2: Valuation assumptions for GSPL's new pipelines

	Mallavaram-Bhilwara	Mehsana-Bhatinda	Bhatinda-Jammu
Cost of Equity	13.90%	13.90%	13.90%
Tariff (Rs/mscm)	1,068	1,165	320
Tariff (Rs/mm btu)	29.92	32.64	8.95
Depreciation rate	3.17%	3.17%	3.17%
Capacity (mmscmd)	52	42	31
Capex	71,500	49,500	13,200
Debt	50,050	34,650	9,240
Distance	1,688	1,611	740
Capex (Rs mn/km)	42	31	18
PV of FCFE to FY43 (Rs. Mn)	7,904	10,042	(1,362)
Pipeline per share value to GSPL (Rs/share)	7.3	9.3	(1.3)
Total	15.3		

Source: Company, I-Sec research

Table 3: Incremental LNG capacities coming up in four years (mmtpa)

	FY12E	FY13E	FY14E	FY15E	FY16E
Dahej					
Existing	10.00	10.00	10.00	10.00	10.00
Operational efficiency	1.50	1.50	1.50	1.50	1.50
Ind Jetty	0.00	0.00	0.25	0.50	0.50
Expansion	0.00	0.00	0.00	3.75	3.75
Total Dahej	11.50	11.50	11.75	15.75	15.75
Kochi	0.00	1.25	5.00	5.00	5.00
Total PLNG	11.50	12.75	16.75	20.75	20.75
Hazira, Shell & Total	3.67	4.34	5.00	5.00	5.00
Mundra, GSPC & Adani	0.00	0.00	0.00	3.75	5.00
Pipavav, Swan Energy, FSRU*	0.00	0.00	0.00	3.75	5.00
Dabhol, GAIL & NTPC	0.44	1.75	1.75	5.00	5.00
Total (mmtpa)	15.61	18.84	23.50	38.25	40.75
Total (mmscmd)	58.2	70.2	87.6	142.5	151.8

*FSRU: Floating Storage & Regasification Unit

Source: I-Sec research

Table 4: Domestic demand-supply scenario (mmscmd)

	FY12E	FY13E	FY14E	FY15E	FY16E	FY17E
Domestic supply	121.9	123.4	124.9	147.4	174.5	192.8
LNG supply	58.2	70.2	87.6	142.5	151.8	151.8
Total supply	180.0	193.5	212.4	289.9	326.3	344.6
Power & fertiliser sector demand	109.9	127.7	144.0	160.7	170.4	180.1
Non-power & fertiliser sector demand	67.0	82.0	108.0	121.0	144.0	153.0
Total demand	176.9	209.7	252.0	281.7	314.4	333.1
Demand-supply gap	3.1	(16.2)	(39.6)	8.2	11.9	11.5

Source: I-Sec research

Investments in CGD provide value: GSPL has stakes in its parent, Gujarat State Petroleum Corporation's (GSPC), CGD business companies. It has 34% stake in GSPC Gas Company and 14% share in Sabarmati Gas Company. Combined these two CGD companies sell more than 5mmscmd in Gujarat and are profitable enough to contribute Rs15/share (at 15x FY11 earnings) to GSPL's stock (though we have not factored in any such contribution to arrive at our fair value). GSPC Gas Company is the largest CGD company in India in volume terms and its profitability could surge once its gross margins currently depressed at Rs2.2/scm normalise.

Table 5: Valuation potential from CGD

FY11 financials	GSPC Gas Co.*	Sabarmati*
GSPL's share (%)	36.59	13.75
Volume (mmscmd)	3.75	0.8
CNG Stations (nos)	110	17
Domestic connections (nos)	251,000	50,000
Other connections (nos)	1170	325
Revenue (Rs mn)	19,080	4,570
Rs/scm	13.9	15.7
Gross margin (Rs mn)	3,010	720
Rs/scm	2.2	2.5
PAT (Rs mn)	1,480	270
Rs/scm	1.1	0.9

* Provisional numbers; Source: Company, I-Sec research

Table 6: CGD business valuations

(Rs mn)

FY11	GSPC Gas Co.*	Sabarmati*
GSPL's share	541.5	37.1
Total	578.7	
Equity value (@15x)	8679.9	
Value/share for GSPL	15.4	

* Provisional numbers; Source: Company, I-Sec research

Maintain BUY

At the current market price of Rs76/share, GSPL is attractively valued at FY13E P/E of 8.5x. Also on cash earnings basis, the company is appealing at 6.3x FY13E CEPS. Our DCF valuation for GSPL's Gujarat transmission network yields a fair value of Rs95/share. The new pipelines can add up to Rs15/share upside to the target price even after capturing in apparent risks like execution delays and gas supply tie-ups.

GSPL's overall fair value works out to Rs110/share, implying a comfortable 9.2x FY13E cash earnings. We maintain BUY on the stock, reiterating it to be an ideal long-term pick considering the favourable risk-reward.

Table 7: DCF valuations

(Rs mn)

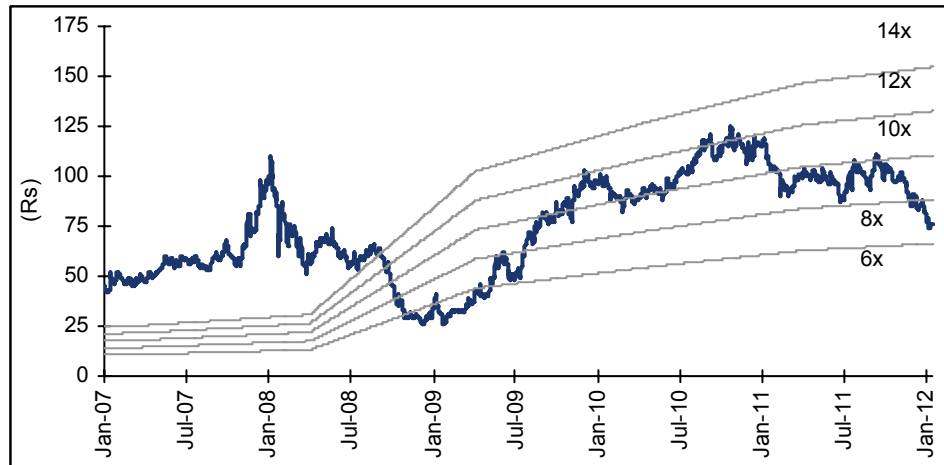
PV of FCF to FY24E	38,549
Terminal value	94,521
PV of terminal value	25,655
EV	64,204
Less: Net debt	10,897
Value for shareholders	53,307
GSPL – Value for extant business (Rs/share)	95
Value from new pipelines (DCF)	15
Total value for GSPL (Rs)	110

Source: I-Sec research

Key risks to our call

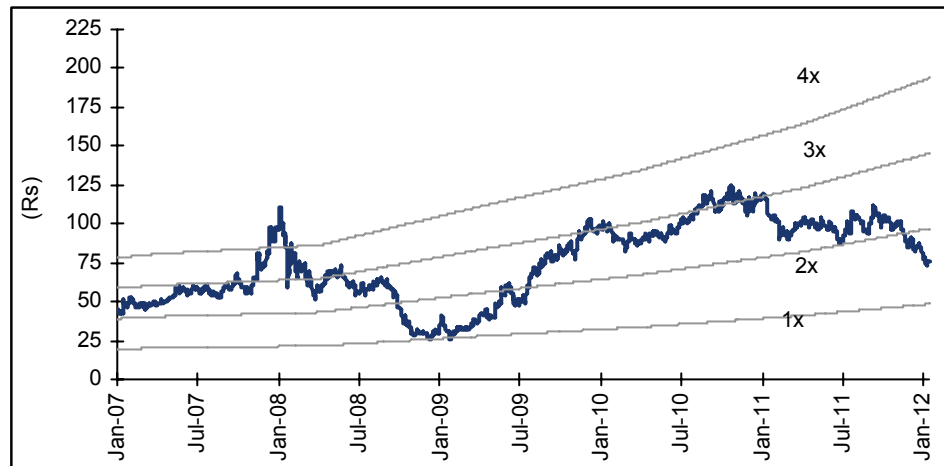
- Delays in setting up new LNG terminals and ramp up of domestic gas production could hamper the profitability of GSPL's new pipelines
- Under-utilisation of pipeline assets led by lower demand on account of economic slowdown or any other macro developments could hamper the profitability of the company
- Cost escalation in GSPL's trunk pipeline network (due to delays) could affect the IRR of the project

Chart 2: Rolling price/EPS trend



Source: I-Sec Research

Chart 3: Rolling PBV trend



Source: I-Sec research

Financial summary

Table 8: Profit & Loss statement

(Rs mn, year ending March 31)

	FY11	FY12E	FY13E	FY14E
Operating Income (Sales)	10,470	9,995	9,998	10,687
Operating Expenses	772	740	802	919
EBITDA	9,698	9,255	9,196	9,768
Depreciation & Amortisation	1,299	1,491	1,631	1,841
Gross Interest	961	1,059	1,081	1,015
Other Income	212	343	350	334
Recurring PBT	7,650	7,048	6,834	7,247
Add: Extraordinaries	-	-	-	-
Less: Taxes	2,586	2,091	1,969	2,036
- CSR tax	-	-	-	-
- Current tax	1,351	953	865	866
- Deferred tax	1,235	1,138	1,103	1,170
Net Income (Reported)	5,064	4,957	4,865	5,211
Recurring Net Income	5,064	4,957	4,865	5,211

Source: Company data, I-Sec research

Table 9: Balance sheet

(Rs mn, year ending March 31)

	FY11	FY12E	FY13E	FY14E
Assets				
Total Current Assets	8,997	9,433	7,868	8,463
of which cash & cash eqv.	2,390	4,471	4,274	4,633
Total Current Liabilities & Provisions	7,586	7,463	7,468	7,658
Net Current Assets	1,410	1,970	400	805
Investments				
of which	766	766	766	766
Strategic/Group	766	766	766	766
Net Fixed Assets	34,284	38,543	42,412	45,071
of which				
Capital Work-in-Progress	117	5,500	3,000	3,000
Total Assets	36,460	41,279	43,577	46,642
Liabilities				
Borrowings	14,882	15,367	13,459	11,904
Deferred Tax Liability	2,641	3,779	4,882	6,052
Equity Share Capital	5,624	5,624	5,624	5,624
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	14,420	18,718	22,925	27,478
Less: Misc. Exp. n.w.o.	1,107	2,211	3,314	4,418
Net Worth	18,937	22,132	25,236	28,685
Total Liabilities	36,460	41,278	43,577	46,642

*Excluding revaluation reserves; # not written off

Source: Company data, I-Sec research

Table 10: Quarterly trend

(Rs mn, year ending March 31)

	Dec-10	Mar-11	Jun-11	Sep-11
Net sales	2,792	2,551	2,843	2,808
% growth (YoY)	4.0	(1.1)	12.91	11.01
EBITDA	2,620	2,297	2,619	2,584
EBITDA Margin (%)	93.83	90.02	92.14	92.02
Other income	54	97	112	143
Add: Extra ordinaries	-	-	-	-
Net profit	1,591	1,506	1,374	1,293

Source: Company data, I-Sec research

Table 11: Cashflow statement

(Rs mn, year ending March 31)

	FY11	FY12E	FY13E	FY14E
Operating Cash flow	7,386	7,243	7,250	7,888
Working Capital Changes	(1,547)	1,521	1,373	(47)
Capital Commitments	(5,929)	(5,750)	(5,500)	(4,500)
Free Cash Flow	(89)	3,014	3,123	3,341
Cash flow from Investing Activities	212	343	350	334
Issue of Share Capital	-	-	-	-
Inc (Dec) in Borrowings	2,287	485	(1,908)	(1,555)
Dividend paid	(658)	(658)	(658)	(658)
Extraordinary Items	-	-	-	-
Chg. in Cash & Bank balance	648	2,080	(197)	359

Source: Company data, I-Sec research

Table 12: Key ratios

(Year ending March 31)

	FY11	FY12E	FY13E	FY14E
Per Share Data (in Rs.)				
Diluted Recurring EPS	9.0	8.8	9.0	9.6
Recurring Cash EPS	11.3	11.5	12.0	13.0
Dividend per share (DPS)	1.0	1.0	1.0	1.0
Book Value per share (BV)	33.7	39.4	46.5	52.9
Growth Ratios (%)				
Operating Income	5.5	(4.5)	0.0	6.9
EBITDA	4.3	(4.6)	(0.6)	6.2
Recurring Net Income	23.2	(2.1)	(1.9)	7.1
Diluted Recurring EPS	23.2	(2.1)	1.8	7.1
Diluted Recurring CEPS	(1.7)	1.3	4.5	8.6
Valuation Ratios (x)				
P/E	8.4	8.6	8.5	7.9
P/CEPS	6.7	6.6	6.3	5.8
P/BV	2.3	1.9	1.6	1.4
EV / EBITDA	5.7	5.8	5.6	5.1
EV / Operating Income	5.3	5.4	5.2	4.7
EV / Operating FCF	9.5	6.1	6.0	6.4
Operating Ratio				
SG&A/Sales (%)	5.9	5.6	6.0	6.4
Other Income / PBT (%)	2.8	4.9	5.1	4.6
Effective Tax Rate (%)	33.8	29.7	28.8	28.1
NWC / Total Assets (%)	(2.7)	(6.1)	(8.9)	(8.2)
Working capital cycle (days)	(61.9)	(63.5)	(116.4)	(131.5)
Receivables (days)	25.6	25.1	24.6	23.9
Payables (days)	66.0	50.2	49.0	47.4
D/E Ratio (%)	92.5	86.5	72.7	62.6

Return/Profitability Ratio (%)

Recurring Net Income Margins	48.4	49.6	48.7	48.8
RoCE	17.2	14.7	13.3	13.2
RoNW	29.3	24.1	20.5	19.3
Dividend Payout Ratio	11.1	11.3	11.6	10.8
Dividend Yield	1.3	1.3	1.4	1.4
EBITDA Margins	92.6	92.6	92.0	91.4

Source: Company data, I-Sec research

New I-Sec investment ratings (all ratings based on absolute return)

BUY: >15% return; ADD: 5% to 15% return; REDUCE: Negative 5% to positive 5% return; SELL: < negative 5% return

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