

Gujarat State Petronet Ltd

Rs.32

..... overdone concerns

Buy

Industry	Gas Distribution	BSE/ NSE Code	532702 / GSPL
Company P/E	7x FY'09E	52 Week H/L	105 / 41
Market Cap. (Rs)	18bn	52 Week Avg volumes BSE / NSE	950000 / 1180000
Face Value	10	Dividend (FY'08)	5%

Key Highlights

- Operational Highlights:** Competitive naphtha prices made the users shift from gas usage, thus leading to a significant decline in spot volumes of gas transmitted by GSPL during Q309. Volumes declined to 13.1mmscmd, de-growth of 25.8% yoy. However, with price economics now tilting towards gas again, the gas volumes look likely to pick up from Q409 onwards. The commencement of contract with Torrent Power from November'08 shall also add to the volumes, going forward.
- Financial Highlights:** GSPL reported net sales of Rs 110.6 crore, up 6.2% yoy. Operating profit of Rs 101.6 crore, up by 4.6% yoy. Higher staff and O&M expenses reduced the profit margin by 128 bps. Net profit growth of 10% yoy for Q309 was driven by good realizations, a growth of 51% yoy. Fixed capacity utilization charges ie. take-or-pay clause was triggered on some of the contracts in this quarter, which led to increase in realizations.
- Other developments:** As per the priority set out by the new gas utilization policy, other sectors have been listed out prior to Refineries in the order of gas supply. This, we believe, shall lead to further delay of gas flowing from GSPL's network to RIL's refinery at Jamnagar to Q3'10. Also, many contracts are renewed at the higher tariff price starting 1st January'09, which shall bolster the revenue earnings of the company.
- Social contribution:** Recently, Government of Gujarat directed all the profit making state PSUs to contribute 30% of pre-tax profit to newly formed Gujarat Socio-Economic Development Society (GSEDS) for welfare activities. In line with the expectations, Board & shareholder had approved payment of 30% of PBT for socio-economic projects. However, as per the management, there have been no eligible projects this year to entail a meaningful contribution out of profits. Thus, we believe there will not be any hit on the bottom line this year. However, such contributions from the future earnings cannot be ruled out.
- Tariff Regulations:** Currently, GSPL's gas transmission agreements are typically with bulk buyers/sellers with a fixed tariff component being chargeable for the reservation of the network capacity. GSPL fixes tariffs based on pipeline distance and utilization, duration of contract, tariff offered by competing pipelines and the comparative cost of alternate fuels. Looking at these parameters, we feel that GSPL's current tariff strategy is more aligned towards Cost of Service (CoS) methodology favored by the draft regulations for determination of network tariff for city or local natural gas distribution networks. Hence, we believe that GSPL will have limited potential downside from any tariff regulatory development in the sector.

Company Profile

GSPL is a pure gas transmission company and hence it is insulated from the vagaries of the gas pricing. It derives its income from transportation tariff which is a sum of a fixed and a variable component. GSPL, after having a wide coverage in Gujarat, has also announced its intention to diversify into areas outside Gujarat like Rajasthan, Andhra Pradesh and Maharashtra. It has invested approx. Rs.600mn in GSPC Gas (GSPC's wholly owned subsidiary), Sabarmati Gas (GSPC's joint venture with BPCL) and Krishna Godavari Gas Network Ltd.

Valuations

We have reduced our volume expectation to 26.5mmscmd & 36mmscmd due to delay in KG Gas D6 volume to RIL Jamnagar refinery, 30% of PBT towards social contribution, and changing competitive pricing in naphtha prices. We believe, all these factors have been discounted in the current stock price and the concerns over the reduced volumes of gas transmission are overdone. At the same time the current valuations are not factoring the significant volume increase beyond Q2'11 and any upside from its expansion beyond Gujarat. At the CMP of Rs 32, GSPL is trading at 6.8x its TTM CEPS. Considering its strategic position in the sector, we recommend a BUY on the stock with a price target of Rs.42 for a medium term horizon.