Initiating Coverage

Gujarat State Petronet Ltd (GSPL)

Current Price	Target Price
Rs 76.7	Rs 85
Potential upside	**Time Frame**
11%	12-15 months

PERFORMER

The growth engine...

Gujarat State Petronet (GSPL), a pure gas transmission company, will be one of the major beneficiaries of increased gas availability in India. GSPL's extensive gas transmission network and additional expansion of its pipeline network in the next two years will contribute significantly to volume growth. GSPL's transmission volumes are expected to increase at 61.8% CAGR over FY09-FY11E. This would lead to 19.1% CAGR in profitability. We believe GSPL's returns would be more than 12% RoCE owing to high spot volumes. We have also factored in 30% CSR contribution to the Gujarat government in our valuations. We are initiating coverage on GSPL with PERFORMER rating and target of Rs 85.

- **Extensive gas transmission network**

  GSPL has a gas transmission network of ~1300 km connecting the major industrial cities of Gujarat. The company has a capital expenditure of ~Rs 1,200 crore for additional 400-500 km of pipelines under implementation. GSPL has also proposed new pipelines, which would thereby contribute to the volume growth, going forward.

- **Increased availability of gas to drive transmission volumes**

  The increase in domestic gas supply volumes from Petronet LNG and the Reliance KG D6 basin will drive the gas transmission volumes at 61.8% CAGR over FY09-FY11E. We expect the transmission volumes to increase from 14.9 mmscmd in FY09 to 30.6 mmscmd and 39 mmscmd in FY10E and FY11E, respectively.

- **Gas Pipeline Policy to improve returns**

  Petroleum and Natural Gas Regulatory Board (PNGRB) has allowed 12% post-tax RoCE on gas transportation pipelines. GSPL's returns for FY09 remained below PNGRB's regulated returns. We believe a favourable Gas Pipeline Policy would result in GSPL generating more than 12% RoCE owing to high spot volumes and lower depreciation.

Valuation

We expect the increase in gas transmission volumes and the favourable Gas Pipeline Policy to lead to 19.1% CAGR in earnings over FY09-FY11E. We have valued GSPL on the DCF methodology to arrive at a price target of Rs 85 (WACC- 10%, terminal growth – 2.5%).

Exhibit 1: Key Financials

Year to March 31	FY08	FY09	FY10E	FY11E
Revenues (Rs Crore)	417.9	487.5	859.2	860.1
EBITDA (Rs Crore)	364.5	424.5	789.5	766.1
Net Profit (Rs Crore)	99.9	123.4	207.8	175.2
Shares in Issue (In Crore)	56.2	56.2	56.2	56.2
EPS (Rs)	1.8	2.2	3.7	3.1
P/E (x)	43.1	34.9	20.7	24.6
Price/Book Value (x)	3.8	3.5	3.1	2.9
EV/EBITDA (x)	14.5	12.9	7.5	7.8
RONW (%)	8.8	10.2	15.1	11.8
ROCE (%)	9.6	10.7	18.7	14.7

Source: Company, ICICIdirect.com Research

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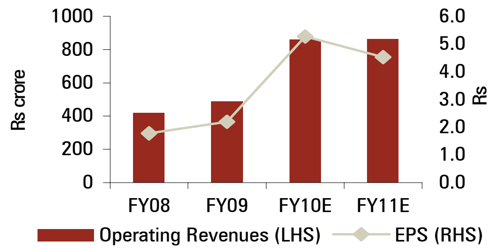
Sales & EPS trend



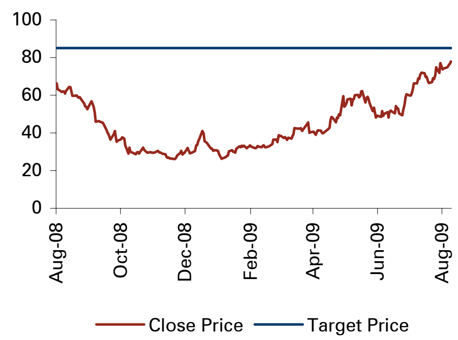
Stock Metrics

Bloomberg Code	GUJS IN
Reuters Code	GSPT.BO
Face value (Rs)	10
Promoters Holding	38%
Market Cap (Rs cr)	4311
52 week H/L	78.6 / 25.3
Sensex	15781
Average volumes	1373437

Comparative return metrics

Stock return (%)	3M	6M	12M
GSPL	29	127	18
Guj Gas Company	18	70	34
GAIL (India)	17	68	30
Indraprastha Gas	9	51	39

Price Trend



Company background

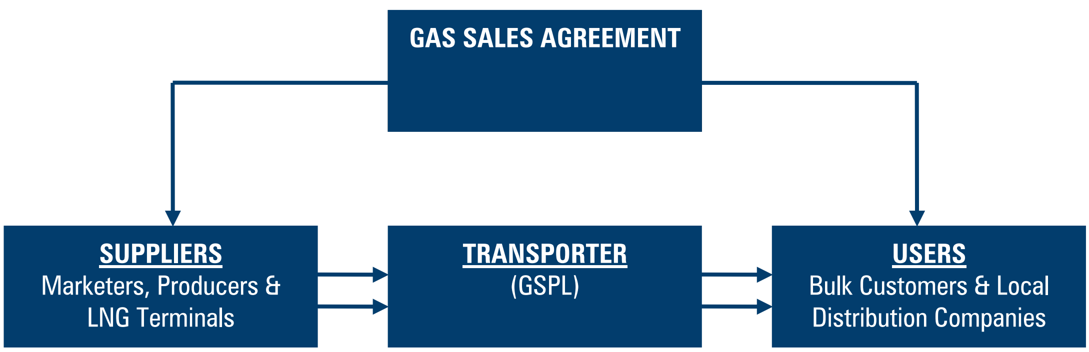
Gujarat State Petronet Ltd (GSPL), a GSPC group company, is a pioneer in developing energy transportation infrastructure and connecting natural gas supply basins and LNG terminals to growing markets. GSPL is continuously expanding its pipeline network in Gujarat. The company has proposed to expand in Rajasthan to reach the demand centres by laying the gas pipeline network.

GSPL is India's first company operating on an open access basis. It is a pure transmission network company. The open access system implies that any user or producer can access the pipeline for a transportation fee. The transmission network of the company envisages development of a systematic and seamless pipeline network across Gujarat connecting various suppliers and users. The suppliers of natural gas include traders, producers and LNG terminals. The users comprise industries such as power, fertiliser, steel, chemical plants and local distribution companies.

The company was incorporated in December 1998 and obtained its certificate of commencement of business in April 1999. GSPL commenced transportation of natural gas following completion of the first segment of network in November 2000. The company commissioned the Hazira-Mora pipeline, with a grid that was 14 km long. It acquired this pipeline from GSPC in exchange for issue of shares of the company to GSPC. In 2005, the total gas transmission network length was increased to 433 km.

Currently, GSPL has a gas transmission pipeline network of 1300 km connecting Hazira, Vadodara, Ahmedabad, Kalol, Himmatnagar, Mehsana, Rajkot, Morbi and Vapi. GSPL transported approximately 15 mmscmd of gas last year. Out of this, a majority of the gas supply was made by R-LNG. GSPL has also acquired strategic stakes in the Krishna Godavari Gas Network (KGGN), GSPC Gas Company and Sabarmati Gas. KGGN is planning to develop a gas transmission network in Andhra Pradesh while GSPC Gas Company and Sabarmati Gas will be developing a city gas distribution (CGD) network in Gujarat.

Exhibit 2: Business model



Source: Company, ICICIdirect.com Research

Exhibit 3: Glossary

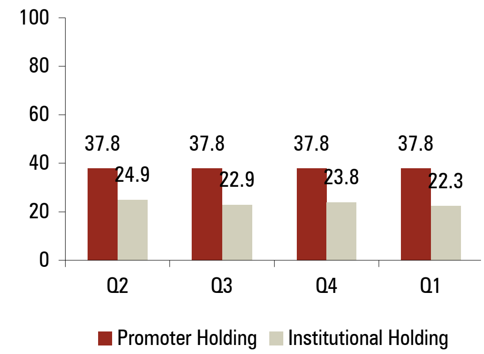
SCM	standard cubic meter
MMSCM	million metric standard cubic meter
MMSCMD	million metric standard cubic meter per day

Source: ICICIdirect.com Research

Shareholding pattern (Q3FY08)

Shareholder	% holding
Promoters	37.8
Institutional investors	22.3
Other investors	11.0
General public	28.9

Promoter & Institutional holding trend (%)

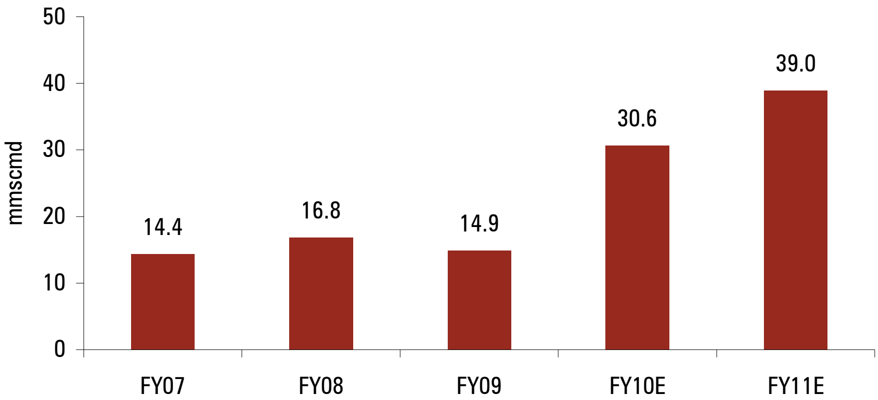


Investment rationale

Gujarat State Petronet (GSPL), a pure gas transmission company, will likely be one of the major beneficiaries of increased gas availability in India. GSPL, with its extensive gas transmission network of ~1300 km, connects major industrial cities of Gujarat. The company also has connectivity to all major natural gas sources in Gujarat. We believe GSPL's ability to cater to demand centres and increase in domestic supplies of gas from Petronet LNG and Reliance KG D6 basin will drive gas transmission volumes at 61.8% CAGR over FY09-FY11E. We expect GSPL's gas transmission volumes to increase from 14.9 mmscmd in FY09 to 30.6 mmscmd and 39 mmscmd in FY10E and FY11E, respectively.

GSPL's gas transmission volumes will increase at 61.8% CAGR over FY09-11E

Exhibit 4: Gas transmission volumes

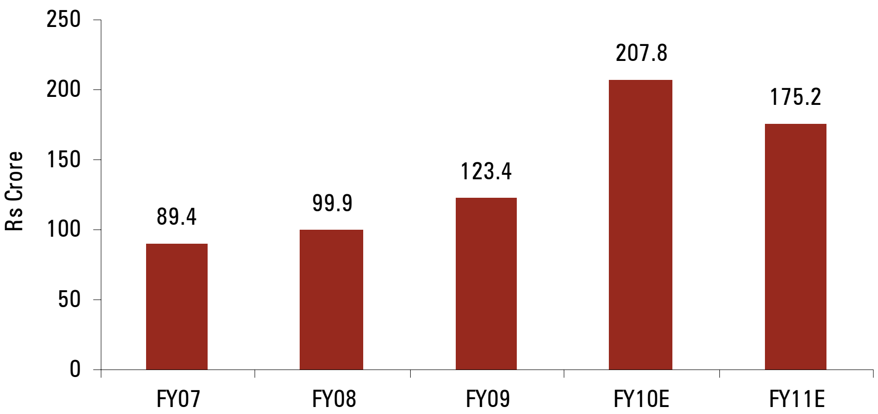


Source: Company, ICICIdirect.com Research

GSPL's revenues are expected to increase at 32.8% CAGR over FY09-FY11E from Rs 487.5 crore in FY09 to Rs 859.2 crore and Rs 860.1 crore in FY10E and FY11E, respectively. We expect the revenue growth in FY10E to be driven by a 105% increase in volumes while revenues for FY11E are expected to decline on implementation of the new PNGRB Gas Pipeline Policy. However, the return ratios are expected to improve from 10.7% RoCE in FY09E to 14.7% RoCE in FY11E. We expect GSPL's net profit after 30% CSR contribution to the Gujarat government to increase at 19.1% CAGR over FY09-FY11E from Rs 123.4 crore in FY09 to Rs 207.8 crore and Rs 175.2 crore in FY10E and FY11E, respectively.

Net profitability will increase at 19.1% CAGR over FY09-11E after accounting for 30% CSR contribution to the Gujarat government

Exhibit 5: GSPL's net profit after 30% CSR contribution



Source: Company, ICICIdirect.com Research

Extensive gas transmission network

GSPL has an extensive gas transmission network of ~1300 km connecting major industrial demand areas and supply sources in Gujarat. GSPL covers the key markets of Surat, Bharuch, Baroda, Anand, Ahmedabad and Mehsana, which are the main demand centres of Gujarat. GSPL's close proximity to the LNG terminals (Dahej and Hazira) and gas fields in Gujarat also ensures secure gas supplies, in turn, leading to higher gas demand.

Year	Pipeline	Length (kms)
2000-01	Hazira - Mora	14
2001-02	Amboli - Dahej	45
2002-03	Mora - Utran	25
	Bhadhut - Paguthan	26
2003-04	Paguthan - Baroda	64
2004-05	Baroda - Ahmedabad - Kalol	143
	Mora - Sajod	58
	Kalol - Santej	15
2006-07	Mora - Vapi	138
	Anand - Rajkot	294
	Kalol - Mehsana	47
	Kalol - Himmatnagar	63
2007-08	Padamla - Halol	37
2008-09	Rajkot - Jamnagar	110

Gujarat being the second most industrialised state in India is one of the main demand centres of natural gas. The power and fertiliser sectors are the main demand drivers of natural gas in Gujarat. Also, the refinery and petrochemicals sector, steel and city gas distribution (CGD) companies would likely be the demand drivers for natural gas, going forward. GSPL with its existing gas pipeline network and additional 450-500 km of pipelines under implementation is well poised to cater to demand from across Gujarat. We believe GSPL will invest Rs 600 crore each in the next two years for the expansion in its pipeline network.

Exhibit 6: GSPL gas transmission network

Pipelines	Major Customers
Hazira-Mora-Vapi	Kribhco, Essar, GSEG
Mora-Bhadbut-Baroda	GEB Utran, Torrent Power, Videocon, GNFC, NTPC
Paguthan-Baroda-Anand-Ahmedebad-Kalol	Torrent, IFFCO, GIPCL, GSFC, GACL
Himmatnagar-Kalol-Mehsana	Across Industries
Anand-Rajkot-Jamnagar	Reliance Industries, Companies in GIDC

Source: Company, ICICIdirect.com Research

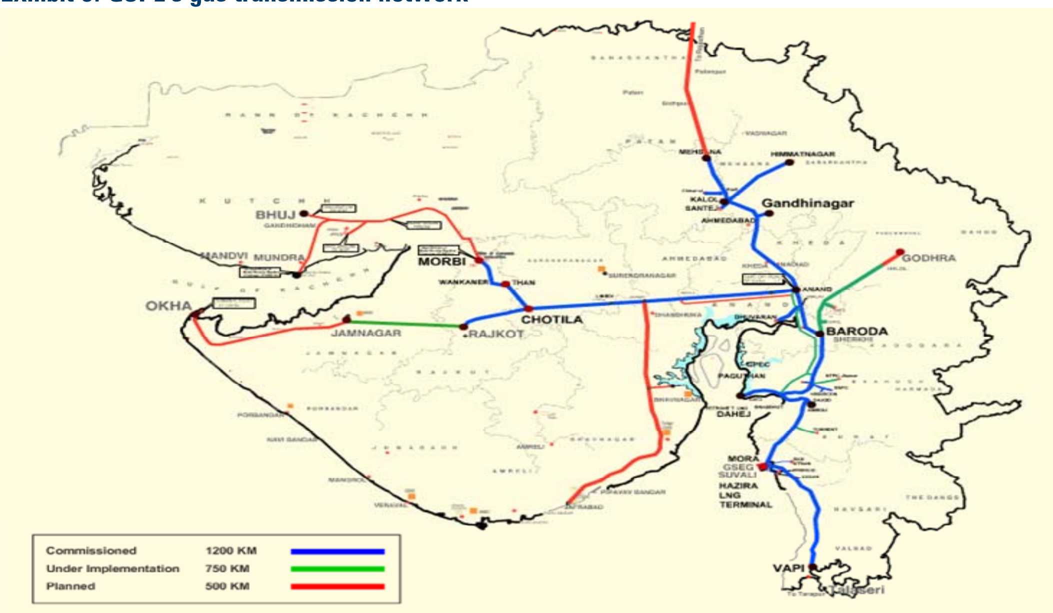
Exhibit 7: Pipelines under Implementation

Pipelines	Length
Morbi-Mundra	225 kms
Darod-Pipavav	225 kms
Baroda-Godhra	40 kms

Source: Company, ICICIdirect.com Research

GSPL has submitted an expression of interest (EoI) to PNGRB for setting up the 960 km Mehsana-Bhatinda pipeline at ~Rs 3,500 crore. GSPL has also proposed to set up the Jamnagar–Okha and Bhatinda–Srinagar pipelines, which could provide further earnings upsides in the next few years.

Exhibit 8: GSPL's gas transmission network

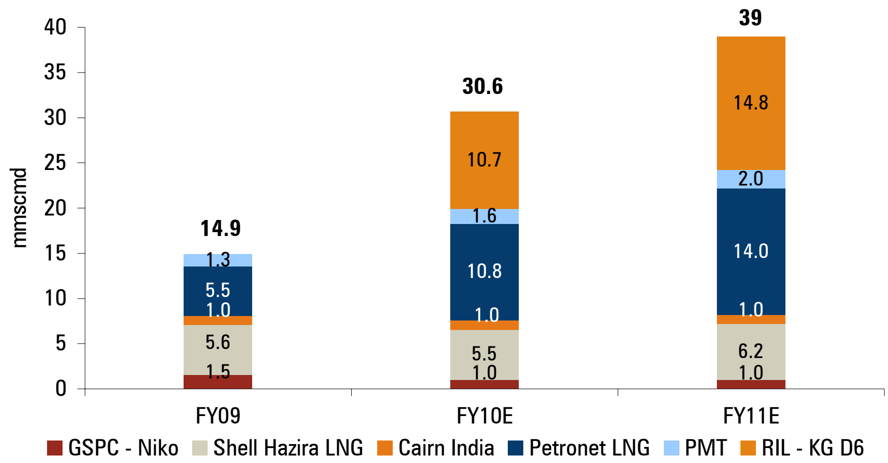


Source: Company, ICICIdirect.com Research

Increased availability of gas to drive transmission volumes

We believe GSPL will be one of the prime beneficiaries of increased gas availability in India. The commencement of gas production from the Reliance KG-D6 field will be the key growth driver for the company over the next two years. We expect gas transmission volumes from Reliance to be 10.7 mmscmd and 14.8 mmscmd in FY10E and FY11E, respectively. The additional gas supply from the new Petronet LNG capacity of 5 MTPA and higher capacity utilisation of Shell's LNG terminal will also contribute to the volume growth for GSPL in the next two years. We expect gas transmission volumes from Petronet LNG to be 10.8 mmscmd and 14 mmscmd in FY10E and FY11E, respectively.

Exhibit 9: Expected gas supply from different sources



Source: ICICIdirect.com Research

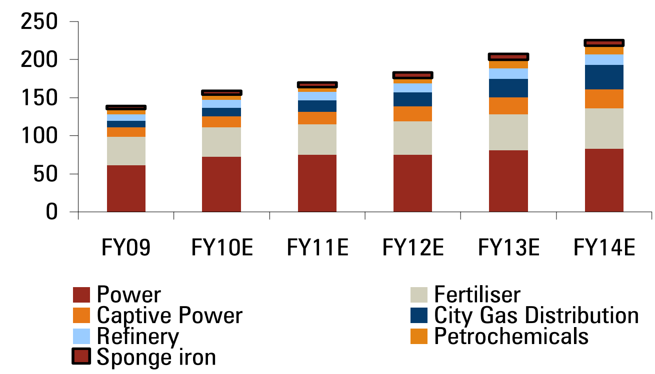
Transmission volumes will report robust growth on increased gas supplies mainly from Reliance KG-D6 basin and Petronet LNG

The new gas finds in the KG basin from GSPC and ONGC may offer further upsides to gas volumes in the country. The increase in domestic gas supply volumes from Petronet LNG and Reliance KG D6 basin will drive gas transmission volumes of GSPL at 61.8% CAGR over FY09-FY11E. We expect the transmission volumes to increase from 14.9 mmscmd in FY09 to 30.6 mmscmd and 39 mmscmd in FY10E and FY11E, respectively.

Higher demand for natural gas to double GSPL's volumes in next two years

The demand for natural gas has continuously outpaced the supply in India. We expect a 10.2% CAGR in demand for natural gas over FY09-FY11E. A 28.8% and 15.1% CAGR in volumes over FY09-FY14E for city gas distribution and captive power plants, respectively, will primarily lead the demand growth. We expect the demand for power and fertiliser sectors to be 83.2 mmscmd and 52.9 mmscmd in FY14E, respectively.

Exhibit 10: Natural gas demand growth in India (mmscmd)



Source: Company, Crisil Report, ICICIdirect.com Research

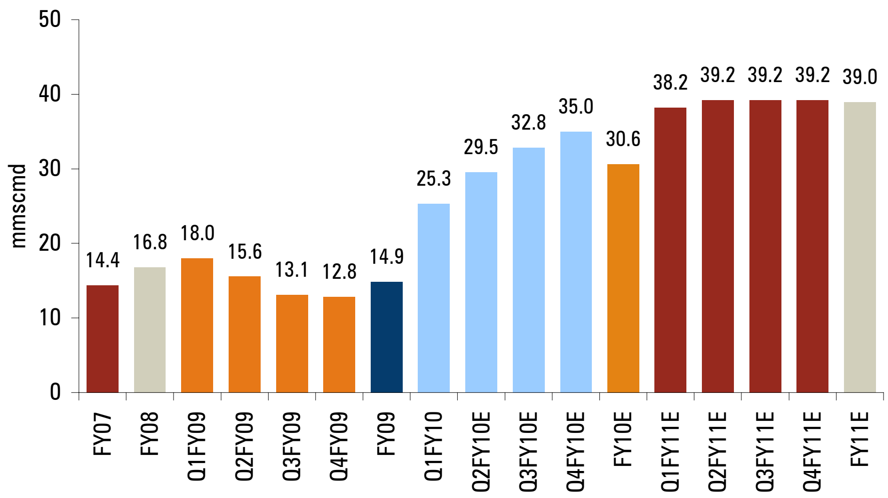
Exhibit 11: Natural gas demand growth in India (mmscmd)

Demand	FY09	FY10E	FY11E	FY12E	FY13E	FY14E	CAGR
Power	61.4	72.5	75.1	75.2	81.1	83.2	**6.3%**
Fertiliser	37.0	38.6	40.1	44.3	47.2	52.9	**7.4%**
Captive Power	12.4	14.2	16.3	19.1	21.9	25.0	**15.1%**
City Gas Distribution	9.1	11.4	15.3	18.8	24.8	32.2	**28.8%**
Refinery	8.3	10.5	10.6	11.6	13.5	13.6	**10.4%**
Petrochemicals	6.7	6.7	6.7	6.7	11.3	11.3	**11.0%**
Sponge iron	4.4	5.0	6.2	7.4	7.6	7.7	**11.8%**
Total demand	**139.1**	**158.9**	**170.3**	**183.0**	**207.3**	**225.9**	**10.2%**

Source: Company, Crisil Report, ICICIdirect.com Research

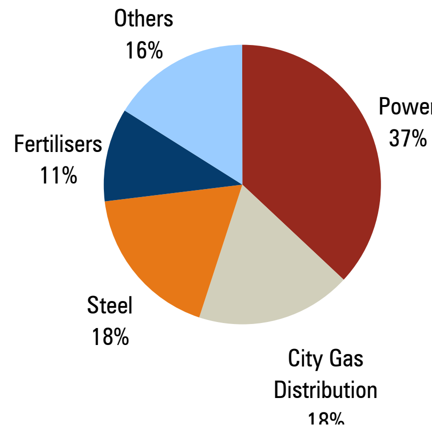
GSPL has signed an agreement with Reliance Industries for gas supply of 11 mmscmd for 15 years. According to the agreement, the volumes can be scaled up to 14 mmscmd. The management has also indicated that volumes are expected to be 20 mmscmd in the next few years. We expect gas transmission volumes to the Reliance Jamnagar refinery to be 7.9 mmscmd and 11 mmscmd in FY10E and FY11E, respectively. GSPL has also signed a gas transmission agreement with Torrent Power to supply 4.5 mmscmd for the next 20 years. The additional volumes mainly from Reliance and Torrent will contribute to the incremental volumes for GSPL. We expect GSPL's gas transmission volumes to improve from 14.9 mmscmd in FY09 to 30.6 mmscmd and 39 mmscmd in FY10E and FY11E, respectively.

Exhibit 12: GSPL's gas transmission volumes



Source: Company, ICICIdirect.com Research

Exhibit 13: Customer profile across different sectors



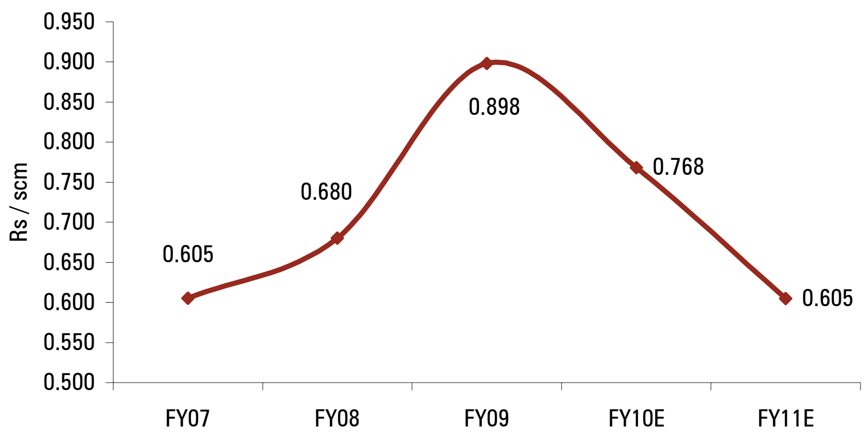
Source: Company, ICICIdirect.com Research

GSPL's RoCE to increase despite decline in transmission tariffs

GSPL's gas transmission tariffs have increased since the announcement of the PNGRB's Gas Pipeline Policy (GPP) in 2008. We believe GSPL's gas transmission tariffs would decline and remain at Rs 0.605 per scm post implementation of the Gas Pipeline Policy due to the additional contracted volumes mainly from Reliance and Torrent. Hence, despite the decline in transmission tariffs, we believe GSPL would report higher post-tax RoCE at 11.9% in FY11E.

Gas transmission tariffs will decline post implementation of GPP. However, we expect post-tax ROCE to improve at 11.9% in FY11E

Exhibit 14: GSPL's gas transmission tariffs



Source: Company, ICICIdirect.com Research

Gas pipeline policy to improve returns

The Petroleum and Natural Gas Regulatory Board (PNGRB) in its Gas Pipeline Policy 2008, has allowed for a 12% post-tax RoCE on inter-state gas transportation pipelines. This announcement was positive for GSPL as the company has generated returns below 12% for the earlier years. We believe the favourable Gas Pipeline Policy would result in GSPL generating more than 12% RoCE owing to ***high spot volumes, lower depreciation, leveraging balance sheet*** and ***lower volume assumption in the initial four years of operations***.

High spot volumes: The PNGRB policy states that contracted volumes should be used for determination of pipeline tariffs/regulated returns. The additional returns from spot volumes will not used for calculation of regulated returns. We believe the company would be able to generate more than 12% returns after two years. The spot volumes would be considered in the contracted volumes only after the initial tariff period of five years.

Lower depreciation: The PNGRB policy considers depreciation according to Schedule VI of The Companies Act, 1956 (our assumption: 4%) for the calculation of capital employed. GSPL currently depreciates its plant & machinery at a higher rate of 8.33%. This implies the company would benefit from higher capital employed and earn higher returns.

Leveraging balance sheet: As PNGRB has allowed 12% post-tax RoCE, the company with a higher leverage would be able to generate a higher RoE. GSPL would benefit from higher leveraging to fund its expansion plans and it would lead to increased RoE.

Lower volume assumption: The PNGRB Gas Pipeline Policy considers lower volumes in the initial four years of operations for the computation of pipeline tariffs. The volumes for the first year shall be taken as 60% of the firmed-up contracted capacity, increasing 10% every year to reach 100% in the fifth year for the determination of the tariffs. This would lead to higher returns for the company in the initial years of operation.

Assumptions for calculation of capital employed according to PNGRB

- Land and plant & machinery used for the gross block from FY01 onwards for the calculation of total capital employed
- Depreciation rate of 4% used for calculation of net block
- 30 days operating costs and 18 days tariff receivable added to the net block to arrive at the regulated capital employed.

Exhibit 15: Capital employed and returns according to PNGRB Gas Pipeline Policy **(Rs Crore)**

	FY01	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09E	FY10E	FY11E
Gross Block	60.1	171.5	293.3	429.3	822.0	914.9	1773.2	1885.0	2235.0	3108.7	4002.4
Less: Accumulated Depreciation	1.9	6.4	15.7	30.1	55.1	89.9	143.6	216.8	299.2	406.1	548.3
Net Block	58.2	165.1	277.7	399.2	766.8	825.0	1629.6	1668.2	1935.8	2702.6	3454.1
Add: 30 days operating costs	0.2	0.9	3.0	4.9	6.1	5.7	4.1	4.4	5.2	5.7	7.7
Add: 18 days tariff receivable	0.0	0.0	0.0	0.0	0.5	0.7	1.7	2.1	2.6	4.6	4.6
Total Capital Employed	**58.4**	**166.0**	**280.7**	**404.2**	**773.5**	**831.4**	**1635.4**	**1674.6**	**1943.6**	**2713.0**	**3466.5**

	FY06	FY07	FY08	FY09E	FY10E	FY11E
EBITDA	194.2	267.7	364.5	424.5	789.5	766.1
Less: Depreciation	34.7	53.8	73.2	82.4	106.9	142.2
EBIT	159.4	214.0	291.3	342.1	682.6	623.9
Pre tax ROCE (%)	19.2	13.1	17.4	17.6	25.2	18.0
Post tax ROCE (%)	**12.7**	**8.6**	**11.5**	**11.6**	**16.6**	**11.9**

Source: Company, ICICIdirect.com Research

There has been a delay on the part of PNGRB in the implementation of regulated gas pipeline tariffs. We have assumed the implementation of regulated tariffs from Q1FY11E in the model according to our discussion with the management. Using the total capital employed and volumes according to PNGRB, we have arrived at the required gas pipeline tariffs of Rs 0.605 per scm from FY11E onwards. From Exhibit 11, we see an increase in the regulated post-tax RoCE from 11.5% in FY08 to 11.9% in FY11E.

Exhibit 16: Tariff calculation

	FY10E	FY11E	FY12E	FY13E	FY14E	FY15E	FY16E*
Total Capital Employed (Rs Crore)	2713.0	3466.5	3365.4	3262.8	3158.7	3053.1	2945.8
Volumes assumed (MMSCM)	7459.3	9631.2	10574.9	11477.1	12475.7	13021.5	15702.4
Required Tariffs (Rs / SCM)	0.605	0.605	0.605	0.605	0.605	0.605	0.605

We have assumed 1.5% investment in gross block towards replacement, upgradation and improvement of network each year, 2.5% CAGR in volumes till FY34 and operating costs as 2.35% of the gross block.

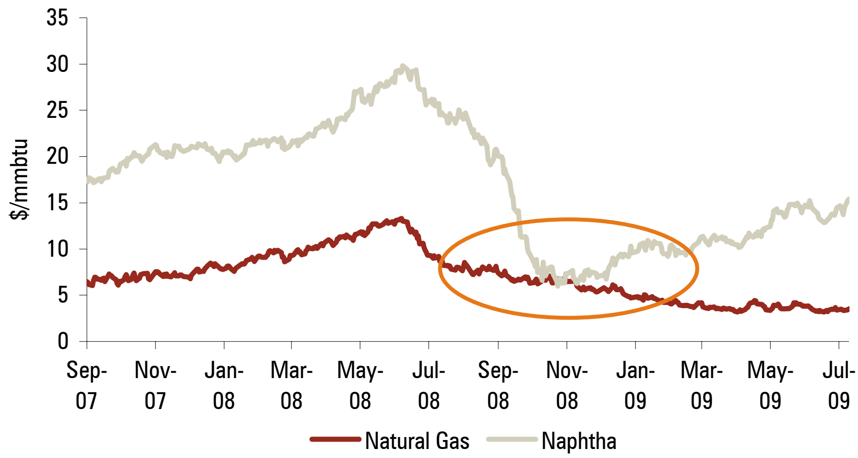
Source: ICICIdirect.com Research

Risks & concerns

Lower than expected gas supply volumes

GSPL's profitability and valuations may be negatively impacted on lower than expected gas supply volumes. Any reduction in existing gas supply volumes from Petronet LNG and Reliance will also have an impact on the earnings estimates of the company. Currently, natural gas has better economics against alternative fuels like naphtha and fuel oil. However, any competitiveness of alternative fuels vis-à-vis natural gas would impact the volumes of GSPL as witnessed last year.

Exhibit 17: Price movement of Henry Hub natural gas and naphtha spot prices



Source: Bloomberg, ICICIdirect.com Research

Delay in authorisation and construction of new pipelines

GSPL's growth plans would be impacted if the company faces regulatory delays in authorisation for installing new pipelines. Any delay in execution and construction of new pipelines would also impact the profitability of GSPL.

Regulatory risk

Petroleum and Natural Gas Regulatory Board (PNGRB) has been set up for the determination of transmission tariffs and authorisation of gas transportation pipelines. PNGRB has also prescribed technical operating parameters for gas transporting companies. If GSPL's transmission tariffs are lower than our estimates, this will have an impact on the financial performance of the company. GSPL's failure to comply with prescribed technical parameters may result in a heavy fine and the company coming under the scanner of the regulator. We value GSPL at Rs 97 on transmission tariffs of Rs 0.7 per scm, Rs 72 on transmission tariffs of Rs 0.5 per scm and Rs 85 on transmission tariffs of Rs 0.605 per scm.

Gujarat government CSR at 30%

The Gujarat government has implemented 30% CSR on pre-tax profits on state-owned companies. GSPL's contribution towards Gujarat Socio-Economic Development Society will have an impact on the earnings and valuations of the company. We value GSPL at Rs 85 per share on 30% CSR, Rs 90 on 20% CSR, Rs 97 on 10% CSR and Rs 102 per share on removal of CSR contribution by the Gujarat Government.

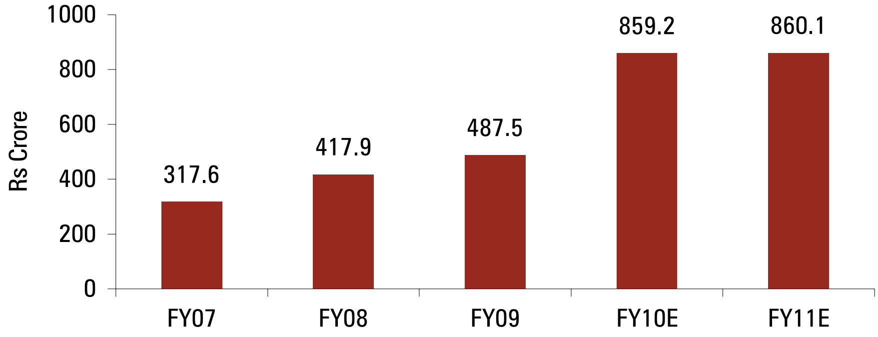
We value GSPL at Rs 102 per share on removal of 30% CSR to the Gujarat Government. However, GSPL's value decreases to Rs 85 per share assuming 30% CSR contribution

Financials

Robust growth in revenues

We expect GSPL to report robust revenue growth on account of increase in gas transmission volumes mainly from Reliance and R-LNG terminals. GSPL's volumes are expected to increase from 14.9 mmscmd in FY09 to 39 mmscmd in FY11E at 61.8% CAGR over FY09-FY11E. However, the revenue growth would be lower on account of decline in transmission tariffs. We believe GSPL's revenues would increase at 32.8% CAGR over FY09-FY11E from Rs 487.5 crore in FY09 to Rs 860.1 crore in FY11E.

Exhibit 18: Projected revenue growth



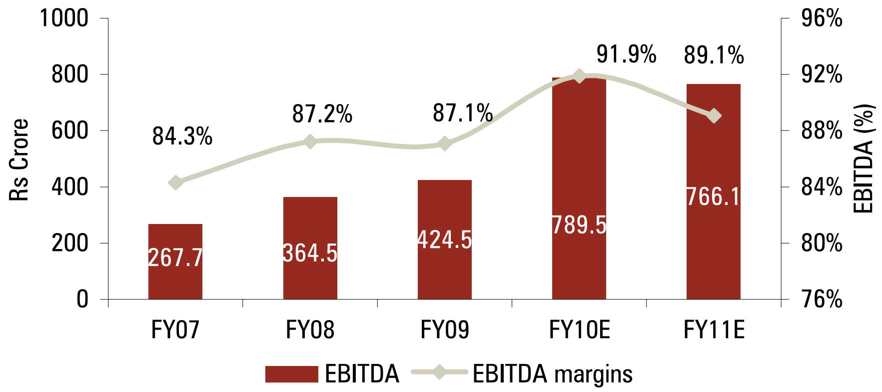
Source: Company, ICICIdirect.com Research

Robust revenue growth of 32.8% over FY09-11E on increased gas transmission volumes

EBITDA margin to settle at a higher trajectory

GSPL's EBITDA is expected to increase from Rs 424.5 crore in FY09 to Rs 766.1 core in FY11E. We believe the EBITDA margin for GSPL would settle at a higher trajectory in the absence of gas transportation and connectivity charges (2.6% of revenues in FY09) from FY11E. GSPL used to pay gas transportation charges to Gujarat Gas for transmitting its gas through a pipeline network in Surat. However, GSPL has now built and commissioned its own pipeline and, thus, ceased to pay any charges to Gujarat Gas. Similarly, it has commissioned its own pipeline network to Petronet LNG terminal and does not pay any connectivity charges to GAIL. We expect the EBITDA margin for GSPL to increase from 87.1% in FY09 to 91.9% and 89% in FY10E and FY11E, respectively. We see a marginal decline in the FY11E margin as compared to FY10E due to the increase in operating and maintenance costs due to capacity additions.

Exhibit 19: Trend in EBITDA margin



Source: Company, ICICIdirect.com Research

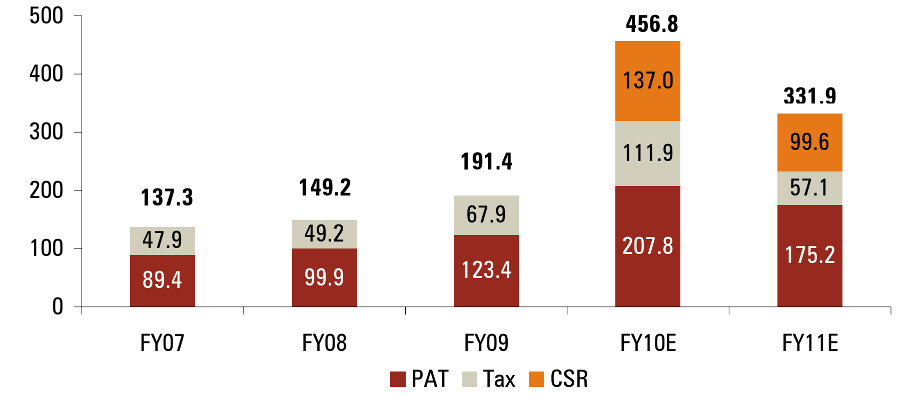
EBITDA margins will settle at a higher trajectory on absence of gas transportation and connectivity charges

CSR of 30% on pre-tax profits to impact PAT

The Gujarat government has implemented 30% CSR on pre-tax profits on state-owned companies. GSPL's shareholder's approval for the proposal to make charitable contribution to Gujarat socio-economic development society (GSEDS) would have an impact on the profitability in the years ahead. However, the management has indicated that unless a specific project is identified for the utilisation of funds, the company will not be required to make provision for that particular year. So far, no progress has been made on CSR by the Gujarat Government. Currently, ***we have assumed 30% CSR on pre-tax profits to calculate PAT and valued the stock on a conservative basis***. We expect GSPL's earnings to increase at 19.1% CAGR over FY09-FY11E from Rs 123.4 crore in FY09 to Rs 175.2 crore in FY11E. However, we expect GSPL's profitability to improve to Rs 296.1 crore and Rs 254.2 crore in FY10E and FY11E, respectively, on removal of CSR contribution by the Gujarat Government.

GSPL's profitability would improve to Rs 296.1 crore and Rs 254.2 crore in FY10E and FY11E, respectively, if 30% CSR is removed by the Gujarat Government.

Exhibit 20: Trend in profitability of GSPL **(Rs Crore)**

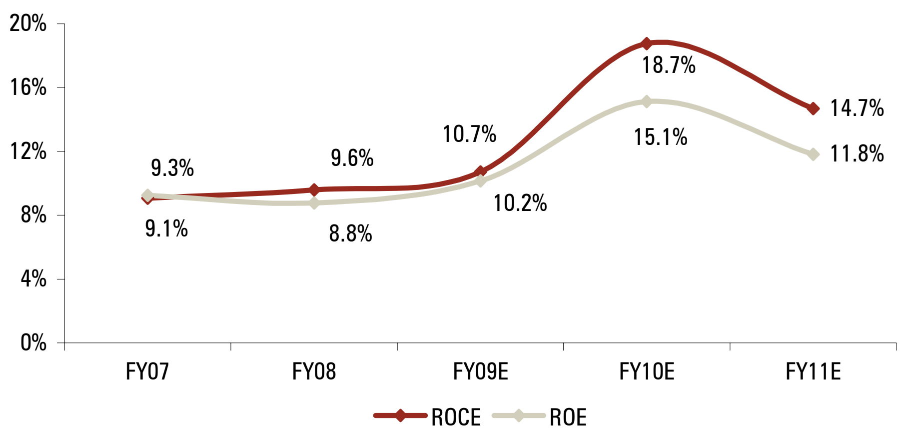


Source: Company, ICICIdirect.com Research

Return ratios to improve, going forward

GSPL's return ratios have improved since the announcement of the PNGRB Gas Pipeline Policy 2008. We expect the RoCE to improve from 10.7% in FY09E to 14.7% in FY11E post implementation of the PNGRB policy. The increase in RoE was not to the same extent as RoCE as we have assumed 30% CSR on pre-tax profits. We expect an improvement in RoE from 10.2% in FY09E to 11.8% in FY11E.

Exhibit 21: Return ratios



Source: Company, ICICIdirect.com Research

Valuations

GSPL's extensive gas transmission network to the major demand and supply centres of Gujarat will drive gas transmission volumes at 61.8% CAGR over FY09-FY11E from 14.9 mmscmd in FY09 to 30.6 mmscmd and 39 mmscmd in FY10E and FY11E, respectively. The revenues are expected to increase at 32.8% CAGR over FY09-FY11E from Rs 487.5 crore in FY09 to Rs 859.2 crore and Rs 860.19 crore in FY10E and FY11E, respectively. Also, a favourable Gas Pipeline Policy would result in GSPL generating more returns. We expect GSPL's net profit after 30% CSR contribution to increase at 19.1% CAGR in earnings over FY09-FY11E from Rs 123.4 crore in FY09 to Rs 175.2 crore in FY11E.

We have valued GSPL based on the DCF methodology to arrive at a price target of Rs 85 (WACC — 10%, terminal growth rate — 2.5%). We recommend **PERFORMER** rating on the stock, with potential upside of 10.8%.

Exhibit 22: DCF valuation (Rs Crore)

	FY10	FY11	FY12	FY13	FY14	Terminal Cash Flows
EBITDA	789.5	766.1	796.7	828.6	861.7	883.3
Less: Contribution for GSEDS	137.0	99.6	103.5	107.7	112.0	114.8
Less: Tax paid	111.9	57.1	59.4	61.8	64.3	65.9
Cash Profit	540.6	609.4	633.7	659.1	685.4	702.6
Adjustment for working capital	-117.2	-29.0	-30.1	-31.3	-32.6	-33.4
Operating Cash Flows	423.4	580.4	603.6	627.7	652.8	669.2
Less: Capex	596.7	602.5	60.0	60.0	60.0	40.0
Free Cash Flows	-173.3	-22.1	543.6	567.7	592.8	629.2
WACC	10.0%					
Present Value of Cash Flows till FY14E	987.8					
Terminal Growth Rate	2.5%					
Terminal Value	8370.2					
Present Value of Terminal Cash Flows	5193.3					
Total Present Value of the Firm	6181.1					
Less: Net Debt (FY10E)	1391.2					
Total Present Value of Equity	4789.9					
Number of Outstanding shares (In Crore)	56.2					
DCF - Target Price (Rs per share)	85					

Source: ICICIdirect.com Research

GSPL's value would increase to Rs 102 per share on removal of the CSR contribution to the Gujarat Government.

Exhibit 23: Sensitivity analysis of DCF valuation

		WACC				
		9.5%	10.0%	10.5%	11.0%	11.5%
Terminal	**1.5%**	82	75	68	63	58
	2.0%	88	80	73	67	61
Growth	**2.5%**	95	86	78	71	65
	3.0%	103	93	84	77	70
Rate	**3.5%**	113	101	91	82	75

Source: ICICIdirect.com Research

Financial summary

P&L Statement					(Rs Crore)
	FY07	FY08	FY09	FY10E	FY11E
Revenue	317.6	417.9	487.5	859.2	860.1
Growth (%)		31.6	16.7	76.2	0.1
Op. Expenditure	49.8	53.4	63.0	69.7	94.1
EBITDA	267.7	364.5	424.5	789.5	766.1
Growth (%)		36.1	16.5	86.0	-3.0
Depreciation	102.6	163.2	170.5	230.0	304.2
EBIT	165.1	201.3	254.0	559.5	461.9
Interest	45.7	81.5	87.0	118.1	147.2
Other Income	17.8	29.4	24.3	15.4	17.2
PBT before GSEDS provision	137.3	149.2	191.4	456.8	331.9
Growth (%)		8.7	28.3	138.7	-27.3
GSEDS provision	0.0	0.0	0.0	137.0	99.6
PBT after GSEDS provision	137.3	149.2	191.4	319.8	232.3
Growth (%)		8.7	28.3	67.1	-27.3
Tax	47.9	49.2	67.9	111.9	57.1
Reported PAT	89.4	99.9	123.4	207.8	175.2
Adjustments	11.6	19.7	15.7	10.0	13.0
Adj. Net Profit	77.8	80.2	107.8	197.8	162.2
Growth (%)		3.1	34.3	83.6	-18.0

Key ratios					(%)
	FY07	FY08	FY09E	FY10E	FY11E
Employee Costs	1.0	1.3	1.8	2.2	1.6
Gas Transportation Chg.	7.3	2.3	0.3	0.7	0.2
Connectivity Charges	8.4	4.1	2.7	1.9	0.0
Admin. and Other Exp	4.3	4.5	4.1	3.5	2.7
Operat. and Maintain. Exp	5.3	3.5	3.8	4.6	3.7
Average cost of debt	6.3	8.9	8.2	9.0	9.0
Effective Tax rate	34.9	33.0	35.5	35.0	24.6
Profitability ratios (%)					
EBITDA Margin	84.3	87.2	87.1	91.9	89.1
PAT Margin	28.1	23.9	25.3	24.2	20.4
Adj. PAT Margin	24.5	19.2	22.1	23.0	18.9
Per share data (Rs)					
Revenue per share	5.9	7.4	8.7	15.3	15.3
EV per share	92.6	93.9	97.4	105.4	106.3
Book Value	17.8	20.3	21.6	24.4	26.4
Cash per share	3.3	4.6	1.6	3.9	1.0
EPS	1.6	1.8	2.2	3.7	3.1
Cash EPS	3.5	4.7	5.2	7.8	8.5
DPS	0.5	0.5	0.8	0.8	1.0

Costs as % to revenue except tax rate and average cost of debt

Balance Sheet					(Rs crore)
	FY07	FY08	FY09E	FY10E	FY11E
Equity Capital	542.8	562.0	562.0	562.0	562.0
Preference capital	0.0	0.0	0.0	0.0	0.0
Reserves & Surplus	423.1	579.0	653.1	811.6	921.0
Shareholder's Fund	965.9	1141.0	1215.1	1373.6	1483.0
Loan Funds	863.8	966.0	1161.0	1611.0	1661.0
Deferred Tax Liability	91.7	99.9	104.9	109.9	114.9
Minority Interest	0.0	1.0	2.0	3.0	4.0
Source of Funds	1921.4	2206.9	2481.0	3094.5	3259.0
Gross Block	1888.9	2019.1	2385.4	3285.4	4185.4
Less: Acc. Depreciation	322.8	481.9	663.4	896.8	1201.0
Net Block	1566.1	1537.1	1721.9	2388.5	2984.3
Capital WIP	136.8	588.8	647.5	347.5	50.0
Investments	0.0	35.6	35.6	35.6	35.6
Inventories	44.2	39.7	66.8	117.7	117.8
Debtors	34.9	41.6	53.4	94.2	94.3
Cash	181.1	256.9	87.2	219.9	57.3
Loans & Advances, Other CA	130.6	211.4	233.7	423.7	424.2
Total Current assets	390.8	549.7	441.1	855.4	693.6
Current Liabilities	132.4	419.9	280.5	411.9	412.4
Provisions	49.2	90.7	87.9	120.9	92.2
Total CL and Provisions	181.5	510.6	368.4	532.8	504.6
Net Working Capital	209.3	39.1	72.7	322.6	189.0
Miscellaneous expense	9.3	6.3	3.3	0.3	0.0
Application of Funds	1921.4	2206.9	2481.0	3094.5	3259.0

Key ratios					(%)
Return ratios	FY07	FY08	FY09E	FY10E	FY11E
RoNW	9.3	8.8	10.2	15.1	11.8
ROCE	9.1	9.6	10.7	18.7	14.7
Financial health ratio					
Operating CF (Rs Cr)	98.3	487.4	49.2	279.4	389.9
FCF (Rs Cr)	-342.1	-98.8	-364.7	-317.3	-212.6
Cap. Emp. (Rs Cr)	1921.4	2206.9	2481.0	3094.5	3259.0
Debt to equity (x)	0.9	0.8	1.0	1.2	1.1
Debt to cap. emp. (x)	0.4	0.4	0.5	0.5	0.5
Interest Coverage (x)	3.6	2.5	2.9	4.7	3.1
Debt to EBITDA (x)	3.2	2.7	2.7	2.0	2.2
DuPont ratio analysis					
PAT/PBT	0.7	0.7	0.6	0.7	0.8
PBT/EBIT	0.8	0.7	0.8	0.6	0.5
EBIT/Sales	0.5	0.5	0.5	0.7	0.5
Sales/ Total Asset	0.2	0.2	0.2	0.3	0.3
Total Asset/ Net Worth	2.0	1.9	2.0	2.3	2.2

Financial summary

Cash Flow Statement					(Rs crore)
	FY07	FY08	FY09E	FY10E	FY11E
Profit after Tax	89.4	99.9	123.4	207.8	175.2
Less: Dividend Paid	31.8	32.9	49.3	49.3	65.8
Add: Depreciation	102.6	163.2	170.5	230.0	304.2
Add: Others	43.9	11.2	8.0	8.0	5.3
Cash Profit	204.1	241.5	252.6	396.6	418.9
Increase/(Decrease) in CL	4.5	329.1	-142.2	164.4	-28.3
(Increase)/Decrease in CA	-110.2	-83.1	-61.2	-281.6	-0.7
CF from Operating Activities	98.3	487.4	49.2	279.4	389.9
Purchase of Fixed Assets	440.4	586.3	414.0	596.7	602.5
(Inc)/Dec in Investments	0.0	-35.6	0.0	0.0	0.0
CF from Investing Activities	-440.4	-621.8	-414.0	-596.7	-602.5
Inc/(Dec) in Loan Funds	285.2	102.2	195.0	450.0	50.0
Inc/(Dec) in Sh. Cap. & Res.	0.8	108.0	0.0	0.0	0.0
CF from financing activities	286.0	210.2	195.0	450.0	50.0
Change in cash Eq.	-56.1	75.8	-169.8	132.7	-162.6
Op. Cash and cash Eq.	237.2	181.1	256.9	87.2	219.9
Cl. Cash and cash Eq.	181.1	256.9	87.2	219.9	57.3

Working Capital Ratios	FY07	FY08	FY09E	FY10E	FY11E
Fixed Asset Turnover	0.2	0.2	0.2	0.3	0.3
Inventory Turnover (Days)	50.8	34.7	50.0	50.0	50.0
Debtor (Days)	40.1	36.4	40.0	40.0	40.0
Loan and Advances (Days)	150.1	184.7	175.0	180.0	180.0
Current Liabilities (Days)	152.2	366.8	210.0	175.0	175.0
Current Ratio	2.2	1.1	1.2	1.6	1.4
Quick ratio	1.9	1.0	1.0	1.4	1.1

Valuation	FY07	FY08	FY09E	FY10E	FY11E
Market Capitalisation	4163.3	4310.6	4310.6	4310.6	4310.6
Enterprise Value (EV)	5027.1	5276.7	5471.7	5921.7	5971.7
PE	46.6	43.1	34.9	20.7	24.6
Price to Book Value	4.3	3.8	3.5	3.1	2.9
Price to Cash EPS	21.7	16.4	14.7	9.8	9.0
EV/EBITDA	18.8	14.5	12.9	7.5	7.8
Market Cap/Sales	13.1	10.3	8.8	5.0	5.0
EV/Sales	15.8	12.6	11.2	6.9	6.9

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Hold (H): +10% return;
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