Gujarat State Petronet Ltd.

Earnings Review

BUY

Equity | India | Gas Utilities
07 June 2007

Strong volume growth story on track

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Volume growth prospects improve; retain buy

GSPL's FY07 earnings jumped by 91% YoY driven by 37% YoY rise in gas transmission volumes. Gas transmission volumes of GAIL, India's main gas transmission company, declined by 2% YoY in FY07. Transmission volumes on GSPL's proposed pipeline to Jamnagar are likely to rise to 20-22mmscmd by FY11E vis-à-vis 17mmscmd by FY12E assumed by us. This is apparent from recent disclosures by Reliance (RIL) and GSPL. Volume growth prospects thus have improved. We retain BUY on GSPL.

FY07 earnings up 91% YoY; 8% below MLe

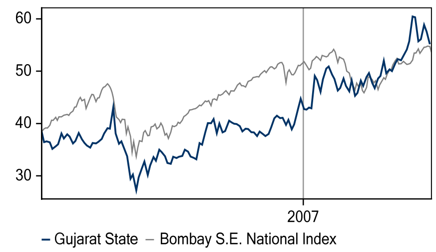
GSPL's FY07 EPS surged by 91% YoY to Rs1.65 driven by 37% YoY rise in transmission volumes to 14.3mmscmd. 4Q earnings rose by 79% YoY driven by 75% YoY jump in transmission volumes. FY07 earnings were 8% below MLe and 4Q 30% below MLe. Volumes were 6% lower than expected due to lower supply from PLNG ('force majeure' at RasGas). Interest and depreciation was also higher as new pipelines were in operation for longer than expected in 4Q.

FY08 earnings kept unchanged; long term prospects better

We have kept FY08E earnings unchanged at Rs2.3/share, which implies 42% YoY growth. The drivers are expected to be 33% YoY rise in volumes and 16% rise in tariff. GSPL's volumes are already 17-18mmscmd in 1Q vis-à-vis our forecast of 19.3mmscmd. Tariffs rise is expected to be driven by higher tariff on new pipelines commissioned in FY07. Growth prospects appear to have improved especially for transmission of RIL's gas to its Jamnagar complex. It could be 20-30% higher than assumed. An additional demand of 4-5mmscmd (25-30%) from other consumers especially Essar Oil in Jamnagar cannot be ruled out, we think.

Stock Data

Price	Rs53.90
Price Objective	Rs65.00
Date Established	9-Mar-2007
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs26.50-Rs61.40
Mrkt Val / Shares Out (mn)	US$718 / 542.2
Average Daily Volume	415,401
ML Symbol / Exchange	GJRSF / BSE
Bloomberg / Reuters	GUJS IN / GSPT.BO
ROE (2008E)	12.6%
Net Dbt to Eqty (Mar-2006A)	100.4%
Est. 5-Yr EPS / DPS Growth	NA / NA
Free Float	60.9%



Estimates (Mar)

(Rs)	2006A	2007A	2008E	2009E	2010E
Net Income (Adjusted - mn)	467	894	1,267	1,721	3,350
EPS	0.861	1.65	2.33	3.17	6.17
EPS Change (YoY)	88.2%	91.3%	41.8%	35.7%	94.7%
Dividend / Share	0.250	0.500	0.467	0.634	1.23
Free Cash Flow / Share	(7.31)	(10.81)	(6.62)	2.34	10.95

Valuation (Mar)

	2006A	2007A	2008E	2009E	2010E
P/E	62.61x	32.74x	23.08x	17.00x	8.73x
Dividend Yield	0.464%	0.928%	0.866%	1.18%	2.29%
EV / EBITDA*	16.80x	12.18x	7.57x	5.30x	3.90x
Free Cash Flow Yield*	-13.56%	-20.07%	-12.30%	4.35%	20.34%

* For full definitions of *iQmethod* SM measures, see page 7.

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Refer to important disclosures on page 8 to 9. Analyst Certification on page 6. Price Objective Basis/Risk on page 6.

iQprofile SM Gujarat State Petronet Ltd.

Key Income Statement Data (Mar)	2006A	2007A	2008E	2009E	2010E
(Rs Millions)					
Sales	2,635	3,176	4,932	6,841	9,138
Gross Profit	1,943	2,681	4,310	6,153	8,361
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	1,152	1,655	2,519	3,616	5,549
Net Interest & Other Income	(368)	(282)	(627)	(1,127)	(1,052)
Associates	NA	NA	NA	NA	NA
Pretax Income	784	1,373	1,892	2,489	4,497
Tax (expense) / Benefit	0	(70)	(374)	(768)	(1,147)
Net Income (Adjusted)	467	894	1,267	1,721	3,350
Average Fully Diluted Shares Outstanding	542	543	543	543	543
Key Cash Flow Statement Data					
Net Income (Reported)	467	894	1,267	1,721	3,350
Depreciation & Amortization	791	1,026	1,791	2,537	2,812
Change in Working Capital	(481)	425	103	(13)	(282)
Deferred Taxation Charge	317	409	250	0	0
Other Adjustments, Net	991	(851)	(206)	26	564
Cash Flow from Operations	2,084	1,903	3,206	4,271	6,444
Capital Expenditure	(6,047)	(7,769)	(6,800)	(3,000)	(500)
(Acquisition) / Disposal of Investments	NA	NA	NA	NA	NA
Other Cash Inflow / (Outflow)	0	0	0	0	0
Cash Flow from Investing	(6,047)	(7,769)	(6,800)	(3,000)	(500)
Shares Issue / (Repurchase)	4,713	6	0	0	0
Cost of Dividends Paid	(155)	(306)	(286)	(388)	(756)
Cash Flow from Financing	5,908	5,713	4,214	(388)	(5,756)
Free Cash Flow	(3,963)	(5,866)	(3,594)	1,271	5,944
Net Debt	3,414	9,581	13,461	12,578	7,389
Change in Net Debt	(595)	6,167	3,880	(883)	(5,189)
Key Balance Sheet Data					
Property, Plant & Equipment	13,651	20,394	25,403	25,865	23,554
Other Non-Current Assets	0	0	0	0	0
Trade Receivables	137	131	203	300	401
Cash & Equivalents	2,372	2,219	2,839	3,722	3,911
Other Current Assets	858	593	841	1,112	1,435
Total Assets	17,017	23,336	29,286	30,999	29,300
Long-Term Debt	5,702	11,550	16,000	16,000	11,000
Other Non-Current Liabilities	508	917	1,167	1,167	1,167
Short-Term Debt	85	250	300	300	300
Other Current Liabilities	1,771	1,074	1,292	1,673	2,379
Total Liabilities	8,065	13,791	18,759	19,140	14,846
Total Equity	8,952	9,545	10,527	11,859	14,454
Total Equity & Liabilities	17,017	23,336	29,286	30,999	29,300
iQmethod SM **- Bus Performance***					
Return On Capital Employed	9.0%	8.7%	8.6%	9.2%	15.3%
Return On Equity	7.2%	9.7%	12.6%	15.4%	25.5%
Operating Margin	43.7%	52.1%	51.1%	52.9%	60.7%
EBITDA Margin	73.7%	84.4%	87.4%	89.9%	91.5%
iQmethod SM **- Quality of Earnings***					
Cash Realization Ratio	4.5x	2.1x	2.5x	2.5x	1.9x
Asset Replacement Ratio	7.6x	7.6x	3.8x	1.2x	0.2x
Tax Rate (Reported)	NM	5.1%	19.8%	30.9%	25.5%
Net Debt-to-Equity Ratio	38.1%	100.4%	127.9%	106.1%	51.1%
Interest Cover	2.8x	3.6x	3.1x	2.7x	4.3x

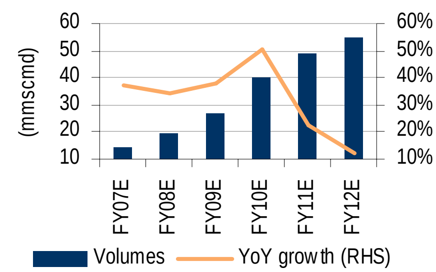
Key Metrics

* For full definitions of *iQmethod* SM measures, see page 7.

Company Description

Gujarat State Petronet (GSPL) was promoted in 1998 by Gujarat government-owned companies led by Gujarat State Petroleum Corp., which owns 39% of GSPL. It has a 1,000km-plus pipeline network to transmit gas in Gujarat. It transmits 16mmscmd of gas and regassified LNG imported at the Hazira and Dahej LNG terminals. It has signed an agreement with Reliance to transmit 11mmscmd of gas from Bharuch to Jamnagar from 2008.

Chart 1: GSPL's volume growth



Source: DSP Merrill Lynch

Stock Data

Price to Book Value	2.8x

FY07 earnings up 91% YoY

GSPL's 4Q earnings 79% YoY higher; volumes up 75% YoY

GSPL's 4Q net profit is 79% YoY higher at Rs193mn. The rise in profit was driven by 75% YoY jump in gas transmission volumes to 15.5mmscmd. The increase in volumes offset the 30% YoY decline in tariffs.

4Q net profit 30% below MLe; lower volumes and higher costs

GSPL's 4Q net profit was 30% lower than our estimates. The negative surprise was mainly due to

- Gas transmission volumes being 6% lower than our expectation of 16.5mmscmd. This was due to lower supply of regassified LNG from Petronet LNG's (PLNG) import terminal in 4Q. Technical problems at RasGas, which supplies LNG to PLNG, reduced PLNG's volumes by 2mmscmd in 4Q.

- Staff and other administrative expenses in 4Q being 46% higher than our expectations. Arrears payable to employees boosted staff cost.

- 4Q depreciation at Rs345mn being 44% higher than our expectations. Depreciation on new pipelines that includes Mora-Vapi and Anand-Rajkot pipelines commissioned in 4Q are for longer period than expected by us.

- 4Q interest cost being 50% higher than our expectation at Rs164mn. The interest cost surprise is mainly related to new pipelines being in operation for longer period than expected in 4Q

Table 1: 4Q FY07 and FY07 results

	4Q FY07	4Q FY06	% Change	FY07	FY06	% Change
Net sales	831	675	23.2	3,176	2,635	20.5
Total expenditure	121	180	-32.9	495	692	-28.5
EBDITA	711	495	43.5	2,681	1,943	38.0
EBDITA margin	85.5%	73.4%		84.4%	73.7%	
Interest	164	124	32.4	457	413	10.6
Depreciation	345	225	53.4	1,026	791	29.8
Other Income	50	28	81.8	175	45	290.4
Extra-ordinary items	0	0				
PBT	252	174	44.8	1,373	784	75.1
Tax	59	66	-10.3	479	317	50.8
PAT	193	108	78.5	894	467	91.3
EPS	0.4	0.2	78.5	1.6	0.9	91.3
Volumes (mmscmd)	15.5	8.9	75.4	14.3	10.5	36.9
Tariff (Rs/tcm)	595	847	(29.8)	607	689	(11.9)

Source: Company, DSP Merrill Lynch

FY07 earnings jump driven by 37% jump in transmission volumes

GSPL's FY07 earnings jumped by 92% YoY to Rs1.6/share. This rise in earnings were mainly driven by 37% YoY jump in gas transmission volumes to 14.3mmscmd from 10.5mmscmd in FY06. Transmission volumes of GAIL on the other hand declined 2% YoY to 77.3mmscmd (see Table 2).

Table 2: Gas transmission volumes in India in FY07

	FY07	FY06	Chg YoY
GSPL	14.3	10.5	37%
GAIL	77.3	78.9	-2%
Total	91.6	89.3	3%

Source: Companies, DSP Merrill Lynch

FY07 earnings 8% below MLe; lower volumes and higher cost in 4Q

GSPL's FY07 earnings were 8% below MLe of Rs1.8/share. This negative surprise was mainly due to transmission volumes being lower than expected and interest and depreciation cost being higher than expected in 4Q.

Update on other significant issues

RIL's gas transmitted to Jamnagar likely to be higher

Gas transmission volumes could rise to 20-22mmscmd by FY11E

Reliance Industries (RIL) at their last analyst meet had indicated that gas consumed at its Jamnagar complex is likely to rise to 20-22mmscmd by FY11E. RIL plans to commission an ethylene cracker in FY11E in Jamnagar. RIL has a gas transmission agreement with GSPL to transport 11-14mmscmd of gas to Jamnagar. Under the agreement RIL has an option to increase transmission volumes to 20mmscmd. GSPL also confirmed this on their FY07 earning call.

A loop line needed to transmit higher volumes; can be done in 9 months

RIL needs to exercise the option to transmit higher volumes through GSPL's pipeline to Jamnagar by June 2009. RIL has to give GSPL 24 months time to upgrade the pipeline to be able transmit the higher volumes as per their agreement. GSPL indicated on their earnings call that a loop line was needed if 20mmscmd or higher volumes were to be transmitted on the pipeline to Jamnagar. However preliminary work on this loop line has already begun. The completion of the loop line is expected to take just nine months.

Gas transmission to other consumers also likely on pipeline to Jamnagar

More gas consumers other than RIL are also likely in and around Jamnagar. This would mean higher gas transmission volumes along GSPL's pipeline to Jamnagar. One potential large gas consumer is Essar Oil, which has a refinery at Vadinar 5-10 kilometers from RIL's refinery and petrochemical complex. Its gas demand is likely to be 4-5mmscmd.

Upside to our gas transmission volumes assumptions

We have assumed that RIL's gas transmitted by GSPL to Jamnagar will ramp up to 17mmscmd by FY12E. As discussed gas transmitted to RIL's Jamnagar complex are likely to ram up to 20-22 mmscmd by FY11E itself. There could also be additional demand from other consumers like Essar Oil.

Expansion of pipeline network to states other than Gujarat

Expanding network to Maharashtra and Rajasthan being considered

GSPL's existing pipeline network is in the state of Gujarat. It is now considering expanding its pipeline network to the neighboring states of Maharashtra and Rajasthan. It has signed a MoU with Maharashtra Industrial Development Corporation (MIDC) to extend its pipeline to the industrial estate in Tarapur in Maharashtra. GSPL has a pipeline up to Vapi in Gujarat. Tarapur is 70kms from Vapi. GSPL is also actively considering extending its pipeline network to Rajasthan, which is to the north of Gujarat.

Direct pipeline access to PLNG's LNG terminal by end-June

PLNG's board had earlier in 2007 decided to give GSPL direct pipeline access to its LNG terminal. GSPL is laying a pipeline to get direct connectivity to the LNG terminal and expects to complete it by end-June 2007. Only GAIL currently has direct pipeline access to PLNG's terminal. GSPL therefore has to take delivery of regassified LNG from GAIL and pay it inter-connectivity charges of Rs140m pa. These inter-connectivity charges will need to be paid until December 2008. However from January 2009 no inter-connectivity charges are likely.

Maintain FY08E estimates

42% YoY earnings rise driven by 33% rise in volumes and higher tariff

We are keeping our FY08E EPS forecast unchanged at Rs2.3/share, which implies 42% YoY rise. We have assumed gas volumes to rise by 33% YoY to 19.3mmscmd. GSPL's gas volumes are already 17-18mmscmd in 1Q FY08. We expect the incremental gas volumes to come from rise in Tapti gas production and rise in spot LNG imports at the Hazira terminal. Shell is debottlenecking its LNG terminal capacity from 8.6mmscmd to 11mmscmd. We also expect GSPL's average pipeline tariffs to rise 16% YoY to Rs702/tcm in FY08E.

Higher tariff on volumes on new pipelines to boost average tariff

A significant portion of incremental gas volumes in FY08E are likely to be transported along the new pipelines commissioned in FY07. These pipelines (Mora-Vapi, Kalol-Himmatnagar, Kalol-Mehsana and Anand-Rajkot) are all in new areas where there were no other pipelines. GSPL thus has a first mover advantage. It has meant GSPL has been able to do the last mile and thereby charge higher tariff especially to some small industrial consumers. The tariff on these pipelines on some already tied up contracts is Rs1,300-1,800/tcm. This is far higher than GSPL's average FY07 tariff of Rs607/tcm.

Maintain BUY

GSPL's FY07 earnings were marginally lower than our expectation. However there are indications that there could be upside risk to GSPL's future transmission volumes especially to Jamnagar. Volumes to Jamnagar could ramp up to 20-22mmscmd by FY11E vis-à-vis 17mmscmd by FY12E assumed by us. GSPL is also considering expanding its pipeline network to other neighboring states. We retain Buy on GSPL

Price Objective Basis & Risk

GSPL's DCF-based price objective works out to Rs65/share. This is calculated by applying weights to DCF under three different scenarios. We have applied 50% probability to DCF based on base case volume and tariff assumptions, 25% probability to DCF assuming lower volumes and 25% probability to DCF assuming lower tariff. WACC applied is 10% based on 12.2% cost of equity, 10% cost of debt, 34% tax rate and debt-equity ratio of 65%.

Key risks include i) regulatory intervention in the form of cut in tariff – based on high ROEs likely over FY10E-12E; and ii) lower than expected transmission volumes. However, this is likely to be mitigated by i) higher than expected capex which may lower the ROEs in the future; and ii) any shortfall in supplies from one source being made up from other sources.

Analyst Certification

I, Vidyadhar Ginde, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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iQmethod SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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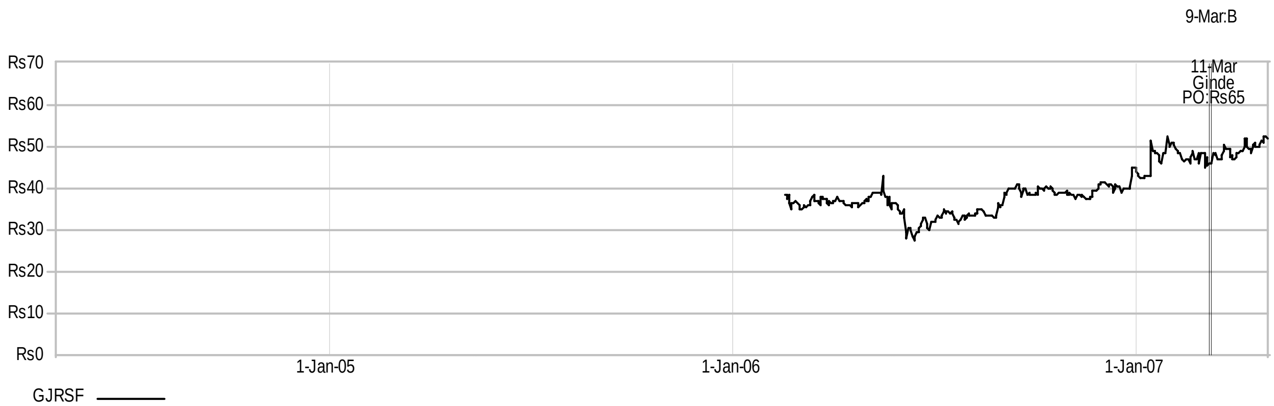
Important Disclosures

GJRSF Price Chart



B : Buy, N : Neutral, S : Sell, PO : Price objective, NA : No longer valid

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of April 30, 2007 or such later date as indicated.

Investment Rating Distribution: Utilities Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	62	37.35%	Buy	19	37.25%
Neutral	89	53.61%	Neutral	39	51.32%
Sell	15	9.04%	Sell	2	14.29%

Investment Rating Distribution: Global Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1562	45.16%	Buy	415	30.09%
Neutral	1615	46.69%	Neutral	446	30.65%
Sell	282	8.15%	Sell	49	19.76%

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