

Company In-Depth

23 January 2007 | 8 pages

Gujarat State Petronet (GSPT.BO)

Buy: Spot Cargos Boost 3Q; Raising Estimates and Target Price

Rating change ☐

Target price change ☒

Estimate change ☒

- **3Q FY07 ahead of expectations** — 3Q FY07 net profits of Rs284m were up 27% qoq, driven by strong growth in gas volumes. GSPL transported 16.1mmscmd of gas in 3Q (up 27% qoq), with new gas volumes coming in from spot LNG cargos. Average transportation tariff was lower at Rs0.59/scm (vs. Rs0.65/csm in 2Q), as the spot volumes were delivered at shorter distances.
- **Raising estimates on better volume prospects** — Spot cargo volume build-up was ahead of our earlier estimate (we had expected only 1mmscmd of spot volumes from the Hazira LNG terminal in FY07). We are raising our earnings forecasts by 14% for FY07 and FY08 on higher spot LNG volume assumptions.
- **Raising target price to Rs60** — Our new target price is based on our revised DCF value for the stock following our earnings upgrade.
- **Reiterate Buy/Medium Risk rating** — With greater visibility of gas supplies ensuring better utilization of GSPL's network, we remain positive on the stock despite its very strong performance over the past month.

| | |
|------------------------------|--------------|
| Buy/Medium Risk | 1M |
| Price (23 Jan 07) | Rs47.55 |
| Target price | Rs60.00 |
| <i>from Rs55.00</i> | |
| Expected share price return | 26.2% |
| Expected dividend yield | 1.1% |
| Expected total return | 27.2% |
| Market Cap | Rs25,784M |
| | US\$584M |

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



See page 6 for Analyst Certification and important disclosures.

Statistical Abstract

| Year to | Net Profit | Diluted EPS | EPS growth | P/E | P/B | ROE | Yield |
|---------|------------|-------------|------------|------|-----|------|-------|
| 31 Mar | (RsM) | (Rs) | (%) | (x) | (x) | (%) | (%) |
| 2005A | 160 | 0.53 | na | 89.2 | 4.2 | 4.8 | 0.4 |
| 2006A | 467 | 1.04 | 95.1 | 45.7 | 2.8 | 7.1 | 0.5 |
| 2007E | 840 | 1.55 | 48.9 | 30.7 | 2.7 | 9.0 | 1.1 |
| 2008E | 678 | 1.25 | -19.2 | 38.0 | 2.6 | 6.9 | 1.1 |
| 2009E | 1,516 | 2.80 | 123.6 | 17.0 | 2.4 | 14.6 | 2.3 |

Source: Powered by dataCentral

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| Fiscal year end 31-Mar | 2005 | 2006 | 2007E | 2008E | 2009E |
|--|---------------|---------------|---------------|---------------|---------------|
| Valuation Ratios | | | | | |
| P/E adjusted (x) | 89.2 | 45.7 | 30.7 | 38.0 | 17.0 |
| EV/EBITDA adjusted (x) | 23.2 | 15.3 | 12.1 | 10.6 | 6.9 |
| P/BV (x) | 4.2 | 2.8 | 2.7 | 2.6 | 2.4 |
| Dividend yield (%) | 0.4 | 0.5 | 1.1 | 1.1 | 2.3 |
| Per Share Data (Rs) | | | | | |
| EPS adjusted | 0.53 | 1.04 | 1.55 | 1.25 | 2.80 |
| EPS reported | 0.53 | 1.04 | 1.55 | 1.25 | 2.80 |
| BVPS | 11.33 | 16.74 | 17.71 | 18.39 | 19.93 |
| DPS | 0.20 | 0.25 | 0.50 | 0.50 | 1.10 |
| Profit & Loss (RsM) | | | | | |
| Net sales | 2,035 | 2,635 | 3,093 | 3,926 | 6,214 |
| Operating expenses | -1,398 | -1,483 | -1,465 | -2,286 | -2,989 |
| EBIT | 637 | 1,152 | 1,628 | 1,640 | 3,225 |
| Net interest expense | -363 | -413 | -431 | -673 | -1,011 |
| Non-operating/exceptionals | 20 | 45 | 129 | 56 | 73 |
| Pre-tax profit | 293 | 784 | 1,326 | 1,023 | 2,287 |
| Tax | -133 | -317 | -487 | -345 | -771 |
| Extraord./Min.Int./Pref.div. | 0 | 0 | 0 | 0 | 0 |
| Reported net income | 160 | 467 | 840 | 678 | 1,516 |
| Adjusted earnings | 160 | 467 | 840 | 678 | 1,516 |
| Adjusted EBITDA | 1,293 | 1,943 | 2,617 | 3,457 | 5,521 |
| Growth Rates (%) | | | | | |
| Sales | 45.2 | 29.5 | 17.4 | 26.9 | 58.3 |
| EBIT adjusted | 57.9 | 81.0 | 41.3 | 0.7 | 96.7 |
| EBITDA adjusted | 61.4 | 50.2 | 34.7 | 32.1 | 59.7 |
| EPS adjusted | 1,456.4 | 95.1 | 48.9 | -19.2 | 123.6 |
| Cash Flow (RsM) | | | | | |
| Operating cash flow | 1,123 | 1,871 | 1,963 | 2,882 | 3,238 |
| Depreciation/amortization | 656 | 791 | 989 | 1,817 | 2,296 |
| Net working capital | 306 | 613 | 134 | 387 | -575 |
| Investing cash flow | -2,313 | -6,047 | -6,419 | -8,390 | -150 |
| Capital expenditure | -2,313 | -6,047 | -6,419 | -8,390 | -150 |
| Acquisitions/disposals | 0 | 0 | 0 | 0 | 0 |
| Financing cash flow | 1,159 | 3,065 | 2,487 | 4,941 | -3,083 |
| Borrowings | 137 | 1,350 | 2,798 | 5,250 | -2,400 |
| Dividends paid | -80 | -155 | -311 | -309 | -683 |
| Change in cash | -31 | -1,111 | -1,969 | -567 | 5 |
| Balance Sheet (RsM) | | | | | |
| Total assets | 9,226 | 17,140 | 20,938 | 27,234 | 25,800 |
| Cash & cash equivalent | 426 | 2,372 | 862 | 628 | 1,318 |
| Accounts receivable | 107 | 137 | 161 | 204 | 323 |
| Net fixed assets | 8,392 | 13,650 | 19,080 | 25,653 | 23,507 |
| Total liabilities | 5,200 | 8,065 | 11,335 | 17,262 | 14,994 |
| Accounts payable | 265 | 1,261 | 1,339 | 1,750 | 31 |
| Total Debt | 4,436 | 5,786 | 8,585 | 13,835 | 11,435 |
| Shareholders' funds | 4,026 | 9,075 | 9,604 | 9,972 | 10,806 |
| Profitability/Solvency Ratios (%) | | | | | |
| EBITDA margin adjusted | 63.6 | 73.7 | 84.6 | 88.1 | 88.8 |
| ROE adjusted | 4.8 | 7.1 | 9.0 | 6.9 | 14.6 |
| ROIC adjusted | 6.6 | 7.8 | 7.2 | 6.0 | 10.1 |
| Net debt to equity | 99.6 | 37.6 | 80.4 | 132.4 | 93.6 |
| Total debt to capital | 52.4 | 38.9 | 47.2 | 58.1 | 51.4 |

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Figure 1. GSPL — Quarterly Results (Rs in Millions)

| (Rs m) | 1Q07 | 2Q07 | 3Q07 | CIR Comment |
|--|--------------|--------------|--------------|--|
| Net sales | 715 | 758 | 871 | Boosted by higher volumes |
| Employee costs | 8 | 8 | 11 | |
| Gas transportation charges | 25 | 25 | 25 | |
| Connectivity charges | 56 | 21 | 32 | |
| O&M expense of pipelines and compressors | 19 | 20 | 24 | |
| Admin & others | 49 | 27 | 25 | |
| Total expenditure | 157 | 100 | 117 | |
| EBITDA | 558 | 658 | 754 | |
| <i>EBITDA margin</i> | <i>78.1%</i> | <i>86.8%</i> | <i>86.6%</i> | |
| Depreciation | 215 | 230 | 236 | Newly commissioned pipelines will impact next quarter |
| Interest | 89 | 100 | 104 | |
| Non-operating income | 41 | 44 | 39 | |
| Profit before tax | 296 | 372 | 453 | |
| Tax | 103 | 148 | 169 | |
| - Current tax | 1 | 1 | 138 | |
| - Deferred tax | 102 | 147 | 31 | |
| <i>Tax rate</i> | <i>34.7%</i> | <i>39.8%</i> | <i>37.3%</i> | |
| Profit after tax | 193 | 224 | 284 | |
| Operational parameters | | | | |
| Gas transported (mmscm) | 1,152 | 1,160 | 1,477 | Spot LNG cargoes accounted for 25% of volumes |
| Gas transported (mmscmd) | 12.7 | 12.6 | 16.1 | |
| Avg. transportation charge (Rs/tcm) | 621 | 654 | 590 | Spot LNG was delivered to consumers at shorter distances |

Source: Company Reports and Citigroup Investment Research

Upping earnings estimates by 14% on higher volume assumptions

GSPL transported 16.1mmscmd of gas during the quarter, up sharply from the average of 12.6mmscmd transported in 1H FY07. The significant sequential increase in volumes was driven primarily by new LNG cargoes from the Shell Hazira terminal, which accounted for around 25% of total 3Q volumes. While we were earlier factoring in improving LNG volumes in FY07-08 of 1 and 1.5 mmscmd respectively (from 0.7mmscmd in FY06), we have now increased these further on the back of the performance this quarter to 2.0 and 2.5 mmscmd during the same periods. We have correspondingly also adjusted our earnings estimates up by 14% for FY07-08 to reflect the changes in our volume forecasts.

Figure 2. GSPL Earnings Revisions

| Year to | Net Profit (Rs Mils.) | | Diluted EPS (Rs) | | | Dividend Per Share (Rs) | |
|---------|-----------------------|-------|------------------|------|-------|-------------------------|------|
| | Old | New | Old | New | % Chg | Old | New |
| 31-Mar | | | | | | | |
| 2007E | 736 | 840 | 1.36 | 1.55 | 14.1 | 0.45 | 0.50 |
| 2008E | 594 | 678 | 1.09 | 1.25 | 14.2 | 0.44 | 0.50 |
| 2009E | 1,504 | 1,516 | 2.77 | 2.80 | 0.8 | 1.08 | 1.10 |

Source: Citigroup Investment Research estimates

Gujarat State Petronet

Company description

GSPL is a gas transmission company with a network of pipelines in the western Indian state of Gujarat. The company has a gas transmission network comprising 496km of pipelines (includes the recently commissioned 63km long Kalol-Himmatnagar pipeline) connecting Hazira-Vadodara-Ahmedabad-Kalol-Himmatnagar and is in the process of expanding the network by 679km by July 2007. GSPL's network connects all the major supply sources in Gujarat to important consumption centres in the state and currently transports 13mmscmd of gas.

Investment thesis

We rate Gujarat State Petronet as Buy/Medium Risk (1M). GSPL has seized the opportunity for setting up an "open access" pipeline network in India's most vibrant gas market, Gujarat. Gujarat has the advantage of being the landfall point of gas from India's western offshore fields (still the largest source of gas for India) as well as having two LNG receiving terminals. The state is also among the most industrialized regions in India with a large presence of energy-intensive industries (chemicals, ceramics, glass) in addition to traditional gas using industries (power, fertilizers). Gas usage in Gujarat is also aided by being distant from India's coal producing region (Eastern India), which makes transportation of coal to the region unviable.

Strong parentage: GSPL's parent GSPC (Gujarat State Petroleum Corporation) has played and continues to play an important role as an aggregator of gas demand and supplies. GSPL is seeding new consumption centers across Gujarat; and with a deficit of natural gas supplies even for existing users, we do not see an issue on the demand side. Though gas supplies would improve with better utilization of LNG terminals and PMT, the major inflection point is in 2009-10 (when gas from KG basin + Dahej LNG expansion is expected to be available). We assume low utilization (c.50%) of GSPL's network over our FY07-FY08. In FY09, gas from Reliance's KGD6 block will be transmitted on GSPL network from Bharuch to Jamnagar under an existing GTA. We have not assumed any additional gas from KG basin in our model.

Low regulatory risk: While the regulatory framework is still evolving, we believe that GSPL's unique model has low risk of adverse regulatory scrutiny on its pipeline tariffs. Most Gas Transportation Agreements (GTAs) are negotiated deals with large commercial entities, and with assumed risk of marketing its services GSPL should have greater flexibility in tariff pricing.

Valuation

Our target price for GSPL of Rs60 is based on our DCF fair value for the company for Dec 2007E (vs. Sept 2007E previously). Our DCF is based on higher gas volumes tied up with Reliance (11-14mmscmd) and the higher capex associated with the deal (Rs7bn). We use DCF to value the company given the utility nature of the business, which ensures steady cash flows. Discounted cash flows also capture the value of the business over a longer term given the new investments being made and the longer-term growth opportunity

for the gas transportation business in western India. Our DCF valuation is based on conservative assumptions for volume growth – with FY11E committed volumes assumed at 38mmscmd (existing GTAs + Reliance GTA = 36mmscmd) – and terminal growth of 3%. We use a WACC of 10.8% (risk free ~ 8.0%, risk premium ~ 6.0%, beta of 0.9, target D/V~ 35%). Also, on a price/cash earnings basis, we think GSPL is at a justifiable premium to other gas utilities (10.4x FY08E) given our high growth expectations of its gas transmission business. We prefer P/CEPS to the more traditional P/E multiple as a valuation tool given GSPL's aggressive depreciation policy (GSPL depreciates pipelines at 8.33%).

Figure 3. GSPL – DCF Valuation

| | 2007E | 2008E | 2009E | 2010E | 2011E |
|-----------------------------|---------------|---------|-------|-------|---------|
| EBIT*(1-t) | 1,031 | 1,087 | 2,138 | 2,401 | 2,639 |
| Add: Depreciation | 989 | 1,817 | 2,296 | 2,383 | 2,429 |
| Add: Decrease in net WC | 134 | 387 | (575) | (599) | (16) |
| Less: Capex | (6,419) | (8,390) | (150) | (100) | (1,000) |
| Free Cash Flow to Firm | (4,265) | (5,098) | 3,709 | 4,085 | 4,052 |
| NPV of cash flows | | (4,969) | 3,263 | 3,243 | |
| Terminal Value | | | | | 38,347 |
| Total Firm value | 39,884 | | | | |
| Less: Net Debt | 7,723 | | | | |
| Total Equity value | 32,160 | | | | |
| Value per share (Rs) | 59 | | | | |

Source: Citigroup Investment Research estimates

Risks

We assign a Medium Risk rating to GSPL – rather than a default Speculative Risk for stocks with a trading history of less than 12 months – in view of the utility nature of the business. The key downside risks to our target price include: 1) Government regulation of gas pipeline tariffs. With the setting up of the Petroleum and Natural Gas Regulatory Authority, pipeline tariffs across India could come under scrutiny. 2) Gas supplies – We assume an 11% CAGR in gas supplies for GSPL. If supplies are lower than our expectations, this could impact earnings and valuations. 3) Project risk – GSPL is implementing a Rs14.5bn 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.

Analyst Certification Appendix A-1

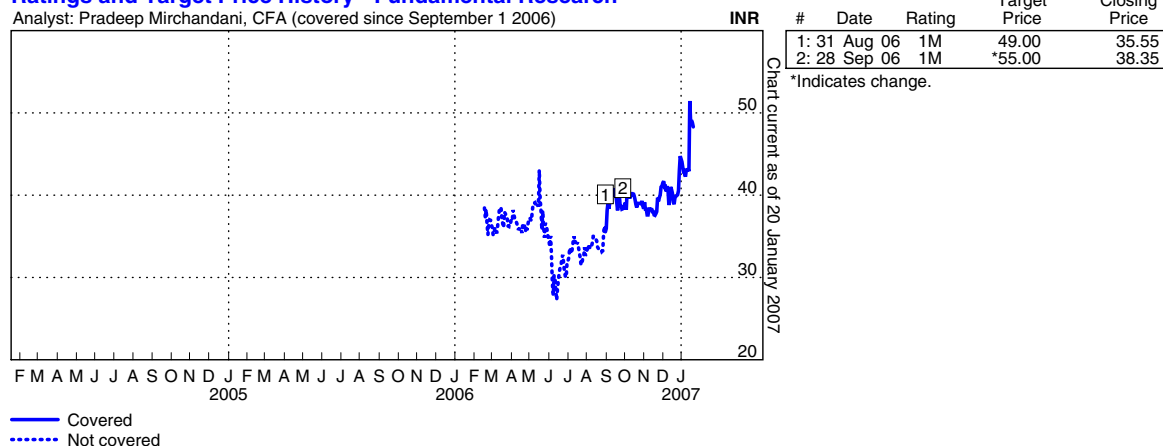
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Ratings and Target Price History - Fundamental Research

Analyst: Pradeep Mirchandani, CFA (covered since September 1 2006)



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