

Risk reward favourable, retain Buy

We retain our BUY rating on Gujarat State Petronet Ltd. (GSPL) with a revised TP of Rs185 (earlier TP Rs180). Volumes improved sequentially to a commendable 26.2MMSCMD. We reiterate that the current regulatory regime is less harsh and we believe it can modestly get 10% incremental tariff noting the recent positive tariff orders pronounced for GAIL and that in the pre-regulatory regime, it charged a weighted average tariff of Rs27.41/MMBTU (including SuG) vs the current tariff of Rs26.58 (excluding SuG). Additionally, in a scenario of zero tariff hike, our TP will decline to Rs165 and hence the downside is capped. This apart, the long term valuation upside from investments in cross country pipelines and the city gas distribution business offer a margin of safety as well and hence the risk-reward looks favourable.

- Outlook on volumes:** GSPL's Q3FY17 volumes at 26.2MMSCMD (+4.6% YoY and +6.6% QoQ) surpassed our estimates. But, the volumes have slowed down in Jan-17 owing to less spot cargoes by Petronet LNG amidst contractual issues, but are indicated to recover partly from Feb/Mar-17. In our view, spot LNG prices will taper-off after the winter season from their current level of USD7.5/MMBTU and it will drive the demand, and increase volumes from FY18E. Hence, we remain optimistic and factor in volume of 29MMSCMD in FY18E, backed by incremental gas flow from Petronet Dahej, GSPC Mundra, ONGC and Shell Hazira LNG terminal. *Although we extend optimism in FY19E, a zero offset to the decline in demand by RIL (not rated) of 4-5MMSCMD post commissioning of its petcoke gasification project poses risks and can dampen earnings.*
- Outlook on tariffs:** During the quarter, GSPL reported average transmission tariff of Rs1.1/SCM (+1.5% QoQ). We built in tariff of Rs1.1/SCM with take-pay revenue. We estimate (as it is not disclosed) take-pay revenue of Rs0.2bn in Q3FY17 (-7.4% QoQ). *Although PNGRB had amended the tariff regulations in Jan-16 which lower the capacity utilisation to 75% vs 100% and GSPL's revised tariff petition are positive, we believe that GSPL can modestly get 10% or Rs2.6/MMBTU incremental tariff for its HP network. The Public Consultative paper on HP network reveals tariff submission by GSPL of Rs59.65/MMBTU (vs Rs26.58 currently) and for LP network at Rs9.27/MMBTU (vs Rs1.88 currently). The tariff submitted is certainly steep and we expect a haircut in submitted tariffs primarily on capex disallowance for the prospective period, but see prospects of at least 10% increase in tariffs for HP network.*
- Outlook:** Our interaction with management revealed that GSPL will pick up momentum in its capex for cross-country pipelines from FY17E over the next three years, and it has been clarified that despite the time over-run and media reports, the capex will largely remain the same. We however have relied on an ET report which entailed capex of Rs164.7bn (GSPL stake at 52%) and demand by State government for a 40% grant. *An assigned 0.5x equity BV implies fair value of Rs15 vs negative Rs1 factored-in our SoTP and thus upside potential is not factored-in.* We believe an upside risk to our volume estimates is less probable than upward revision in tariff. We continue to believe that negative earnings surprise from the tariff petition is unlikely. Our valuation model factors in incremental tariff of Rs2.6/MMBTU hence, further upside will be a positive surprise and remains a key trigger for further re-rating.
- Valuations and key risks:** We arrive at a revised SOTP-based TP of Rs185 based on Mar'19E (vs Mar'18E earlier). Our valuation model factors in a 'what-if' scenario and 10% incremental tariff, ie, Rs2.6/MMBTU, pending final tariff order by PNGRB. We value the standalone business on DCF, with a WaCC of 10.1% to arrive at Rs155. Additionally, we apply DCF with a higher WaCC of 14.5% to arrive at a fair value for interstate pipelines at Rs(1). Investments in CGD at Rs31 have been derived by assigning a 20% holding company discount to CMP of Gujarat Gas. Key risks are (1) changes in volume, (2) changes in tariffs

Y/E Mar – Stand. (Rsmn)	Q3FY17	Q3FY16	YoY (%)	Q2FY17	QoQ (%)	Q3Y17E	Var (%)
Net sales	2,643	2,431	8.7	2,444	8.1	2,486	6.3
EBITDA	2,275	2,092	8.8	2,262	0.6	2,267	0.3
EBITDA margin (%)	86.1	86.0		92.5		91.2	
PAT	1,186	1,235	(4.0)	1,298	(8.7)	1,316	(9.9)
Operating Metrics:							
Transmission volume (MMSCM)	2,414	2,307	4.6	2,265	6.6	2,293	5.3
Transmission Tariff (Rs/SCM)	1.1	1.1	3.9	1.1	1.5	1.1	1.0
EBITDA/scm (Rs)	0.9	0.9	3.9	1.0	(5.6)	1.0	(4.7)
PAT/scm (Rs)	0.5	0.5	(8.2)	0.6	(14.3)	0.6	(14.4)

Source: Company, Centrum Research

Y/E Mar (Rsmn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	APAT	YoY (%)	Adj.DEPSRs.	RoE (%)	RoCE (%)	P/B (x)	EV/EBITDA (x)
FY15	10,646	1.3	9,275	87.1	4,225	0.8	7.5	12.2	9.5	1.5	6.6
FY16	9,919	(6.8)	8,654	87.2	4,445	5.2	7.9	11.7	9.2	1.8	7.1
FY17E	10,477	5.6	8,974	85.7	4,391	(1.2)	7.8	10.6	8.6	1.9	8.2
FY18E	12,165	16.1	10,493	86.3	5,331	21.4	9.5	11.8	9.3	1.6	7.2
FY19E	12,357	1.6	10,631	86.0	5,540	3.9	9.8	11.2	8.8	1.5	7.2

Source: Company, Centrum Research Estimates

Target Price	Rs185	Key Data	
CMP*	Rs156.5	Bloomberg Code	GUJS IN
Upside	18.2%	Curr Shares O/S (mn)	563.5
Previous Target	Rs180	Diluted Shares O/S(mn)	563.5
Previous Rating	BUY	Mkt Cap (Rsbn/USDbn)	88.2/1.3
Price Performance (%)*		52 Wk H / L (Rs)	172.9/119
	1M 6M 1Yr	5 Year H / L (Rs)	172.9/46.6
GUJS IN	13.9 16.5 15.5	Daily Vol. (3M NSE Avg.)	463003
NIFTY	6.8 1.4 17.5		

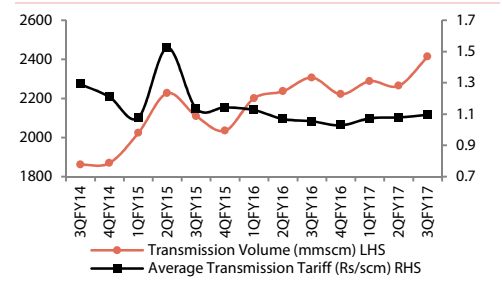
*as on 06 February 2017; Source: Bloomberg, Centrum Research

Shareholding pattern (%)*

	Dec-16	Sep-16	Jun-16	Mar-16
Promoter	37.7	37.7	37.7	37.7
Flls	17.1	17.1	16.5	15.4
Dom. Inst.	18.9	19.0	e19.1	19.7
Public & Others	26.4	26.2	26.7	27.2

Source: BSE, *as on 06 February 2017;

Trend in volume & average transmission tariffs



Source: Company, Centrum Research

Earning Revision

Particulars (Rsmn)	FY17E			FY18E		
	New	Old	Chg (%)	New	Old	Chg (%)
Revenue	10,477	11,010	(4.8)	12,165	12,165	0.0
EBITDA	8,974	9,481	(5.4)	10,493	10,493	0.0
PAT	4,391	4,832	(9.1)	5,331	5,331	0.0

Source: Centrum Research Estimates

Centrum vs. Bloomberg Consensus*

Particulars (Rsmn)	FY17E			FY18E		
	Centrum	BBG	Chg (%)	Centrum	BBG	Chg (%)
Revenue	10,477	10,927	(4.1)	12,165	12,899	(5.7)
EBITDA	8,974	9,613	(6.6)	10,493	11,415	(8.1)
PAT	4,391	5,195	(15.5)	5,331	6,361	(16.2)

Bloomberg Consensus				Target Price (Rs)	Centrum Target Price (Rs)	Variance (%)
BUY	SELL	HOLD				
24	1	7	172	185	7.8	

*as on 06 February 2017; Source: Bloomberg, Centrum Research

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Valuation and View

We arrive at our revised SOTP-based TP of Rs185 based on Mar'19E (earlier Mar'18E). We value the standalone business on DCF basis, with a WACC of 10.1% to arrive at Rs155. Additionally, we apply DCF with a higher WACC of 14.5% to arrive at a fair value for interstate pipelines at Rs(1) and investments in CGD at Rs31 (based on revised methodology of assigning a 20% discount to CMP). Our valuation model factors in a 'what-if' scenario and a 10% incremental tariff, i.e. Rs2.6/MMBTU pending final tariff order by PNGRB, implying potential EPS accretion of RsRs1.3 in FY18E/19E.

We revise our FY18E to factor-in lower transmission volumes in Q4FY17 amidst lower LNG supplies and issues between Petronet LNG and RasGas.

Exhibit 1: SoTP Valuation on Mar-19E

SOTP Valuation	Rs/share	Comments
GSPL – Standalone	155	DCF, WACC of 10.1%, CoE at 10.8%
Mehsana – Bhatinda SPV	(5.5)	DCF, WACC of 14.5%
Mallavaram – Bhilwara SPV	3.6	DCF, WACC of 14.5%
Bhatinda – Srinagar SPV	1.0	DCF, WACC of 14.5%
Investments in City Gas Distribution (Gujarat Gas + Sabarmati Gas)	30.7	At 20% holding discount to CMP of Gujarat Gas.(Not Rated) and at BV for others
Fair Value (Rounded-off)	185	

Source: Company, Centrum Research Estimates

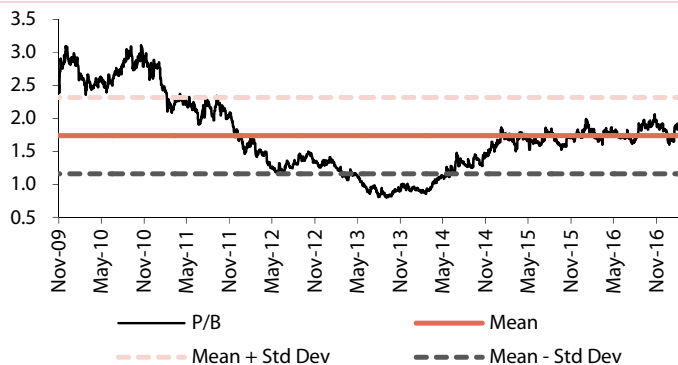
For interstate pipelines, our DCF-based TP of Rs(1) is based on WACC of 14.5%. We have adopted the higher discounting rate following our conservative approach to remove the overhang of project-related uncertainties.

Exhibit 2: Sensitivity Analysis to FY18E

Sensitivity to key variables	Change	% impact on EBITDA	% impact on EPS
Increase in transmission volumes	1 MMSCMD	3.0	2.0
Increase in transmission tariffs	1%	1.0	1.3

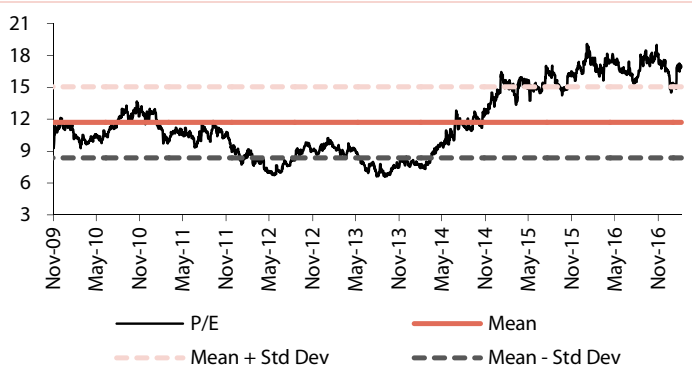
Source: Company, Centrum Research Estimates

Exhibit 3: 1 year forward P/B chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 4: 1 year forward P/E chart



Source: Bloomberg, Company, Centrum Research Estimates

Exhibit 5: Comparative Valuations

Company	Mkt Cap (Rsmn)	CAGR FY16-FY18E (%)			EBITDA Margin (%)			PE (x)			P/B (x)			RoE (%)			Div Yield (%)		
		Rev.	EBITDA	PAT	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E	FY16	FY17E	FY18E
GSPL	88.2	10.7	10.1	9.5	87.2	85.7	86.3	16.0	18.4	14.6	1.8	1.9	1.6	11.7	10.6	11.8	1.2	1.0	1.1
GAIL	612.0	12.0	34.4	39.2	8.2	11.1	11.8	19.2	13.8	13.7	1.4	1.5	1.6	7.7	11.4	12.5	1.4	1.5	1.2
Petronet LNG	290.5	2.5	47.4	46.0	5.9	12.4	12.1	17.0	13.3	14.9	2.4	3.1	3.1	15.2	25.7	22.3	1.2	0.8	1.3
Guj. Gas^	84.1	(1.3)	19.4	62.9	12.1	17.0	17.7	47.9	25.9	20.8	3.5	3.3	3.2	NA	13.6	16.4	0.5	0.8	1.0
IGL^	140.1	7.7	17.1	25.5	21.0	25.7	24.8	18.7	17.8	21.7	2.7	3.6	4.2	15.6	21.7	20.6	1.3	1.1	0.9
MG:L^*	89.5	0.6	13.5	14.1	23.6	NA	30.0	NA	20.9	22.8	NA	NA	5.2	22.3	18.8	23.9	NA	2.5	1.8

Source: Company, Centrum Research Estimates ^Bloomberg estimates, *follows December year ending; NA: Not Applicable/Available

Quarterly financials, Operating Metrics and Key Performance Indicators

Exhibit 6: Quarterly Financials - Standalone

Particulars (Rsmn)	Q4FY15	Q1FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17	Q3FY17
Net Sales	2,326	2,478	2,390	2,431	2,284	2,455	2,444	2,643
Other operating income	61	113	138	49	36	127	136	25
O&M expenses	193	193	121	243	130	117	175	185
Staff cost	70	74	113	89	71	79	77	144
Admin / Other expenses	126	53	52	57	69	52	67	64
EBITDA	1,998	2,271	2,242	2,092	2,049	2,333	2,262	2,275
Depreciation	601	434	464	472	473	430	436	465
Interest	262	207	213	184	168	167	148	165
Other Income	115	108	120	282	131	144	287	177
PBT	1,251	1,738	1,685	1,718	1,538	1,879	1,965	1,822
Tax	580	610	600	483	541	668	666	636
RPAT	671	1,128	1,085	1,235	997	1,213	1,298	1,186
YoY Growth (%)								
Net Sales	2.8	13.7	(29.6)	1.5	(1.8)	(0.9)	2.3	8.7
EBITDA	(0.5)	13.3	(30.8)	2.9	2.6	2.7	0.9	8.8
PAT	(26.6)	32.7	(36.0)	39.0	48.7	7.5	19.6	(4.0)
Margins (%)								
EBITDA	85.9	91.7	93.8	86.0	89.7	95.0	92.5	86.1
PAT	28.8	45.5	45.4	50.8	43.7	49.4	53.1	44.9
Key operational parameters								
Transmission volume (MMSCM)	2,035	2,201	2,237	2,307	2,222	2,289	2,265	2,414
Transmission Tariff (Rs/SCM)	1.1	1.1	1.1	1.1	1.0	1.1	1.1	1.1
EBITDA/SCM (Rs)	1.0	1.0	1.0	0.9	0.9	1.0	1.0	0.9
PAT/SCM (Rs)	0.3	0.5	0.5	0.5	0.4	0.5	0.6	0.5
YoY Growth %								
Transmission volume	8.9	8.8	0.4	9.3	9.2	4.0	1.2	4.6
Transmission Tariff	(5.5)	4.5	(30.0)	(7.2)	(10.1)	(4.7)	1.0	3.9
EBITDA/SCM	(8.6)	4.2	(31.1)	(5.9)	(6.1)	(1.2)	(0.4)	3.9
PAT/SCM	(32.6)	22.0	(36.2)	27.2	36.2	3.4	18.2	(8.2)

Source: Company, Centrum Research

Exhibit 7: Key Performance Indicators

Assumptions	FY15	FY16	FY17E	FY18E	FY19E
Transmission Volumes (MMSCMD)	23.0	24.6	26.0	29.0	29.5
Transmission Tariffs (Rs/scm)	1.2	1.1	1.1	1.1	1.1

Source: Company, Centrum Research Estimate

Financials (Standalone)

Exhibit 8: Income Statement

Y/E March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Revenues	10,646	9,919	10,477	12,165	12,357
Material Costs	249	150	213	247	251
% of revenues	2.3	1.5	2.0	2.0	2.0
Employee Costs	356	347	382	420	462
% of revenues	3.3	3.5	3.6	3.5	3.7
Others	767	769	908	1,005	1,013
% of revenues	7.2	7.7	8.7	8.3	8.2
EBITDA	9,275	8,654	8,974	10,493	10,631
EBITDA Margin (%)	87.1	87.2	85.7	86.3	86.0
Depreciation & Amortisation	1,892	1,843	2,009	2,083	2,152
EBIT	7,383	6,810	6,965	8,410	8,479
Interest expenses	1,178	773	987	1,231	1,075
PBT from operations	6,204	6,038	5,978	7,179	7,404
Other Income	520	641	727	778	865
Exceptional items	-120	-	-	-	-
PBT	6,604	6,679	6,704	7,957	8,269
Taxes	2,500	2,234	2,313	2,626	2,729
Effective tax rate (%)	38%	33%	35%	33%	33%
PAT	4,104	4,445	4,391	5,331	5,540
Minority / Share of Associates	-	-	-	-	-
Reported PAT	4,104	4,445	4,391	5,331	5,540
Adjusted PAT	4,225	4,445	4,391	5,331	5,540

Source: Company, Centrum Research Estimates

Exhibit 9: Key Ratios

Y/E March	FY15	FY16	FY17E	FY18E	FY19E
Growth Ratios (%)					
Revenue	1.3	(6.8)	5.6	16.1	1.6
EBITDA	(0.1)	(6.7)	3.7	16.9	1.3
Adj. PAT	0.8	5.2	(1.2)	21.4	3.9
Margin Ratios (%)					
EBITDA Margin	87.1	87.2	85.7	86.3	86.0
PBIT from operations	58.3	60.9	57.1	59.0	59.9
Adjusted PAT	37.8	42.1	39.2	41.2	41.9
Return Ratios (%)					
ROE	12.2	11.7	10.6	11.8	11.2
ROCE	9.5	9.2	8.6	9.3	8.8
ROIC	9.8	11.0	12.2	12.5	10.8
Turnover Ratio (days)					
Gross block turnover ratio (x)	0.2	0.2	0.2	0.2	0.2
Debtors	52	56	53	52	52
Inventory	38	43	39	38	38
Creditors	14	6	14	14	14
Cash conversion cycle	75	93	77	77	77
Solvency Ratio (x)					
Net Debt-equity	0.2	(0.2)	(0.2)	(0.0)	(0.0)
Debt-equity	0.3	0.3	0.3	0.4	0.3
Interest coverage	0.2	0.1	0.1	0.1	0.1
Gross Debt/EBITDA	1.2	1.2	1.6	1.8	1.5
Current Ratio	3.4	3.6	4.9	4.1	3.2
Per share ratios (Rs)					
Adjusted EPS	7.5	7.9	7.8	9.5	9.8
BVPS	64.4	70.4	76.5	84.2	91.6
CEPS	10.7	11.2	11.4	13.2	13.7
DPS	1.2	1.5	1.5	1.5	2.0
Dividend payout %	20	22	22	19	24
Valuation (x)					
P/E (adjusted)	12.9	16.0	18.4	14.6	14.0
P/BV	1.5	1.8	1.9	1.6	1.5
EV/EBITDA	6.6	7.1	8.2	7.2	7.2
Dividend yield %	1.2	1.2	1.0	1.1	1.4
5 Yr Avg AOCF/EV yield %	8.6	8.6	6.7	6.5	6.9

Source: Company, Centrum Research Estimates

Exhibit 10: Balance Sheet

Y/E March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Equity Share Capital	5,630	5,633	5,635	5,635	5,635
Reserves & surplus	30,601	34,051	37,456	41,800	45,988
Shareholders' fund	36,231	39,684	43,090	47,435	51,623
Debt (including short-term borrowings and Pref. Capital)	11,575	10,597	14,716	18,365	16,026
Deferred Tax liability (net)	4,504	4,744	4,744	4,744	4,744
Minority Interest	-	-	-	-	-
Total Liabilities	52,310	55,026	62,551	70,544	72,394
Gross block	48,193	50,626	52,626	54,626	56,626
Less: Accumulated depreciation	(17,540)	(19,370)	(21,379)	(23,462)	(25,614)
Net Block	30,653	31,256	31,247	31,164	31,012
CWIP	7,765	7,704	8,500	8,500	8,500
Net Fixed Assets	38,418	38,960	39,747	39,664	39,512
Investments	6,487	7,311	11,403	20,552	25,540
Inventories	1,102	1,177	1,106	1,275	1,297
Sundry Debtors	1,504	1,518	1,508	1,739	1,768
Cash & bank balances	4,352	5,447	7,247	5,523	2,455
Loans and advances	3,299	3,821	4,247	4,898	4,979
Other assets	241	182	201	232	236
Total current assets	10,498	12,145	14,309	13,667	10,734
Sundry Creditors	405	165	402	464	471
Other Current liabilities	833	1,034	603	696	707
Provisions	1,856	2,191	1,902	2,179	2,214
Net current assets	7,404	8,755	11,402	10,328	7,341
Total Assets	52,310	55,026	62,551	70,544	72,394

Source: Company, Centrum Research Estimates

Exhibit 11: Cash Flow

Y/E March (Rs mn)	FY15	FY16	FY17E	FY18E	FY19E
Operating profit bef working capital changes	7,140	6,659	6,111	7,691	7,726
Net chg in working capital	(871)	-630	(557)	(928)	(116)
CF from op. activities (a)	6,268	6,030	5,554	6,763	7,611
Adj. OCF (OCF - Interest as per cash flow)	4,880	4,822	4,567	5,532	6,536
Net Capex	(2,151)	(1,770)	(2,796)	(2,000)	(2,000)
Adj. FCF (AOCF - Net Capex)	2,729	3,052	1,771	3,532	4,536
CF from invest. activities (b)	(1,518)	(3,210)	(6,888)	(11,149)	(6,988)
CF from fin. activities (c)	(5,391)	(2,972)	3,134	2,662	(3,691)
Net chg in cash (a+b+c)	(641)	(152)	1,800	(1,724)	(3,068)

Source: Company, Centrum Research Estimates

Appendix A

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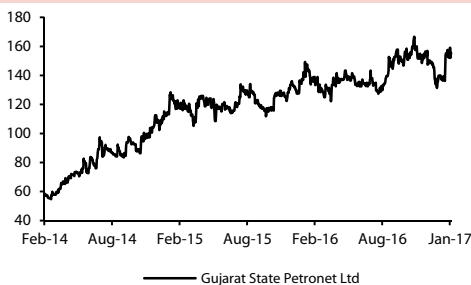
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GSPL price chart



Source: Bloomberg, Centrum Research

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